



# **One Nation, Ungovernable?**

A Bipartisan Agenda for Economic  
Liberalization and Restraint  
on Political Power

Competitive Enterprise Institute



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## Introduction

# Championing Economic Liberty in a Time of Crisis

By Fred Smith

Rahm Emanuel, President Barack Obama's incoming chief of staff, recently commented: "You never want a serious crisis to go to waste." Now, we at the Competitive Enterprise Institute are at least as concerned about the nation's current economic crisis—but we are even more concerned about bad policies that may come out of this crisis.

Still, Emanuel's point is valid. Crises expose unexpected—and often misunderstood—weaknesses in current policies. While our statist friends see this as an opportunity—indeed, a duty—to expand the size and scope of government, we at CEI see it as a chance to challenge the entanglement of the private and political spheres.

Markets have appeared less resilient and less disciplined than we had hoped—but not because of a *laissez faire* ideal. The troubles besetting America's financial sector are best understood as a tragic example of the inevitable consequences of the "mixed economy"—an ungainly mix of government mandates, regulations, subsidies, private sector rent-seeking, and socialization of risk.

The mixed economy model seeks to advance utopian social goals by harnessing the profit motive of capitalism. Thus, we see this crisis as an opportunity to dramatize the disastrous consequences of this collectivist approach, and

to encourage policy makers to rethink the drift away from sound principles over the last century, to restore a world of freedom and responsibility—the essence of truly free markets.

Indeed, America's success has been based on an adherence to sound principles: a government limited to its appropriate sphere—protecting property rights and the nation, enforcing the rule of law—and a voluntary sector enjoying the greatest possible ambit for both economic and non-economic exchanges.

Sadly, we have drifted far from those principles as "progressive" ideas have gained intellectual ground. This has led policy makers to push private enterprise to "do good"—voluntarily, if possible; coercively, if necessary. And the "good" is defined by the intellectual class, which has long championed bigger government.

Unlike in Europe, where socialists sought outright government ownership of industry, American progressives sought to leave in place the illusion of free markets, while imposing on businesses an array of "social" mandates to be enforced through taxes, regulations, and subsidies.

This had the effect that, in Europe, the costs of statist policies were apparent, and the blame for failure could be easily attributed to government. In contrast, the American regulatory welfare state hides its costs by shifting them

on to businesses and consumers, so its failures are more likely to be attributed to the private sector. In America, these factors make it more difficult to reign in the regulatory state, and to discipline its excesses. Yet to do so is necessary now more than ever.

Civilization is the slow process of creating the institutions that allow greater freedom, allowing more of mankind to engage in voluntary exchange with others. For many years, America was the leader in this effort. We pioneered in expanding private property rights to all citizens—including subsurface mineral rights, which allowed entrepreneurial activity to move beneath the Earth, making possible the rapid growth in the mineral and energy sector. And as science found ways to harness the electromagnetic spectrum and the airwaves, those too began to move toward private ownership.

However, policy makers in the early part of the 20th century rolled back many of these efforts as progressive ideas supplanted those of freedom and responsibility. Voluntary exchange was compromised by America's regulatory welfare form of central planning. Gradually, the boundary between government and voluntary exchange weakened, and it became common for policy makers to seek to combine maximizing profits with pursuing political goals, such as subsidizing politically preferred constituencies.

In the financial arena, an example of this is the creation of government sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac—nominally private profit-making firms that enjoyed an implicit government guarantee against losses. Those guarantees allowed the GSEs to dominate the low-risk sectors of the housing market, pushing private lenders into higher risk investments. In addition, politicians insisted that the GSEs make home loans to in-

dividuals with weak credit scores. Government could have honestly sought to increase home ownership for the poor through direct subsidies, but that would have made the policy's costs transparent. Instead, the carrot and stick of subsidies and regulations, helped hide the costs. The resulting confused mix of politics and business became one of the primary factors behind the current financial crisis.

Now a new Democratic administration comes to Washington, promising “change we can believe in”—and that could be a good thing. The last few decades—of over-spending, over-regulating, and over-intervening—call for considerable change. Only a few years ago, a Republican team roared into Washington with its own ambitious reform agenda—and soon became mired in the bogs of Washington. If the Democrats replicate their Republican colleagues' mistakes, their honeymoon will be brief.

Real change is needed. The economic emergency measures advanced by the Bush Administration have done little to alleviate the financial—or any other—crisis. It should be clear by now that such top-down solutions do not work—and are even unlikely to produce any political gains as economic pain turns public opinion sour.

CEI hopes to work with the administration and others on these issues. We hope to share with the new Congress our ideas on how to jump-start the nation's economic engine—the American people's entrepreneurial spirit. There is much to do.

Many sectors of the economy—electricity, telecommunications, airlines, and other network industries—have been hampered by botched, partial deregulations. The solution is not to revert to state control, but to truly liberalize.

We also hope to work with the new Congress to promote the health of the American people by reforming the Food and Drug Administration to speed the process of bringing new life-saving drugs to market.

With major change come major risks. As a Louisianan, I am well aware of populism's something-for-nothing allure. Mistakes made in the name of "helping the little guy" can hurt everybody in the long run, by creating long-lasting economic damage. Proposals for one-size-fits-all mandates in areas like wages and prescription drugs threaten to undermine the dynamism of America's market economy—and thus hurt those whom such measures are supposed to help. We

will happily work with lawmakers of both parties to oppose bad ideas like those.

During the last Congress, Republicans massively expanded the federal government—and the voters punished them for it. Now the Democrats have been entrusted to set aright the ship of state. In a globalized world, they will retain their majority only by advancing a pro-growth agenda.

A revitalized economic liberalization program must be a part of that agenda. This volume offers policy reforms to lawmakers, of all parties, to help boost economic and personal liberties. It will be an interesting few years; we plan to be a part of the debate.





**Secure the Economy**



# One Nation, Ungovernable?

## A Bipartisan Agenda for Economic Liberalization and Restraint on Political Power

By Wayne Crews

### Rediscovering Political Accountability and Limited Government

As both political parties wrangle over economic stimulus packages and appoint czars with unprecedented powers, the federal budget deficit is ballooning above \$1 trillion. The federal government's annual spending before the creation of the \$700 billion Troubled Assets Relief Program (TARP) already topped \$3 trillion. Since the bulk of that goes to "non-discretionary" entitlement, health, and defense budget commitments, the budget was already largely uncontrollable—even before the economic crisis deepened.

Alongside direct spending, economist Mark Crain estimates regulatory compliance costs (health, safety, environmental, and economic rules) to exceed \$1.1 trillion. That is more than one-third the level of annual federal spending. Combining regulatory costs and federal spending, Washington's share of the nation's \$13-trillion annual economic output tops 29 percent. If government intervention were stimulative, the nation should be overflowing with wealth and job creation already. The answers lie elsewhere.

Stimulus bills and TARP-like measures obscure the reality that recessions, and the distortions created by prior decades of mixing politics with free enterprise, must be ridden out—if not now, then in the coming months or years,

when the readjustments could be even more painful. Worse, panicky new political controls and resource misallocation today sow the seeds for future dislocations and recessions. But by then, the economic pain will be other politicians' problem.

From poorly understood (and rapidly shifting) financial market interventions, to the auto industry bailout, to transferring wealth to politically determined "infrastructure" projects, today's policy responses expand state authority, impose new controls on businesses and entrepreneurs, and neglect a vast alternative agenda of private, voluntary stimulus and economic liberalization.

To downplay the voluntary sector's own potential contributions and replace them with state mandates and wealth transfers is to court disaster. A genuine predicament faced by the market today is *not knowing what government will do next*; that uncertainty paralyzes private investment, which could otherwise bloom.

Today's sweeping government interventions appear tectonic, not incremental, and are a grave threat to our nation's future. We face not just the aforementioned bedrock of expanding federal entitlements, but the cost of two wars, grave economic distress, and a new open-ended culture of bailouts and "stimulus." The promise of a new administration is surely dampened

upon confronting the biggest government on Earth, already some 20 percent larger in a matter of months. The stimulus culture, engineered by lawmakers from both parties, has made much else on the Obama agenda a second tier issue—so those items are now being repackaged as stimulative in themselves.

A better economic recovery agenda is to create the conditions for the market to *actually* do what the government *claims* it can do. It would entail an ongoing program, not of “investing” or stimulating or intervening, but of liberalizing the wealth-creating energies of citizens and the private institutions.

Such an agenda would abolish agencies that have contributed to the mess we are in and downsize others, freeze spending, place a moratorium on new regulations, loosen existing rules, reduce capital gains taxes, and return the financial sector to the private market in such a way that the moral hazard created by regulatory guarantees never again occurs. (That’s difficult; already, on a smaller scale in frontier industries like cybersecurity and nanotechnology, government funding and intervention threaten to remove much of the market discipline that would otherwise regulate risk and temper poor investments.) A true recovery agenda would also institute myriad other reforms, such as strengthening the Office of Management and Budget’s central review of regulations with an eye toward reducing mandates, and exploring enterprise zone concepts like those established in New Orleans after Hurricane Katrina.

When times are hard, you share; but the fundamental notion that you do not *take* other people’s stuff to get out of an economic crisis seems alien to the political class. Washington’s primary function is no longer to lightly administer the “silken bands of mild government” envisioned by the Founders, but to transfer

wealth to politically favored constituencies. As Competitive Enterprise Institute President Fred Smith has aptly put it: “The Constitution isn’t perfect; but it’s better than what we have now.”

### “New Steal”

To date, Washington’s economic recovery strategy has been a mash-up of short-term stimulus measures, massive infrastructure projects, and promises about investment and “efficiency.” In mere months, Keynesian demand management has re-conquered economics as surely as the political response to the Wall Street meltdown response furthered Alexander Hamilton’s dreams of centrally managed government finance. In this “New Steal,” government is stimulating like it is 1929. With the federal reindeer on the roof, the economy remains frozen, waiting to see what comes down the chimney next.

Stimulus packages and a stimulus culture foster political ends unrelated to actual economic recovery. Innumerable special interests benefit from an interventionist, mixed economy—and when circumstances deteriorate, as they always do, the liberalizing market reforms that could actually contribute to recovery become further marginalized from the policy discussion.

As George Mason University economist Richard Wagner points out, unconstrained democracy has a built-in bias toward deficit finance, so demand-side Keynesian policy responses to downturns enjoy perennial staying power. And, since modern legislatures are at root wealth-transfer institutions, they rarely publicly acknowledge the limitations of their *actual* contributions to the real economy, not to mention their culpability in downturns. So they “stimulate.” And then they stimulate some more.

Indeed, the real problem—the one jeopardizing actual recovery—is the fact that the political price of pursuing non-governmental recovery measures is too high for election-bound politicians to entertain.

“Stimulating” demand for the burgeoning supply of government programs, services, and wealth transfers is never difficult—and becomes ever easier as successive interventions fail but escape blame and Newer Deals gain sway among a fearful public. So efforts to promote wealth creation by reducing regulatory and fiscal interventions in the economy—and establishing institutions to keep future such interventions minimal—go nowhere.

As the Nobel Prize-winning economist Friedrich Hayek noted, the politicians blamed for problems during a bumpy but real recovery are often those who *stop* state interventions—interest-group benefits, artificially fluid credit, labor union privileges, inflationary monetary policy, and malinvestment from earlier government interventions—not the ones who started those costly processes and even erected entire institutions to enshrine them decades earlier. As one example, few in official Washington seriously discuss phasing out and liquidating Freddie Mac and Fannie Mae, even though those institutions bear responsibility for some of the distortions behind the credit crisis.

### “Stimulate” Supply, Not Demand

A truly effective economic stimulus program would reduce the “tariffs” on wealth creation. It would free the world’s largest economy from excessive regulation and spending—by freezing both, for starters—and from the undisciplined political money and credit creation at the core of the financial crisis. It would never foist the uncertainty of the TARP on a limping economy in the first place (and if it did make that mis-

take it would rapidly eliminate it once it recognized the damage it can create and prolong). For immediate stimulus, rapid and retroactive marginal tax rate cuts could facilitate economic activity via increased supply.

Such real stimulus requires politically difficult changes in what people expect from government—and in government officials’ authority—so political reality prevents halting the compounded economic damage from artificial stimulation and financial “bailouts to nowhere.” That makes America largely ungovernable now, since, along with entitlements on autopilot, wealth transfers managed by unelected czars dominate the federal agenda.

That is depressing, not stimulating. As soon as President Obama gets down to work in the White House, he should announce a regulatory freeze and set about liberalizing wealth creation, not spending yet more wealth that has not even been created, worsening the nation’s prospects.

### Too Big to Fail? Not under True Capitalism

Members of both parties opportunistically blame markets for recession while downplaying the regulatory leviathan that government has become. There is plenty of blame for the private sector to shoulder—make no mistake—but it is the mixed economy that fosters the distortions and ensuing corruption which have led us to the current crisis.

When government interventions artificially collectivize risk beyond what a free market permits, and generate entities considered “too big to fail,” one cannot fairly deem them products of capitalism. One of the gravest threats we now face is that the U.S. government seems determined to impose vague yet vastly powerful programs—led by unaccountable czars—*with more scale and scope than that of any imagin-*

*able private entity*. What happens when *those* entities fail?

When market capitalism, rather than a mixed economy, prevails, no firm is ever “bigger” than the disciplinarians arrayed against it if it misbehaves—clients, suppliers, partners, advertisers, competitors, media, employees, investors, and upstart rivals. Only government guarantees—like those fostered by Fannie Mae and Freddie Mac, and even in the federal deposit insurance program—can remove those disciplinary forces.

We have had a century of government control of money with the too-big-to-fail Federal Reserve—and, more recently, of the credit supply with Fannie and Freddie. The risk now is that today’s “rescuers” are further centralizing risk, kicking decision making upstairs to the federal government itself—a coercive, wealth-transferring institution where few of the disciplinary forces that exist in markets have any sway at all.

A better approach to address errant market behavior is to reestablish the market discipline that governments routinely undermine. Capitalism, by dispersing wealth, is one of the most democratizing institutions ever devised, and thus properly prevents the “too big to fail” phenomenon from occurring in the first place. To allow properly functioning capital markets to flourish, policy makers should remove all barriers to the private, brutal market for corporate control—including allowing hostile corporate takeovers and even more modern equivalents—rather than waste time on side-show distractions like coercive limits on firm size or CEO pay.

Markets and capitalism disperse risk; our failure has been to have too little free enterprise, not too much. Unfortunately, that lesson is not being learned, and the ability to reinvigorate the

disciplinary institutions of capitalism diminish by the day as government assumes even more powers—which will be difficult, if not impossible, to wrest away in the future.

### **Now About this “Infrastructure Investment” Business...**

President-elect Obama has said that he wants the federal government to fund “shovel ready” projects as an infrastructure stimulus to the economy. A December 2008 Drudge Report headline blared: “JOBS, ROADS, BRIDGES, SCHOOLS, BROADBAND, ELECTRONIC MEDICAL RECORDS, ENERGY”—but this high profile campaign may only be shoveling from the right hand to the left. This is an age-old political ploy—not to actually produce, but to transfer yet more of the nation’s dwindling wealth to those with political pull. Each wave of the spending wand toward some high-profile project diverts media and public attention away from what free individuals would have done instead with those resources, and from the many ways to spark private, rather than government, investment in these very ventures.

Genuine leadership does not consist of promising to take yet more of other people’s resources and giving it to federal agencies and favored government contractors. Yet that is what we observe: proposals for government to enact “renewable” energy plans, repair drafty school buildings, provide broadband for everyone, upgrade the electric power grid, computerize medical records, and so forth.

Details are sketchy, but one thing is clear: Golden chains always accompany the receipt of government money. Take power grid investment: Utilities may get the cash, but they will end up diverting it toward politically favored and inferior “renewable” technologies, thereby

draining future wealth and resources from better, more effective uses. (For example, no fuel is “greener,” in the proper sense of the term of using fewer overall resources, than petroleum-based gasoline.) Meanwhile, government power over the nation’s energy supply grows.

Labor unions are not merely being placated with the various spending packages; they helped spearhead them, insisting that they will create “millions” of jobs. Yet it was such a make-work mentality that helped lead to the current disaster in the auto industry: Productivity may still improve if struggling industries are forced to deal with compulsory unionization, but those firms will also become saddled with legacy costs negotiated under monopoly labor conditions—from pensions to health insurance to even paying workers who are no longer needed.

### Fostering Infrastructure Wealth the Right Way

It is undeniably true that America needs to create “infrastructure wealth”—we need it just as we need financial wealth, real estate wealth, manufacturing and service wealth, and health-care wealth, and more. But like all wealth creation, the roots are in *property rights, private ownership, free enterprise and entrepreneurship—voluntary institutions evolved over centuries, which were neither created by fiat nor paid for by tax dollars.*

The proper way to maximize infrastructure wealth—and the jobs and consumer benefits that go with it—is to clear the path for free enterprise to build it. Yanking funds from unseen, voiceless, and dispersed taxpayers and their less-glamorous projects and applying it to high-profile, vocal recipients is a destructive enterprise, not a wealth-building one.

Following are some better steps to lay the groundwork for a wealthier nation. *These are*

*the sort of programs Washington should be implementing in a crisis like that of today.*

- End exclusive franchises that prohibit firms from competing with incumbent electric companies. Today, it is basically illegal to run an extension cord across the street.
- Liberalize all network and infrastructure industries, which are now artificially segregated into regulatory silos—telephone, electricity, water, sewer, cable, railroad, airline, and air traffic control. This would create opportunities for firms in these industries to work together and *jointly* invest in new infrastructure—power lines, fiber optic lines, roads, bridges, airports, toll roads, wireless ventures and more.
- Relax antitrust rules to allow firms within and across industry sectors to combine and create business plans to bring capitalism and infrastructure wealth creation to the next level. This would also aid nascent industries like nanotechnology, for which political regulation amounts to a pointless dispersion of taxpayer money across dozens of universities.
- To encourage broadband deployment, declare “net neutrality” permanently off the table, and make it clear that proprietary networks and investments will never be expropriated in any fashion, that there will be no forced sharing, only voluntary agreements and alliances.
- Liberalize spectrum and secondary markets in spectrum frequencies such that wireless wealth is freely created apart from regulatory decree.

These proposals are only a start. Other initiatives, like privatization of politically provided services like the mails, the mortgage giants, and retirement and health programs, also should be explored. As noted, the nation has



been rendered largely ungovernable because of the expansion of government beyond any constitutional limitations; moving enterprise back to the private sector will help return government to its proper boundaries.

Throwing money at infrastructure “stimulus” but leaving pre-21<sup>st</sup> century regulations intact, while adding new command-and-control and spending schemes, is not governing; it is not courageous, and it is not commendable. We have to do better.

### Deregulate to Stimulate

The call for new regulations alongside new spending points up a need to reconsider *regulation* comprehensively in the context of stimulating economic growth and wealth creation. Reducing the accumulated impact of 70,000 annual pages of new regulations—in a Washington increasingly incapable of cutting spending—offers real stimulus opportunities but goes largely ignored. Pruning the regulatory enterprise would increase returns to investors and offer struggling entrepreneurs greater prospects that risky new ventures would succeed.

A recent Small Business Administration (SBA) initiative called Regulatory Review and Reform exemplifies, on a small scale, the kind of re-thinking needed. Recent regulatory proposals highlighted for reform by SBA cover everything from trans-fat labeling to the airline passenger screening system; from myriad auto and labor safety standards to energy efficiency mandates for anything with an exhaust pipe.

An economic liberalization package would create a more favorable environment for business development and wealth creation by, among other steps:

- Freezing enactment of new non-essential rules;
- Undertaking a sweeping review of the regulatory state as a whole and implementing a bipartisan package of regulatory cuts; and
- Instituting a permanent automatic sunseting of rules, and ongoing rule reviews and purges.

As it stands, voters lack any real control over agency rule making, just as they will lack control over “car czars” and powerful Treasury secretaries. Only congressmen are elected, not bureaucrats. Congress has delegated power to agencies that lack real incentives to police themselves and that rarely acknowledge when their regulations create more costs than benefits. Along with halting the bailout culture and implementing growth-oriented liberalizing reforms, sound public policy requires that elected representatives affirm new major rules, after considering their costs, before they become effective.

Today, leadership requires unleashing America’s creative, competitive, wealth-creating spirit, not dampening it and creating further dependency through compulsory wealth transfers. Those represent the low road and a lack of imagination and leadership.

You don’t need to tell the grass to grow; just take the rock off of it. And lay off the federal “fertilizer” next time.

# Rein in the \$1 Trillion Regulatory State

From transportation to trade, from communications to banking and technology policy, policy makers of both parties have at times challenged the moral legitimacy, intellectual underpinnings, and economic rationality of federal regulatory intervention. Democrats helped spearhead transportation deregulation, and lawmakers from both parties rolled back unfunded mandates in the 1990s.

Regulations are frequently anti-competitive and anti-consumer, annually costing consumers hundreds of billions of dollars. Policy makers still largely do not know the full benefits and costs of the regulatory enterprise. Meanwhile, regulatory agencies grow in power and budget like feudal baronies.

Many reform ideas have been proposed. Cost-benefit analysis, however informative, is politically unpopular—and does not actually bring the largely unaccountable regulatory state under congressional control. Rather, greater congressional accountability and cost disclosure matter most in regulatory reform efforts. A congressional vote on major or controversial agency rules before they take effect—along with regulatory cost transparency

through such tools as improved annual cost and trend reporting—would help voters to hold Congress responsible for the regulatory state. Reining in excessive delegation of power to federal agency bureaucrats would help close the breach between lawmaking and accountability, while forcing Congress to internalize the need to demonstrate regulatory benefits. Among its reforms, Congress should:

- Establish a bipartisan Regulatory Reduction Commission to survey and purge existing rules.
- Develop a review and sunset schedule for new regulations and agencies.
- Explicitly approve major agency regulations.
- Publish an annual Regulatory Report Card to accompany the federal budget.
- Require that agencies report costs (Congress itself must assess relative benefits and compare agency effectiveness).
- Have agencies and the Office of Management and Budget rank rules' effectiveness, and recommend rules for elimination.

*Wayne Crews*

# Reform U.S. Agriculture Programs

With America facing a lengthy and possible deep recession and a deficit approaching \$1 trillion, policy makers should take a hard look at reforming one of the most wasteful and egregious government programs—the 2008 Farm Bill, which expanded U.S. agriculture support programs significantly, with dire effects.

This nearly \$300-billion (over five years) boondoggle paid off every special interest. Farmers got their direct payments, their counter-cyclical payments, their price support loan amounts, their disaster funds, and much more. Cities and towns got their nutrition programs and their food stamps. Environmentalists got their conservation programs, though not as many as they wanted. Energy producers got some biofuel monies.

Some producers who were not subsidized before—such as fruit, vegetable, and nut producers—received significant R&D money that opens the door to future subsidies. The bill includes what was lauded as the “first-ever livestock title,” for yet another group that was not previously subsidized. And special earmarks got some others on board—the “trail to nowhere,” a taxpayer-funded land swap; forests that house fish got some money, as did salmon fisheries.

And for what? Many farm subsidies go to rich farmers. The per-person annual limit for subsidy eligibility is \$500,000 for non-farm in-

come and \$750,000 per year for farm income. Thus, a married couple could have farm income of \$1.5 million per year and still collect taxpayer-funded payments.

The U.S. sugar program needs drastic reform. The 2008 Farm Bill increases sugar price supports, provides incentives for using sugar for ethanol rather than food, further restricts imports of sugar, and may violate existing trade agreements.

Thus, many agricultural producers continue to enjoy subsidies and price supports, which cost taxpayers, increase food costs, and disproportionately impact low-income consumers who pay a larger percentage of their income for food. And many government agricultural programs continue to restrict imports of various products, such as sugar and ethanol; this leads to higher costs for food and fuel. This must change.

With the current financial crisis and recession, policy makers should immediately address ways to reduce large-scale government waste. The 111th Congress should reform existing farm programs that waste taxpayers’ money, increase consumer costs, threaten U.S. credibility in promoting open trade, and harm developing countries’ ability to compete in the world market.

*Fran Smith*

# Curb and Phase Out Taxpayer-Funded Corporate Bailouts

Many Republicans and Democrats voted against the \$700-billion Troubled Asset Relief Program (TARP), rejecting it as corporate welfare for reckless Wall Street firms. Little has been done to assuage these concerns, as the thrust of the program suddenly shifted from buying “toxic” mortgage securities no one would touch to buying ownership stakes in order to provide a “capital cushion” to relatively healthy financial institutions—and even to propping up automakers.

Even in Washington, \$700 billion is a lot of “real” money, and as long as that money is tied up in the TARP, it cannot be used for anything else. Whatever their fiscal policy preferences, lawmakers must ensure strict time limits and eliminate this program as quickly as possible.

Lawmakers and the public have expressed legitimate concerns about banks’ use of these taxpayer dollars, but government should not jawbone banks into rapidly making loans or pile ever more compensation limits on them. Such meddling would conflict with the firms’ fiduciary duties to other shareholders, and would jeopardize the government’s ability to recoup the money it has invested.

Congress should:

*Set firm time limits for the TARP and other bailouts and require the government’s shares in companies to be sold as of a date certain.* The U.S. government should not own banks or other firms, as permanent nationalization has not worked too well in places like Cuba or Venezuela in promoting stable and sustained economic growth.

*Make the bailout deliberations transparent.* Insist on open meetings whenever possible, quick compliance with the Freedom of Information Act, and judicial review of the Federal Reserve Bank and Treasury Department’s actions.

*Respect property rights and private contracts.* The government is one of many owners in the financial institutions participating in the TARP. It should not interfere with any firm’s fiduciary duty to shareholders to deliver profits by pushing it to achieve some politically determined social goal. Similarly, in trying to help families with foreclosures, the government should not require or encourage the abrogation of contracts to investors in mortgages. Many of these investors are also middle-class families, holding mortgage-backed securities in their 401(k) accounts and mutual funds.

*John Berlau*

# Roll Back Burdensome Sarbanes-Oxley Accounting Rules

“How can we have these levels of fictions in financials after Sarbanes-Oxley?” asks Jim Cramer, the colorful host of CNBC’s “Mad Money.” Maybe because Sarbanes-Oxley (known as Sarbox) is an inherently flawed law: costly to entrepreneurs and investors, and counterproductive at ensuring financial transparency. As the *Financial Times* noted, the inordinate amount of time boards of companies such as the former Bear Stearns spend on Sarbox compliance came at the expense of their scrutinizing overall business risk.

Sarbox was rushed through Congress in 2002 following the Enron and WorldCom scandals. In the last two years, the law has come under criticism from all sides. House Speaker Nancy Pelosi (D-Calif.) has criticized aspects of the law and said that she supports revising it, to mitigate its “unintended consequences.” Similarly, Sen. John Kerry (D-Mass.), now chairman of the Senate Small Business and Entrepreneurship Committee, laments the law’s disproportionate effect on small business.

Congress should heed this call. Today, more than ever, it is essential for mid-size companies to have access to the equity markets, as the debt markets have dried up. The Act’s Section 404 requirement for accountants to sign off on vaguely defined “internal controls” is costing American companies \$35 billion a year in di-

rect compliance costs, according to the American Electronics Association. And it adds 35,000 extra man-hours for the average public firm, according to Financial Executive International. Congress should relieve this heavy regulatory burden by doing the following:

- Adopt the Securities and Exchange Commission’s (SEC) advisory committee recommendation that smaller public companies be exempt from Sarbanes-Oxley’s Section 404 and other SEC rules. A letter from seven Democratic members of the House Small Business Committee, including now-Chairman Nydia Velazquez, notes that senior managers at these smaller companies “now have to choose between spending their time on vital business development functions or Section 404 compliance.”
- Repeal the “internal control” rules of Section 404 or make them voluntary. The term “internal controls” is undefined in the statute and has been broadly defined by regulators. And the SEC has found that internal control practices are seldom a tip-off to fraud.
- Abolish the unaccountable Public Company Accounting Oversight Board (PCAOB) and make standard-setters accountable to the President and Congress. Sarbanes-Oxley created this agency to enforce its accounting rules. Congress designated the

board as a private non-profit corporation appointed by the SEC—a structure that violates the Constitution’s Appointments Clause, which reserves such appointment power to the President or to the head of a cabinet department. The PCAOB wields tremendous power without accountability. It levies taxes on all public companies, it can discipline and fine auditors, and it is responsible for the broad interpretation of Section 404’s “internal control” provision.

And the PCAOB wields this power without any presidential supervision and minimal SEC oversight. The PCAOB’s constitutionality now faces a court challenge, but regardless of that case’s outcome, Congress should abolish the Board—giving authority over accounting back to the presidential appointees at the SEC, where it was before Sarbanes-Oxley.

*John Berlau*

# Make Accounting Regulators Accountable

The flawed valuation models for subprime securities have once again brought accounting issues to the forefront. In addition, mark-to-market accounting—which requires financial instruments such as loans to be valued at the price of an ill-defined “market”—has been blamed by both Democrats and Republicans for spreading the credit contagion from bad banks to good. Mark-to-market mandates have generated questions both about their accuracy and about their economic impact. They exaggerate losses by forcing financial institutions to write down performing loans based on another institution’s fire sale even if the market for such loans is highly illiquid and the financial institution in question has no plans to sell the loans.

Underlying all these problems is the fact that there are relatively few checks on the accounting standards body that makes these rules: the Financial Accounting Standards Board (FASB). FASB is a private body, yet Congress requires public companies to support it through a type of tax—an accounting support fee. Moreover, federal regulatory agencies like the Securities and Exchange Commission and the Federal Deposit Insurance Corporation almost always defer to FASB in setting standards for everything from investor reports to solvency rules.

Earlier this decade, FASB greatly limited the use of employee stock options—which had

bipartisan recognition for their effectiveness at spreading the wealth and creating more of it—by requiring companies to “expense”—that is, subtract the estimated value of stock options—from current earnings, even though stock options never result in a cash outflow. This policy has had little effect on levels of executive compensation, but has caused companies to greatly reduce stock options for rank-and-file workers. It has also resulted in misleading financial reports for investors of companies that utilize stock options, as companies are required to report phantom “losses” when there has been no money leaving the firm’s coffers. Congress should:

- Require regulatory agencies to suspend mark-to-market accounting mandates such as Financial Accounting Standard 157 until better guidance is developed for illiquid markets.
- Reverse the options expensing standard (through legislation similar to previous bills that had bipartisan support, including that of Senate Majority Leader Harry Reid and Speaker Pelosi).
- Hold hearings to examine FASB’s process of setting accounting standards and whether the agency should continue to have a de facto monopoly on setting those standards.

*John Berlau*

# Recognize the Value of Hedge Funds and Private Equity for Entrepreneurs and Shareholders

Hedge funds and private equity are vehicles for wealthy investors to take risks and potentially reap high returns. But the benefits of these types of funds—and of funds that combine features of both—extend beyond their investors to all entrepreneurs and shareholders. Private equity funds build wealth in distressed and startup companies. Hedge funds have forced public companies to create more wealth for shareholders through streamlining—cutting costs and, when necessary, selling off divisions.

In addition, both types of funds provide liquidity and have reduced risks of disruptions to capital markets. Private equity firms have helped to ease the credit crunch by helping to recapitalize commercial banks and stepping in to fill the void of investment banks in financing new business growth. Hedge funds were ahead of the curve in short-selling subprime securities—thereby sending out valuable market information about the risks of those instruments. Cumbersome restrictions would impede their ability to perform in these vital roles. Rather than curtail these vehicles, Congress should consider how to make their benefits available to more investors, by doing the following:

- *Reject attempts to subject hedge funds and private equity to the Security and Exchange Commission's (SEC) one-size-fits-all registration process for ordinary investment*

*vehicles.* These entities are already subject to securities fraud statutes, as well as numerous regulations from agencies, like the Commodity Futures Trading Commission. Moreover, Congress should modernize this regulatory structure to get rid of overlapping jurisdictions for more effective oversight

- *Stop the SEC from raising the minimum income requirements for hedge fund and private equity investors.* The SEC is proposing to raise the minimum net worth needed to invest in the funds from \$1 million to \$2.5 million. Obviously, the SEC does not need to protect “poor” millionaires. And this increase will further drain the pool of capital for innovative new businesses.
- *Revise the Investment Company Act of 1940.* This would allow mutual and exchange-traded funds more freedom to pursue some of the strategies of hedge funds and private equity, such as short-selling, and give some of the hedge fund benefits to ordinary investors with minimal risk. This allows useful information to get out to the market earlier. For instance, had mutual funds had more freedom to engage in short selling during the subprime boom, the mortgage bubble likely would never have grown as big as it did.

*John Berlau*



# Encourage Innovation in Credit Availability

The abuses of the subprime crisis have made it all too easy to overlook the myriad benefits of consumer credit. Innovations in mortgages, credit cards, and unsecured loans such as payday advances, have made it possible for more people to borrow money they need for a variety of purposes—from starting a business or advancing one’s education. In the mid-1990s, a college student named Sergey Brin used personal credit cards to start the search engine business that would become Google, the revolutionary firm that has brought countless benefits to America and the world

Muhammad Yunus won the 2006 Nobel Peace Prize for expanding “microcredit” in Bangladesh—yet in America microcredit providers are often derided as “predatory lenders.” In 2007, Austan Goolsbee, now a top economic adviser to President-elect Barack Obama, warned in *The New York Times* that, “regulators should be mindful of the potential downside in tightening too much.” Such restrictions, he wrote, would hurt “someone with a low income now but who stands to earn much more in the future” with the help of access to credit.

Government certainly has a role in preventing fraudulent lending practices, but it should

leave payment terms and interest rates up to the interested parties to negotiate. It should also reduce the paperwork burden of traditional lending institutions to spur competition among credit providers. Congress should:

- Reject attempts to put interest rate or price controls on credit vehicles.
- Repeal or scale back a variety of regulations—from Sarbanes-Oxley provisions to the Internet gambling ban—that impose myriad paperwork requirements on financial institutions that, by adding to their overall costs, indirectly make services more expensive to borrowers and depositors at all income levels. These rules hit small community banks and credit union’s particularly hard.
- Reduce “know your customer” requirements on banks and other financial institutions to investigate their customers’ backgrounds. These rules often overwhelm law enforcement with useless reports and have adverse impacts on the low-income “unbanked” population by making it more difficult to open a bank account.

*John Berlau*

# Liberalize Telecommunications

Appeals to the “public interest” and claims of airwave scarcity have long been invoked to justify telecommunications regulation. But in today’s world, policy makers starting from a clean slate likely would not create a Federal Communications Commission (FCC) with control over prices, entry, and service delivery. Internet-based technologies have helped erase distance, allowing millions to become broadcasters in their own right. Today’s communications landscape has given individuals a power to exercise freedom of speech that the Framers could hardly have imagined.

Yet a pro-government regulation bias persists. Some application and content companies seek “net neutrality” legislation that would effectively impose price and access regulation on network providers and inhibit infrastructure development. The entertainment industries want a “broadcast flag” to deflect piracy. Some groups want the FCC to regulate “indecent” content on new services, or to implement a new “Fairness Doctrine.” Others want to limit the size of media companies. In the latest *Unified Agenda of Federal Regulations*, 145 rules originate in the FCC, an agency whose budget has increased by more than 20 percent over five years.

Competing cable, telephone, and wireless companies have revolutionized the telecommunications industry. Cable companies provide

local phone service; wireless phones have effectively replaced long distance wireline; satellite competes with cable video programming, while phone companies challenge both satellite and cable video. Reform should advance such competitive discipline and consumer empowerment, and avoid the costs of centralized bureaucracy. Congress should radically reform the FCC, and accord it a minimal regulatory role.

Rollback of government regulation does not mean that communications remains “unregulated.” Competition, or even the threat of it, disciplines the behaviors of companies in efficient and consumer-friendly ways. Those concerned about abuses should keep in mind that the Federal Trade Commission (FTC) would continue to enforce general unfair competition rules, states would retain consumer protection authority, and federal antitrust rules would remain in force. Congress should:

- ***Eliminate economic regulation of telecommunications.*** Rules regulating price and access should be phased out entirely. Policy makers should view lightly regulated Internet communications as a baseline and deregulate to bring legacy communications into competitive parity with the new technologies. Congress should not legislate in new areas, such as by imposing price and access controls in the name of net neutrality.

- ***Restructure the Federal Communications Commission.*** Eliminate FCC functions that could be covered by the Federal Trade Commission, provide a clear legislative mandate to bring the broadcast spectrum into the market, and create a “firewall” to prevent FCC regulation of new communications services, such as voice over Internet protocol or digital recorders.
- ***Analyze which governmental authority, federal or state, is best suited to regulate—or whether government regulation is even required.*** In some cases, Congress should assert its interstate commerce regulatory authority by preventing state interference in communications services.
- ***Revisit rationales for economic and social policy regulation.*** Social welfare initiatives and goals—such as the universal service tax—should be disentangled from industry-specific taxes, price controls, and technological mandates.

Wayne Crews

# Avoid Energy and Global Warming Policies that Pose More Risk than Global Warming

Recommendations:

- Do not enact cap-and-trade legislation or a carbon tax in order to reduce greenhouse gas emissions.
- Do not enact further mandates, subsidies, or incentives for alternative energy technologies or for “green jobs” programs.
- Do not withdraw more federal areas from energy production.
- Do not place regulatory obstacles in the way of building energy infrastructure, including transmission lines, pipelines, coal-fired power plants, nuclear plants, and wind-mills.
- Reject any new international agreement to succeed the Kyoto Protocol that would require mandatory emissions reductions by the United States.
- Do repeal existing mandates, subsidies, and incentives for all types of energy production, efficiency, and conservation.
- Do require the Department of Interior to open federal Outer Continental Shelf areas and the coastal plain of the Arctic National Wildlife Refuge to oil and gas exploration and production.
- Do replace the current depreciation schedules for investments in new capital stock and equipment with immediate expensing.
- Consider responses to potential global warming (or global cooling) that would be more effective and less expensive than mandatory greenhouse gas reductions measures, such as cap-and-trade or a tax.

Although global warming has been described as the greatest threat facing mankind, the policies designed to address global warming actually pose a greater threat. The international and domestic policies to ration carbon-based energy would do—and are doing—little to slow carbon dioxide (CO<sub>2</sub>) emissions, but would have enormous costs. These costs would fall most heavily on poor people in this country and on the world’s poorest nations. The correct approach is not energy rationing, but rather long-term technological transformation and building resiliency in developing societies by increasing their wealth.

Since the Kyoto Protocol was negotiated in 1997, atmospheric CO<sub>2</sub> concentrations have increased by over 5 percent. The global mean temperature peaked in 1998 and has since remained flat and now appears to be declining. Precipitate and colossally expensive measures to reduce greenhouse gas emissions are not warranted at this time—and likely never will be warranted.

Per capita carbon dioxide emissions in the United States have remained flat since 1980, according to the Energy Information Adminis-

tration. But the U.S. population has increased by slightly more than 1 percent per year. Population growth means that the U.S. needs more energy, not less.

The European Union (EU) ratified the Kyoto Protocol and has implemented mandatory greenhouse gas reduction programs, but emissions in the EU-15 (the 15 member countries before the recent EU expansions) have risen considerably since Kyoto was negotiated in 1997. The EU's Emissions Trading Scheme has raised energy prices for consumers and producers, but has not yet lowered emissions. Gasoline taxes have been raised to \$3 to \$4 per gallon in most EU countries, yet emissions from transportation continue to increase.

The most thorough economic studies by leading academic economists (who are not global warming skeptics) have found that mandatory emissions reductions add to the total potential costs of global warming. For example, Dr. William Nordhaus, professor of economics at Yale University and one of the world's leading resource economists, concluded that attaining the emissions reductions advocated by former Vice President Al Gore would avert \$12 trillion of the projected costs of global warming impacts, but at a cost of \$34 trillion.

A cap-and-trade program, such as the Lieberman-Warner bill considered and rejected by

the Senate in the 110<sup>th</sup> Congress, would be the biggest government intrusion in the economy since the rationing system adopted during the Second World War. It would also be the biggest government limitation of, and interference with, people's personal freedoms since that war.

The rapid economic growth in major developing countries has been accompanied by rapid emissions increases. According to several international agencies, total Chinese emissions will soon surpass U.S. emissions. The Chinese government has made it clear that it will not undertake mandatory emissions reductions because it would limit the country's economic growth. Instead, China hopes to be paid by developed nations, and corporations in developed nations, to reduce its emissions.

The economic rise of China and India is lifting hundreds of millions of people out of poverty. Hundreds of millions of more people in poor countries hope to follow down the same path. That requires much more—and much more affordable—energy than can be provided by non-carbon sources, like windmills, solar panels, and nuclear plants. Any successor to the Kyoto Protocol requiring emissions reductions in developing countries would consign billions of people to perpetual poverty.

*Myron Ebell*

# Increase Access to Energy

Economic prosperity and our standard of living depend on affordable energy. Yet since the 1970s, successive Congresses have largely pursued anti-energy policies to constrict energy supplies and raise energy prices. The 111<sup>th</sup> Congress should strike out in a new direction.

Mandates and subsidies for renewable, alternative, and conventional energy technologies have done far more harm than good. Tens of billions of taxpayer dollars have been wasted on subsidies, and subsidies and mandates together have provided a disincentive for alternative technologies to become competitive. It is unlikely, for example, that wind and solar power will ever become viable forms of energy production as long as they can count on continuing subsidies and mandates. Congress should:

***Repeal all mandates and subsidies.*** The 2005 and 2007 ethanol mandates, coupled with the 51-cents-per-gallon refundable tax credit, have had particularly unfortunate indirect consequences. The exact contribution of the ethanol mandate to higher grain prices—and thereby to world hunger—is uncertain, but still real, and quite evident in food riots around the world. The ethanol mandates should be repealed immediately. All other mandates, subsidies, and incentives—including those for conventional energy—should also be repealed. The focus on subsidizing and mandating uncompetitive forms

of energy poses grave threats to our future electricity needs. Wind and solar power can at most provide only a fraction of additional electricity demand over the next decade.

***Open the nation's infrastructure to private investment.*** In addition to repealing mandates, subsidies, and incentives for all types of energy production, Congress should remove regulatory obstacles that are preventing private investments in new energy infrastructure. A “smart grid” will never be built until Congress changes regulations so that investors have an opportunity—not a guarantee—to profit from the hundreds of billions of dollars of investments required.

***Allow access to America's domestic energy resources.*** The 110<sup>th</sup> Congress let lapse the moratorium on oil and gas exploration in federal Outer Continental Shelf (OCS) areas that had been in place since 1982. President George W. Bush rescinded the executive order moratorium covering the same 85 percent of OCS areas surrounding the lower 48 states. The 111<sup>th</sup> Congress should push the new Obama administration to prepare OCS areas with high oil and gas potential for leasing by competitive bidding. Congress should also open the coastal plain of the Arctic National Wildlife Refuge to oil and gas exploration and production, and repeal many of the administrative withdrawals of federal lands from

energy production in the Rocky Mountains. Together, these actions will increase domestic oil and gas production, thereby creating hundreds of thousands of high-paying jobs, lowering the trade deficit by tens of billions of dollars annually, and contributing billions of dollars in royalty payments to the federal Treasury.

*Enable technological innovation.* The most effective way to increase energy efficiency is to replace existing technology with new technology. One of the reasons that greenhouse gas

emissions have been rising more slowly (in percentage terms) in the United States than in most European countries is more rapid technological turnover because of higher economic growth in the U.S. Congress can accelerate this trend by changing the tax code to allow immediate expensing of investment in new technology instead of according to a depreciation schedule over a number of years.

*Myron Ebell*

# Allow Workers and Employers to Work without Burdensome Regulation

One of America's greatest economic strengths is individuals' and businesses' ability to adapt to changing economic conditions. However, in the case of labor markets, many workers and employers remain subject to an array of obsolete New Deal-era labor regulations that discourage innovation and hamper flexibility. The old adversarial model of labor relations has little to offer to the 21st century workforce, which is characterized by horizontal company structures and greater job mobility—flexibility which employers and workers need to better ride out downturns in the economy.

America has come a long way since the New Deal, when the National Labor Relations Act was enacted. Since then, the collective bargaining model that has predominated in the U.S. has been one based on compulsory monopoly representation. Under this system, when employees at a given workplace vote on whether they want to be represented by a union, that union becomes the exclusive bargaining agents for all the workers there—including workers who did not vote to be represented by the union. This violates workers' First Amendment rights to freedom of association and freedom of speech—by forcing them to join unions as a precondition of employment and to support, through the compulsory payment of union dues, political activism with which they may not agree.

Since the passage of the Taft-Hartley Act in 1947, states have been able to mitigate this situation through the enactment of right-to-work laws, which bar making union membership a precondition for employment. Today, 22 states have right-to-work laws. But now organized labor is pushing Congress to close even this opening in the labor market, hoping to make compulsory unionism nationwide.

Abolishing unions' monopoly bargaining privilege would end this anachronistic system. However, short of that, Congress should keep from making the situation worse—and that is precisely what another item atop organized labor's agenda would do: the misleadingly named Employee Free Choice Act (EFCA). EFCA would do three things:

- *Enact automatic recognition of “card check” organizing whenever a union requests it.* Card check—a procedure that currently requires employer approval—allows unions to circumvent secret ballot organizing elections, by getting the National Labor Relations Board to recognize a union as the exclusive employee bargaining agent if a majority of employees signs cards requesting union representation. Because cards are signed out in the open, card check exposes employees to high-pressure tactics that secret ballot elections are designed to avoid.



- *Impose binding arbitration on employers and workers.* Under EFCA, if a union and an employer are unable to agree on a contract within 120 days, the federal government would then proceed to impose a contract upon the parties. This is undemocratic, and exposes businesses and workers to being saddled with onerous obligations over which they have no say.
- *Increase penalties for “unfair labor practices.”* Unfair labor practices are actions that are prohibited during union organizing elections. Increased penalties for this would give unions another blunt instrument with which to pressure employers—hardly a recipe for harmonious labor relations.

Finally, several unions are advocating a variety of bills to mandate such detailed workplace issues as wage levels and leave. Yet the parties directly involved in these issues—workers and employers—are best qualified to make these decisions, since they know their own situations better than any federal bureaucrat. Feel-good measures of this sort would exacerbate unemployment by making the entire hiring process more cumbersome, which is the last thing the nation needs in the current economic climate.

*Ivan Osorio*

# Avoid Extending Antitrust Regulation into New Competitive Realms

Over the past several decades, until the financial bailout fiasco, policy makers were justifiably willing to question the presumption that economic regulation automatically benefits consumers. That reform-minded culture helped drive the liberalization of transportation, telecommunications, banking, electricity and more, to the benefit of consumers.

Antitrust regulation, however, enjoys sustained support in the business and popular press, and among policy makers. High-profile antitrust enforcement interventions constitute a business hazard for aggressive, successful firms, and threaten to disrupt innovation and economic growth. Examples include Microsoft, Intel, the scuttled DirecTV/Echostar merger, and the long-delayed XM-Sirius satellite radio merger. New product offerings are delayed or halted, uncertainty destroys wealth, and entities are created that would not have emerged in a free market.

Economic regulations transfer wealth from some companies to others, and nearly always away from consumers. Antitrust regulation, by its mere existence as an option, inevitably attracts political “entrepreneurs” seeking entry or price regulation to hobble or preempt competition. Antitrust enforcement against a rival firm becomes a substitute for actual competition, and generally harms consumers by increasing prices and decreasing output of products and services. Rethinking the true impact of these interventions—whether against “collusion,” “predatory pricing,” or “discrimination”—should be a goal of policy makers in today’s competitive, global marketplace. Antitrust regulations undermine little-understood efficiencies, destroy the wealth-creation process, and rip off consumers while enriching lawyers and bureaucrats.

*Wayne Crews*

# Avoid Privacy Regulation that Could Worsen Personal Security

There are two great ironies in calls by lawmakers and consumer advocates to protect consumer privacy by regulating businesses that handle sensitive personal data. First, the most egregious privacy violations have historically been perpetrated not by businesses engaged in consumer transactions but by governments on their own citizens.

Second, those violations of privacy that *do* result from business and consumer transactions are vastly facilitated by the government's own efforts to collect individuals' personal information. Social Security numbers, names, and birth dates—the holy trinity of information for identity thieves—are all kept in government databases, and the federal government itself has promoted their use by financial institutions as identity verification.

Some lawmakers want to collect even more information into federally controlled databases encompassing all citizens. Others have proposed requiring either national ID cards or that state ID cards meet certain federal standards—which would make state IDs into de facto national IDs.

Yet that is not all. With homeland security becoming an increasingly important national policy issue, there will be a growing impetus to gather still more data on citizens, including proposals to incorporate new technologies like

biometrics and radio frequency ID tags into proposals for ID cards. The key to securing data and privacy is not to give government ever more personal information, but less.

Government efforts to regulate private sector privacy standards are misguided. One-size-fits-all regulations are an ineffective means of maximizing privacy and security. The diverse uses for digital devices and networked communications create privacy and security needs that could not possibly be met by static laws enforced by distant bureaucrats. The appropriate level of privacy and data safety varies depending on the type of information—for example, a level of security that may be acceptable for an online sale on eBay may be inadequate for a computer system that operates a facet of critical infrastructure, such as a chemical or power plant. Similarly, the data transmitted between an individual and his local bank, although sensitive, may be far less sensitive than the data transmitted by a mutual fund manager or a doctor.

With technologies to secure privacy constantly improving, companies are developing techniques to ensure that sensitive data and networks are protected according to user preferences and needs. The market forces of competition and innovation are constantly helping businesses and consumers devise solutions to

new problems. Federal regulation could not anticipate and respond to the ever-changing threats to digital information, nor is regulation likely to encourage robust and competitive markets for privacy-enhancing products. Legislative mandates in computer security are more likely to stifle innovation and ossify technology standards.

Consumers today demand security in addition to functionality when it comes to online transactions and new gadgetry. As that demand grows, market institutions will evolve to produce even higher standards; insurance, company reputation, and third party watchdog groups are examples of market institutions that could negate the need for heavy-handed regulation. As technology advances, governments must constrain their own excesses by:

- Avoiding mandatory databases.
- Ensuring Fourth Amendment protections for public surveillance.
- Avoiding mixing public and private databases.

Beyond that, government involvement in private sector privacy and data security issues should be limited to:

- Enforcing the contractual obligations of both businesses and consumers with respect to information security procedures.
- Tracking and punishing the cyber-criminals responsible for data breaches and identity theft, rather than the companies victimized by such criminals.

*Wayne Crews*

# Forge a Bipartisan Approach to End Corporate Welfare

One of government's primary current undertakings is the transfer of wealth—including through such mechanisms as financial and industry “stimulus” packages, bailouts, and infrastructure “investments.” This money all must come from somewhere. If current taxpayers do not pay the costs for such boondoggles, their descendants will. Well before the economic crisis and the government's responses to it, direct subsidies to agribusiness and other favored enterprises were pervasive and well known as corporate welfare.

Apart from direct payments, government *regulation* can also indirectly transfer wealth, benefiting some economic actors at the expense of competitors and consumers. Price and entry regulations are obvious examples of this. Anti-trust regulation is another less well-known one. But even regulations meant to address health and safety can benefit some firms at the expense of rivals.

Corporate welfare—whether in the form of subsidies or regulations that hamper competitors—creates distortions and inefficiencies, injuring consumers and undermining the evolving, competitive marketplace. Congress should keep a watchful eye on the businesses that set up lobbying shops in Washington, D.C.—are they seeking to reduce burdens on entrepreneurship and employment or to add burdens that, while perhaps costly, benefit them at the expense of competitors? Entry barriers hit smaller companies harder—additional costs that can be absorbed by a large company could be crippling to its smaller competitors. A critical eye and a skeptical approach toward any appeals for political favors should be the stance of the new Congress.

*Wayne Crews*

# Develop Smart Policies to Help Homeowners Deal With Natural Catastrophes

Natural catastrophes such as hurricanes, forest fires, earthquakes, and severe blizzards threaten nearly every state in the Union. Each year, such catastrophes impose billions of dollars' worth of costs on taxpayers, insurers, and governments; claim scores of lives; and destroy thousands of homes. Both the Democratic and Republican 2008 electoral platforms promised to do more to address these catastrophic events. So far, however, federal action has been lacking. Congress should:

- *Avoid policies that encourage unwise building.* During 2008, the House of Representatives passed measures that would have added wind coverage to the National Flood Insurance Program and established an implicitly government-backed entity to reduce reinsurance prices. Neither measure had much promise for providing coverage that would actually cost less than that in the private market. Instead, both would encourage development where it should not occur while sticking taxpayers with the bill. Thankfully, neither measure moved forward in the Senate, but such efforts are likely to come back. Congress should reject any measure that could involve the federal government in the insurance or reinsurance business in disaster-prone regions.
- *Help states decontrol homeowners' insurance rates.* States—not the federal government—

perform nearly all oversight of homeowners' insurance rates. In the long term, federal policy should encourage states to let insurers charge risk-based rates that take all relevant risk factors into account. Many state insurance bureaucracies, however, suppress rates in order to cater to homeowners who live in unsafe areas. (Often simultaneously raising rates for those who live in safer areas.) The federal government should offer tax credits over a phase-out period to homeowners in states that act properly and allow rates to rise. This would temporarily offset higher insurance premiums and allow homeowners to secure their homes against natural disasters. The tax credits should expire with the program.

- *Allow private insurers to reserve against catastrophes without paying taxes up front.* Current U.S. tax law makes it difficult for insurers and reinsurers to build up reserves against catastrophes. Larger reserves could make reinsurance more affordable. The United States should implement laws similar to those in Switzerland, Bermuda, and elsewhere that make it possible for insurers to build up “catastrophic” reserves. Money in these reserves could be held tax-free until spent to pay claims stemming from a major catastrophe.

*Eli Lehrer*

# Liberalize Homeowners, Automobile, Life, and Commercial Insurance Regulation

A confusing patchwork of state-level regulations currently governs insurance in the United States. This balkanized regulatory structure hampers innovation, raises insurance rates for those who behave prudently, and needlessly expands government bureaucracy. In the realms of homeowners', automobile, and life insurance—the types of insurance that most Americans buy for themselves—the United States needs a *national* insurance market that leaves rate regulation to market forces. Three major options exist for creating such a market.

**Optional federal charter.** The single most popular proposal to expand flexibility is an optional federal charter (OFC). This would give insurers the flexibility to choose between federal and state regulation, an option that banks have enjoyed since the Civil War. An OFC would promote innovation. Without the need to get individual approvals in each state in which they want to do business, insurers would be able to introduce many new products. Since the introduction of the modern homeowners' insurance policy in the 1960s, few genuinely new insurance products for individual consumers have appeared on the market.

In addition, with risk factors rather than political ones serving as the primary determinants of insurance rates, the system would provide a

powerful disincentive for people drive fast or live in disaster-prone areas.

Finally, the option of a single federal regulator would place great pressure on states to improve their own regulatory environment, trim bureaucracy, and make their own regulations more consumer- and business-friendly.

**Interstate insurance choice.** Allowing state-regulated insurers to operate across state lines under the laws of their home state could also yield many of the positive consequences of an optional federal charter without the need to create a new federal agency to administer it. (The total expansion of bureaucracy, however, could actually be greater as various states expanded their reach to regulate out-of-state companies.)

**State-level liberalization.** Finally, there is an option that Congress only would need to let happen. States could simply improve and harmonize their laws to the point that insurers and consumers have the benefits of an OFC within the context of a state system. All 50 states have enacted some form of the Uniform Commercial Code as a way of dealing with transactions of personal (that is, moveable) property, so a sufficiently liberal uniform insurance regulatory law could also accomplish many of the purposes of an OFC while keeping the federal government out of the insurance business.

*Eli Lehrer and Michelle Minton*

# Encourage Competition between Different Types of Depository Institutions

Three major types of depository institutions—banks, thrifts (also known as savings and loans), and credit unions—provide checking accounts, credit cards, loans, and savings instruments for American consumers and businesses. Although credit unions face the highest overall level of government regulation, each type of institution enjoys some special privileges and limits. For example, thrifts can open up new branches most easily, credit unions pay the least taxes, and banks have the fewest restrictions on the type of loans they can make. All of these privileges and restrictions have historical reasons for existing but, for the most part, no longer make sense. In the long, medium, and short terms, a variety of approaches could improve the quality of depository institution regulation in the United States.

In the long term, Congress should strive for a single, liberal federal charter for all institutions to allow customers to enjoy the best of all worlds: thrifts' flexibility to open branches anywhere customers want them; banks' and thrifts' ability to let market forces rather than government determine lending distribution; sensible, universal capital reserve requirements; and credit unions' tax-free status. Institution owners—stockholders for banks and some thrifts, customers for credit unions and other

thrifts—rather than legal restrictions, would decide structure and market advantages.

In the medium term, Congress should ease the distinctions between different types of institutions within respective chartering authorities. Lawmakers should allow credit unions to expand their field of membership, while allowing banks the same rights as thrifts to open branches wherever they encounter consumer demand. Over time, such a general easing of regulatory burdens could lay the groundwork for a streamlining of chartering authority.

In the short term, given the current credit crunch—to which the 1970s-era Community Reinvestment Act contributed—Congress should seek to expand credit availability. It should ease restrictions on credit union business lending and simultaneously reduce capital reserve requirements for banks and thrifts.

Repeal of the Community Reinvestment Act would be the ideal situation. However, short of that, Congress should consider allowing banks to qualify as being CRA compliant through a much simpler process with far less room for political interference. This alone would provide a strong inducement to lend.

*Eli Lehrer*



# Phase Out the National Flood Insurance Program

Since it emerged in its current form in 1973, the National Flood Insurance Program (NFIP) has done little to meet its supposed purpose of protecting the nation from flood damage. Instead, it has encouraged development in flood-prone areas, endangered lives, and damaged the environment. Moreover, the program's existence has retarded the emergence of purely private flood insurance and imposed billions of dollars in costs. As of late 2008, the program was almost \$18 billion in debt to the U.S. Treasury and had no feasible way to pay it back. Partial privatization of the program would require three steps: improved flood mapping, rate changes, and a free market auction of policies within the current program.

*Improved flood mapping.* Writing flood insurance coverage requires complex rate maps that make probabilistic determinations of the risk of flooding in various areas. The current maps that underlie the flood program are out of date and, despite hundreds of millions of dollars spent modernizing them, still are not very good. Good maps would make it possible for private

companies to write practical, affordable insurance on a large scale. Because flooding involves so many unknowns, it makes the most sense to allow multiple players to develop flood maps in a competitive market.

*Rate adjustment.* New improved maps would allow companies that want to write flood policies to adjust rates to make them accurately reflect the risk involved. Some rates would go up based on new data while others would fall. In time, a large portion of the NFIP flood policies could be taken over by private insurers.

*Auction of remaining NFIP policies.* Following a period under this quasi-private system, the National Flood Insurance Program could auction off its remaining portfolio of policies. Certain high-risk areas would likely be rendered not insurable at rates that would offer any real value to those purchasing insurance, which would discourage building in the highest risk areas—a desirable outcome in terms of both costs and safety.

*Eli Lehrer*

# Protect Sensitive and Disaster-Prone Natural Areas

Overdevelopment of wetlands, barrier islands, old growth forests, mountainsides and other disaster-prone areas often leads to exacerbating losses from natural disasters. Building on or near mountainsides, for example, can cause landslides and flooding. Such areas—often the most physically beautiful—also provide important wildlife habitat and key areas for recreation. While some of the benefits of conservation are clearly “soft”—appreciation for the beauty of nature, preservation of wildlife—there are also concrete, hard benefits to preserving such areas.

Wetlands, for example, play an enormous role in moderating the storm surges from all but the largest hurricanes and slowing hurricanes on their way inland. Conserving these resources and protecting the nation from disasters requires three policy changes: an appreciation that private property typically provides the best protection of these areas, a withdrawal of implicit and explicit development subsidies from many areas, and a determination to maximize public benefit from whatever land the federal government holds.

*Allow private conservation.* Private property owners have the best incentives to preserve land and federal policy should recognize that. A company with a deeded fee-simple interest in forest land, for example, will almost never de-

cide to clear-cut it simply because clear-cutting provides such a poor return on a long-term investment. On the other hand, a company leasing land from the government can maximize its profits if it clear-cuts that land.

Trusts and other non-profit charitable bodies often have a better incentive structure than the government to make sure that it remains preserved. A government must manage a number of competing interests and may find that a desire for economic development, tax revenue, or a favor to a powerful group overrides its desire for conservation. A private conservation trust, on the other hand, exists only to preserve the land and can be trusted to do so in the long term. Thus, to the extent possible, the federal government should transfer environmentally sensitive land to private owners—charitable and for-profit—that will do a better job managing it.

*End policies that encourage people to live in disaster-prone areas.* Congress should withdraw all subsidies from truly environmentally sensitive areas. For the most part, federal law and regulatory policy already restrict new development in heavily flood-prone areas and no *explicit* federal subsidies exist. Congress should also withdraw all *implicit* federal subsidies for development in these areas. If a developer wants to build over wetlands or on

a mountainside, residents in the area should be denied any federal subsidy that encourages them to live there, including infrastructure. Someone who moves into a disaster-prone area or who chooses to live on wetlands should expect nothing from the federal government besides a rescue craft and a bill. States that

provide more help—except through direct additional taxes paid only by people in the affected areas—should have federal aid reduced by the amount of help provided to residents in disaster-prone areas.

*Eli Lehrer*

# Let Market Forces Regulate Internet Gambling

Americans like to gamble; in 48 states they can do so legally. However, a bevy of federal laws—The Wire Act (which bans interstate bets), the Professional and Amateur Sports Protection Act (which makes it impossible for almost all states to legalize sports betting), and the Unlawful Internet Gambling Enforcement Act (UIGEA, which imposes a variety of burdensome banking regulations in an effort to ban some types of Internet gambling)—make gaming over the Internet very difficult.

In a country where gambling has become a respected, mainstream pastime, these laws make no sense. Letting the free market regulate Internet gambling will result in the best outcome for gamers, Internet casino owners, and payment processing companies. Governments should enforce existing contract and criminal laws against force and fraud.

What people want, they will get. The use of the Internet for gambling was an inevitable outcropping of an activity many people want to engage in. People clearly enjoy gambling on the Internet and will keep doing so, whether it is legal or not. If Congress were to implement regulations effectively banning Internet gaming, then gambling, like any other prohibited activity, would simply shift to the black market where consumers do not have any legal protections.

Some proposed regulations on Internet gambling, such as the Unlawful Internet Gambling Enforcement Act, would do little to protect consumers and would throw a burden onto an already troubled banking industry, proving costly and confusing for financial institutions. The Act is less an Internet gambling regulation than a banking regulation. UIGEA would make it illegal for financial institutions to process payments related to “unlawful Internet gambling,” but it fails to define which types of Internet gambling are unlawful. Such ambiguities make it likely that these institutions will simply decline to handle *any* transaction related to Internet wagering—whether legal or not—and thus constitute a de facto ban on gambling, which, as noted above, would drive the activity itself underground.

Allowing the market to regulate Internet gambling would also help boost international trade, while cracking down on it may hurt America’s standing in this area. In 2004 the World Trade Organization agreed with Antigua when it claimed that U.S. regulations banning international Internet gaming sites in the United States violated international trade agreements.

Because gambling is essentially an entertainment activity where participants enjoy the possibility to profit, there is no reason to assume that private market oversight or certification

would be insufficient. Like cruise ship casinos, which voluntarily abide by specific regulations and agree to audits of their operations, Internet casinos could voluntarily submit to review by a regulator. Inevitably, competition among private auditors would result in greater oversight

than one federal watchdog. Auditors could offer a certificate or rating to guide consumers to the sites at which they are most likely to have fair play.

*Michelle Minton*

# Allow Immigrants to Help Fill America's Need for Workers

Congress should implement more flexible, less restrictive immigration laws, with the ultimate goal of an immigration system that lets law-abiding workers from anywhere fill any job an employer wishes to give them. Measures that move towards comprehensive immigration reform tend to forward such a system.

The detrimental effects of freer immigration are illusory. The standard arguments in favor of restrictive immigration laws—that such laws are necessary to secure the nation's borders and to protect American workers from an influx of cheap foreign laborers—do not hold up to scrutiny.

Immigration critics charge that undocumented workers depress wages. But that is because they are undocumented, which forces them underground. Allowing workers to enter the country legally would protect American workers' wages. In addition, by helping ensure that workers enter the United States legally, a more liberal immigration policy helps enhance control of the border.

Freer immigration would also stem abuse by unscrupulous employers who threaten foreign workers with deportation, by allowing the workers to change jobs.

Meanwhile, even in this economy, some employers still report that they are unable to find

American workers willing and able to take jobs they need filled. They say that they need foreign workers to take these jobs, and that if they cannot hire foreign workers, they will have to shrink or shut their businesses.

Congress should lift caps on hiring guest workers. The United States has two major guest worker programs.

- The H-2A visa allows an unlimited number of foreign workers to be employed as seasonal or temporary agricultural workers in the U.S. It is valid for up to one year, and may be extended for up to three years. H-2A workers may not transfer from one employer to another. Its application process is slow, burdensome, duplicative, and expensive, *by the U.S. Department of Labor's (DOL) own reckoning.*
- The H-2B visa, for temporary and seasonal non-agricultural workers, has a yearly cap of 66,000 H-2B visas given out each fiscal year. Since 2004, the yearly caps have been filled quickly. On January 3, 2008, U.S. Citizenship and Immigration Services (USCIS) announced that, "it has received a sufficient number of petitions to reach the congressionally mandated H-2B cap for the second half of Fiscal Year 2008 (FY2008)."

Congress should lift the caps on the programs. Most foreign workers coming to the

United States to work will only stay in the United States so long as there are jobs. When jobs dry up, foreign workers leave—so long as

they have the ability to return when the jobs are available again.

*Eli Lehrer and other CEI Staff*

# Keep Government's Hands off the Net and E-Commerce

As a network of networks, the Internet transcends political boundaries, making it difficult for any government to regulate. To date, Internet “governance” has been decentralized and its functions distributed among various organizations. Governance need not invoke government—for example, spam, spyware, and other nefarious activities are best addressed by private solutions that authenticate and filter content in ways consistent with free speech and individual choice.

The Internet also makes economic transactions more efficient and less costly, and increases consumer choice; these developments seriously challenge earlier (perfectly appropriate) business models involving intermediaries, high commissions, and controlled information flow. Many old regulatory models simply do

not translate to new business models that bypass such intermediaries and methods of operation. When policy makers attempt to impose legacy models on new technologies, they can end up skewing the regulatory process in favor of established, traditional “off-line” companies. Examples of such regulation include rules banning the direct online purchase of cars, contact lenses, wine, and even caskets.

The rationale of “protecting” consumers via such prohibitions does not withstand scrutiny. Congress should resist all special interest appeals with respect to the Internet and online commerce, and maintain a skeptical attitude toward economic regulation of electronic commerce generally.

*Wayne Crews*



# Clarify the Role of Intellectual Property in the Economy

Copyright and patent laws protect the expression of an artistic work and the formulation of an idea. Intellectual property rights are the basis for privately funded innovation, allowing companies that succeed in the marketplace to recoup their research, development, and marketing costs.

However, digital technologies and the Internet have revolutionized the debate over the fundamental role of intellectual property rights. Peer-to-peer file sharing, CD and DVD burning (both themselves threatened by the pervasiveness of online storage of entertainment), and other forms of digital distribution and reproduction threaten industry business models established

during an earlier, analog era when copying was at least a chore if not nearly impossible.

In the new regime, Congress should not rush to change copyright laws, ban devices capable of recording, mandate copy-protection technologies, or impose secondary liability on networks or technology developers in ways that could decrease innovation. Congress should also resist well-meaning attempts to make federally funded research publicly available, which would rob scientific journals of the proprietary content that they publish—and thereby effectively nationalize scientific publication.

*Wayne Crews*

# Study and Understand Corporate Social Responsibility

Congress should study the confusion created in the market by mixing the welfare (wealth redistribution) elements of politics with the innovative (wealth creation) aspects of the market. The current financial crisis stems in large part from this entanglement of private profit goals with political guarantees and subsidies. Congress should examine the problems inherent in a “mixed economy” and seek ways to ensure that the relative responsibilities of all parties are clearly delineated, that the boundary lines between the private and the political spheres are understood and honored.

To this end, Congress should critically appraise corporate social responsibility (CSR). Too often, CSR blurs those distinctions, transforming wealth-creating firms into wealth-redistributing rent seekers. Congress should also reconsider government sponsored enterprises—nominally private firms which are given special privileges in return for advancing various welfare goals. An example of this are the financial guarantees granted to Freddie Mac and Fannie Mae in exchange for their extending home ownership opportunities to high credit-risk individuals. Fannie and Freddie were widely regarded as ideal examples of CSR.

The doctrine of CSR fails to recognize the ways in which the corporation already contributes to the values of our democracy. The cor-

poration, as Economics Nobel Laureate Ronald Coase has noted, is one of the most successful institutional innovations in history, an extremely effective way of organizing large numbers of people and capital to produce a set of goods and services at affordable prices. Specialization is the key to its success. CSR, by imposing a whole array of “social” mandates on the firm, diverts focus from this wealth creation role to other non-profit relevant goals, and, thus, weakens the firm’s ability to create wealth.

Moreover, CSR is non-democratic, shifting power from the many in the populace to the few in top corporate management. The wealth created by the corporation does not stay with the company; rather it flows out to shareholders, employees, customers, and suppliers. And that diffusion of wealth empowers far more people to advance their own diverse individual values. By compromising the corporation’s wealth creating potential, CSR reduces the ability of individuals to advance their own individual goals. Instead, CSR allows top corporate managers—influenced by powerful political and ideological interests—to determine which values will be championed, and which ones ignored.

Few policy trends threaten world economic growth more than CSR.

*Fred Smith*

# Protect and Enhance Federalism

The Framers of the Constitution intended federalism to act as a check not only on the national government, but on state governments as well. In addition to the relatively well known limits on Congress, the Constitution imposes a number of limitations on the states. For example, the Compact Clause (Article I, Section 10) prohibits states from entering into agreements with other states without congressional approval. This was intended to restrict the ability of groups of states to gang up on other states or on the federal government.

But these restraints have been severely weakened. There has been a growing federal intrusion into state and local issues. More recently, states themselves have begun to create a new form of national regulation through state attorneys general (AGs) acting in concert. The first trend is obvious. The second, because it is too new to

be widely recognized or open to public scrutiny, could well be more dangerous.

In areas ranging from financial regulation and tobacco control to global warming and fuel economy mandates, state attorneys general are entering into new alliances aimed at imposing national regulatory schemes via litigation. These joint litigation campaigns are often fueled by lucrative deals between state AGs and private lawyers, and many states join simply because such lawsuits have the potential to generate huge sums of money. But under the Constitution such joint campaigns by the states require advance congressional approval. Congress should actively review them, rather than sit on the sidelines while new national regulations are imposed by default.

*Sam Kazman*

# Avoid Hampering the Internet through Net Neutrality Regulation

Some observers have speculated that 2009 may finally see net neutrality—the policy that network owners may not give priority or otherwise discriminate between different kinds of data—enshrined into law. But recently, even some of the most ardent net neutrality supporters have softened their stances. It is quickly becoming obvious that private, voluntary arrangements for distributing content are essential mechanisms for the Internet to efficiently cope with the growing amount of content distributed online.

The neutrality debate focuses on three separate policy issues: censorship by Internet Service Providers (ISPs), traffic prioritization, and physical architecture of the Internet.

## Censorship

There is widespread support for the position that Internet Service Providers and other network operators, like wireless telephone carriers, should not be in the business of deciding which users' content is appropriate. But history shows that neutrality laws are not necessary to ensure that network providers have a strong incentive to treat content neutrally.

ISPs already have a strong incentive to not interfere with their users' content. The appearance of content discrimination by network operators can create a public and media backlash against the offending ISP, which must walk a

fine line. Such backlash occurred in September 2007, when Verizon denied the request of the National Abortion Rights Action League (NARAL) for an SMS short code to send a “call to action” text message to members who had opted to receive it. Verizon asserted that it was not picking sides, but merely was trying to avoid being seen as picking favorites in the controversial abortion debate, and pointed to a company policy that forbade such advocacy. Public outcry erupted, anyhow, and Verizon soon changed its stance, allowing NARAL to send out its text messages.

Other examples of public backlash have stemmed from accidental net neutrality violations. Customers of Cox Interactive, a cable ISP, found in early 2006 that the popular classified ad website Craigslist was inaccessible. Users cried foul as pundits claimed Cox had blocked Craigslist to boost its own classified advertising site. But it turned out that security software, not malicious network practices, caused the blocking of Craigslist. The problem was quickly corrected, but Cox took a serious beating in the press. Arguably, the negative publicity dealt Cox a more severe blow than any FCC fine could have.

## Traffic Prioritization

Perhaps the most contentious question in the neutrality debate is how networks should

be managed. The growth of the Internet has been accompanied by increasingly sophisticated processes for moving data around the Net, allowing ISPs and other networks to respond to demand dynamically.

Proponents of neutrality regulation want to ban some forms of network management for fear that they threaten free speech. But the Internet—unlike, say, a public square—has always been a pay-to-play system with prioritization and other optimization elements tightly integrated. Private enterprises must abide by contracts and interact with customers honestly, but regulations should not stand in the way of voluntary market arrangements.

The most notable network management controversy began in the fall of 2007, when network engineers discovered that Comcast was limiting certain types of traffic unbeknownst to its customers. Specifically, Comcast was resetting certain upload streams associated with Bittorrent, a popular file-sharing protocol. Some pundits blasted Comcast's "traffic-shaping" policy. Comcast defended its techniques by arguing that they were necessary to cope with the debilitating effects of congestion caused by Bittorrent users, who were consuming a large portion of overall bandwidth despite representing a tiny portion of its customer base.

Still, Comcast eventually stopped curbing Bittorrent, and even began partnering with file sharing companies to get to the root of the network management dilemma. Amidst intense public pressure, Comcast adopted a 250-gigabyte monthly usage cap and made neutrality toward applications its official policy. While some cited the controversy as proof that neutrality regulations are needed, the episode actually shows how the forces of public opinion *preserved* neutrality.

### **Architecture of the Net**

The Internet is physically constructed of many small, distinct networks that exchange data between each other to form the global Internet. Data traveling across the Internet typically passes through several networks. Some of these networks—the major interchanges between top tier carriers such as AT&T, Verizon, or Sprint—constitute the Internet's "core."

In recent years, connections known as "short lanes" and "fast lanes" have augmented the traditional Internet.

Short lanes, which are used by firms like Akamai and Google to deliver content like high definition video, require files to be sent over the core network to the end user's ISP only once, where the data resides on servers located inside consumer ISP networks close to end users. This technique, known as "edge-caching," relieves the burden on the public Internet by reducing the amount of data that must travel through the core of the Internet.

Fast lanes, on the other hand, transmit data across long distances on private networks, skipping the Internet's core altogether. One such fast lane, Limelight Networks, provided online video streaming for the 2008 Beijing Olympics. Limelight's servers in Beijing sent data directly to the United States over a private fiber network separate from the public Internet. Transmitting video content over fast lanes lowers the cost of delivery, allowing data to reach its destination faster than if it were to traverse the Internet's core.

Some consider these arrangements unfair because they can be quite expensive. But while access to these lanes is not free, both short lanes and fast lanes are accessible to small companies and even individuals thanks to affordable services like Amazon's Cloudfront. Non-neutral lanes also reduce the amount of traffic flowing

across the Internet's core, making it faster and more efficient for everyone.

### **A Market for Neutrality, Not Neutrality by Regulation**

The win-win scenarios offered by these new architectures will ultimately render neutrality proposals obsolete. Many of the major companies that once supported neutrality regulation—Microsoft, Yahoo, and Amazon—have changed their tune, and are now forming partnerships with ISPs and negotiating non-neutral arrangements for content delivery and other purposes.

Some prominent net neutrality advocates, like Harvard Professor Lawrence Lessig, have admitted that “there are good reasons to be able to prioritize traffic.”

Any neutrality regulation would be unable to keep pace with ever-changing technologies. As networks evolve and new technologies emerge, the definition of acceptable network

management will surely shift. Consumers will vote with their feet by either staying with the provider they have or switching to one that better meets their needs.

The proper public policy approach to neutrality concerns is to focus on ways to expand consumer choice. By continuing to auction off the airwaves and limiting municipal franchising rules that discourage ISP competition, policy makers could dramatically stimulate competition in the broadband marketplace.

The Obama Administration and Congress should steer clear of neutrality legislation. Just as excessive regulations gave us an overly concentrated ISP marketplace, creating a whole new regulatory regime to fix perceived problems would undoubtedly lead to new problems down the road. The main priority of Congress must be the repeal of the regulations that curtailed competition to begin with.

*Cord Blomquist*

# Protect Free Speech by Rejecting Content Regulation

In recent years, the First Amendment's protections have been increasingly extended to commercial speech, such as product advertisements. However, significant gaps still exist; in areas such as the health benefits of moderate alcohol consumption, federal prohibitions still restrict the public's ability to learn about well-documented scientific findings.

As new technologies provide an ever-growing array of media, Congress will face increasing pressure to impose content regulations—including regulations on video games and on social networking websites like Facebook. As portable devices such as iPods and cell phones

become increasingly equipped for video and multimedia playback, regulation advocates will begin to push for laws governing what can and cannot be viewed in public areas. Most of these regulations will initially arise under the guise of protecting children from harmful material, but regardless of the reasoning, all such regulations should be avoided. Parents, not government regulators, are best equipped to determine what content is appropriate for their children, and all such regulatory ventures pose a threat to free speech.

*Cord Blomquist and Wayne Crews*

# Advance a Global Pro-Trade Agenda

Increasing liberalization of world trade is one engine behind the dramatic increase in global prosperity since the 1950s, yet the country is faced with a negative view of trade and globalization. During the recent election campaign, few came forward to defend free trade, which provides benefits for rich and poor in both developed and developing countries. The efforts of the World Trade Organization (WTO) to lower international trade barriers have particularly benefited poor countries seeking prosperity. The current impasse in advancing the WTO's Doha Round mainly hinges on rich countries' reluctance to reduce their extensive agricultural support programs, which distort the world market and harm developing countries' ability to compete.

The progress that more open trade can bring is increasingly threatened by involving the WTO in setting environmental and labor standards—a form of disguised protectionism. Imposing uniform American- or European-level environmental and labor standards on developing countries would deprive poor people of jobs and harm the environment in those countries by undermining their economies' varying competitive advantages. There is also a more recent push to introduce carbon border taxes to penalize countries that have not taken steps to enact Kyoto-like regimes. Armchair environ-

mentalism is a luxury. Increasing wealth—via liberalized trade—is a key to raising both labor standards and environmental protection in the developing world.

Some constituencies seek this disguised protectionism. In the United States, organized labor would like to restrict labor market competition for its members by thwarting international trade liberalization as well as bilateral trade negotiations. Environmentalists likewise would like to “export” U.S. environmental mandates to poor countries.

In 2007, Trade Promotion Authority (TPA) expired. TPA or “fast track” authorizes the President to negotiate and sign trade agreements and have them voted up or down by Congress without amendments. Today, TPA's requirements have burdened trade agreements with developing countries with U.S.-style environmental and labor provisions. Labor unions and environmental groups insist that any new TPA must include greater enforcement of even more stringent labor and environmental mandates. If successful, this will further harm developing countries' sovereignty—their ability to set their own policies to deal with their own needs and priorities—and stifle their economic growth through more open trade.

Special interests are positioning themselves to push the new president to back up his pre-



election positions on international trade with action. Meanwhile some Democratic lawmakers may try to end tax breaks for companies that outsource jobs overseas, reopen the North American Free Trade Agreement (NAFTA) to add enforceable labor and environmental standards and change its investment provisions, and declare China's currency "manipulation" as an unfair subsidy and impose retaliatory duties on Chinese imports.

In foreign policy, President Obama will need to improve relations with neighbors, allies, and emerging world powers. Trade relationships help open the door for that. Latin America, with many countries going increasingly leftist, has a few strong U.S. allies, most prominently Mexico and Colombia. Pummeling those countries with new trade demands would foment more anti-Americanism and play into the hands of populist demagogues like Hugo Chavez of Venezuela. Likewise, in Asia, major trading countries in the region—including Japan, South Korea, Indonesia, China, and Singapore—have free trade agreements concluded or under negotiation with each other through both regional

and bilateral trade pacts. Asia-Pacific countries are setting up the structure for greater economic integration that the U.S. is ignoring in most cases.

To ignore such developments would set up the U.S. as more isolationist than many of its major trading partners. The recent sustained growth of U.S. exports has been one of the few positive economic developments in a faltering economy. If closer ties with trading partners are not negotiated, the U.S. stands to lose out on increased economic growth through trade.

More open trade greatly benefits consumers. Too often, consumers have been neglected in the mercantilist assumptions that frame most trade debates: "Exports good, imports bad."

The Obama Administration and the new Congress will face enormous pressure from interest groups to make good on campaign promises on trade. They should resist such calls for divisive and misguided trade initiatives that would harm our fragile economy and isolate the U.S. from its international interests.

*Fran Smith*

# Counteract Politicization of Federal Science Policy

The federal politicization of science in many areas is harming science itself. Ethics rules and advisory panel guidelines are isolating the market from the marketplace of ideas as commercial interests are frozen out of the science policy debate. With industry R&D investment now double federal funding for the same, this is a significant problem. Moreover, government patronage today threatens to distort science in several areas. If science is

to be insulated from the risks associated with patronage, a new, innovative system of federal funding needs to be adopted. One option is the replacement of the current grant system with one based on prizes, lotteries, and loans—a system that would reduce the influence of the politician and grant officer and increase the freedom of the scientist.

*Iain Murray*

# Resist New Burdens on the Transportation Sector

The transportation industries—airline, railroad, shipping, and trucking—are networks involving both a flow and a grid. The flow element relates to what is being transported—e.g. airplanes and trains—and the grid is the physical infrastructure used to manage the flow—e.g. airports and air traffic control. Some transportation industries have been freed of extensive federal regulation, including railroads and trucking. However, air travel had only its flow element—the airlines—economically liberalized under the 1978 Airline Deregulation Act.

The Federal Aviation Administration remains a command-and-control government agency that poorly manages air transport infrastructure to the detriment of consumers. Air traffic control services should be privatized, and landing slots and airport space should be allocated using market prices and new technology rather than through administrative fiat.

As air travel is a global industry, the U.S. must continue to open up international markets, especially an “open skies” agreement with the European Union, and remove laws that restrict foreign investment in American airline companies.

***Encourage Private Investment in Freight Rail.*** Attempts to roll back the successful 1980 Staggers Act and re-regulate America’s freight railroads must be resisted. Staggers has enabled a genuine market to operate in which the rail-

roads are finally able to make a sustainable rate of return and invest in badly needed new infrastructure. Re-regulation would suffocate new infrastructure investment and lead to greater highway congestion. Rail also suffers in that its main infrastructural competition—highways—are government-owned. Congress should consider tax reforms to make it easier to invest in rail infrastructure.

***Privatize Passenger Rail.*** Amtrak is an inefficient waste of taxpayer money. Congress should pursue privatization of Amtrak’s routes and infrastructure, possibly through such preliminary reforms as breaking up the network. Competition in passenger rail choices can only benefit travelers.

***Liberalize Air Travel.*** Congress should reject attempts to tax airlines on environmental grounds, which would be extremely harmful to the industry. Congress should also revise, or repeal, outdated rules that forbid industry consolidation or foreign ownership. Privatization and modernization of the air traffic control system not only would allow faster flights and less delay at airports but save up to 400,000 barrels of oil per day, and reduce greenhouse gas emissions accordingly. And there is no need to reinvent the wheel. Canada’s successful air traffic control privatization offers a useful model.

*Iain Murray*

# Facilitate Electricity Competition

A fully responsive electricity industry would use active demand and distributed generation to better meet customer needs. Digital technologies and flexible pricing can enable consumers, rather than producers, to make decisions about supply. Laws that restrict this flexibility in the name of fairness increase the power of suppliers at the expense of consumers and contribute to energy waste.

Congress must deregulate not just the flows—generation—but the grid itself. It should guard against a knee-jerk defense of either the utilities’ “go slow” position or that of large industrial power users who demand forced open access to (somebody else’s) grid. As in the “net neutrality” debate, mandatory access to the power grid is being sold as a model of liberalization, though it is far from that. Forced open access to the grid, by further institutionalizing central price and entry regulation, will actually delay the genuine competition that would emerge if reformers would instead target the government-granted exclusive franchises that utilities currently enjoy.

Properly, new electric generators do not have a “right” to force existing utilities to transport their power to customers, only the right to figure out how to do it themselves. At the same time, states have no legitimate authority to prevent electricity customers within their borders from purchasing power from one of those competi-

tive generators, *if the generator or someone else is willing to transport that power voluntarily.*

If incumbent utilities do not offer competitive service—which is certainly their right—then others must be free to provide competitive delivery if they can figure out a way. Recognizing and affirming property rights of utilities to subsurface and overhead rights-of-way could vastly expand competitive processes and lead to innovative cross-sectoral delivery methods. Cross-industry consortia could exploit the many rights of way to existing consumers. New entrants would find it much easier to lay their lines and compete with existing providers. Yet the states generally do not permit delivery competition.

There is no state “right” to violate the rights of individuals who attempt to execute voluntary trades. Thus, reformers can unite around the Commerce Clause’s injunction against states erecting artificial barriers to competition, a position that is consistent with federalism. Federal action—but not forced access legislation—will be needed in those instances in which states remain in the business of restraining voluntary trade through the continued use of the exclusive franchise. Federal action should *not* be used to induce *involuntary* trade, which is the essence of forced access.

*Wayne Crews and Iain Murray*



**Protect the Environment**



# Restore the Constitutional Right to Property

The right to property is an essential part of a free society, and widespread private property ownership is a chief limitation on government power and growth. Property rights have traditionally been more secure in the United States than in any other country. However, this is being severely eroded with respect to ownership of real property, as the Supreme Court dramatically underscored in its 2005 *Kelo* decision, which deprived homeowners of their right to private property to allow commercial development. Private property has also been undermined by the Endangered Species Act (ESA), wetlands regulation under the Clean Water Act, and other environmental laws and treaties.

- Lawmakers should advance the constitutional principle of private property by re-

forming laws that adversely impact landowners to at least demand that government provide compensation when property values are decreased by regulatory measures.

- Lawmakers should ensure that governments—at all levels—do not have the right to seize private property for the purposes of commercial development. When the Framers of the Constitution established eminent domain, they did not intend it to be used to allow one private party to benefit at the expense of others. Public policies should ensure that use of eminent domain be restricted to cases of legitimate public use.

*Angela Logomasini*



# Embrace Private Conservation of Land and Natural Resources

Private stewardship and markets play a critical role in land and natural resource conservation. Much of America's land and other natural resources have suffered because government ownership encourages mismanagement and overuse because no individual has a long-term stake in protecting resources owned in common. In addition, public lands are managed based on political priorities that often produce misguided political management decisions. Examples include the devastation caused by uncontrolled forest fires, overgrazing, and destruction of species and habitat.

- Lawmakers should consider marketplace incentives and private property-based approaches to encourage land and natural resource conservation.

- Existing laws impede private conservation by making property owners lose use of their land. These laws should be reformed. These include measures in the Endangered Species Act, wetlands regulations, and potential invasive species laws.
- Lawmakers should look for ways to privatize resources owned in common to allow private conservation. Areas in which this has been done successfully but could be expanded include the establishment of fishing rights, privatization of coral reefs, and privatization of species and their habitats in private wildlife refuges.

*Angela Logomasini and other CEI Staff*

# Protect Endangered Species

The Endangered Species Act (ESA) of 1973 is bad for wildlife, because it is bad for people. It has largely failed to protect endangered plants and animals because the threat of regulatory “takings” creates perverse incentives, inducing property owners to ensure that their land never becomes habitat or potential habitat for an endangered species.

- Congress should replace the ESA with a non-regulatory, incentive-based conservation program to encourage private landowners to protect and provide habitat. Property owners’ natural incentive to be good stewards of their land can work in concert with effective species protection.
- Absent reforms that eliminate the ESA’s punitive land use regulations, policies should

require just compensation for landowners who are deprived of the right to use their land and whose lands are devalued by government regulation.

- Another policy change that would help species would be elimination of the estate tax. The costs of these taxes often force families to sell off estate properties to developers to pay for the estate taxes on the property. In many cases, individuals would rather keep the properties free from development, but high inheritance taxes make that impossible.

*Angela Logomasini and Robert J. Smith*

# Clarify the Role of Invasive Species

In the past, policies addressing problem plants and animals followed a rational path: They focused on controlling organisms that posed serious threats to agricultural crops and other valued American plants and animals as well as public health. However, the issue associated with so-called invasive species is moving in a new direction, leading to an almost religious crusade to rid the nation of all “non-native” plants and animals. Despite claims to the contrary, many non-native species provide valuable public benefits. Wholesale eradication, instead of management, promises to cause more problems than it would solve. It would result in wasted taxpayer dollars and reduced access to many valuable plant and animal products. In addition, these policies

are likely to expand federal land use regulations, undermining the constitutional right to property.

- Policy makers in Congress and in the administration should focus on developing a scientifically sound definition of invasive species—one that focuses on harmful and noxious characteristics rather than on country of origin.
- In addition, lawmakers should include language in all legislation involving this issue stating that all affected landowners will receive compensation for any economic costs placed on them to meet any invasive species regulations.

*Angela Logomasini and Robert J. Smith*

# Develop New Approaches to Preserve Ocean Resources

The world's fisheries face severe decline. Indeed, because many of the world's ocean resources are not "owned," these resources tend to be overexploited—as everyone attempts to fish out of the ocean as much as possible before competitors can consume the resources. Several governments actively subsidize such destructive practices in attempts to protect traditional fishing industries. However, where tradable rights have been assigned to ocean resources, owners of these rights help ensure long-term conserva-

tion. Similarly, private establishment and ownership of artificial reefs have helped preserve habitat, while government attempts to create artificial reefs have been catastrophic failures. Many of these man-made structures provide critical habitat and ensure plentiful fish supplies. Such promising policies hold the key to ensuring long-term sustainability of the world's fishery resources.

*Iain Murray*

# Trash Counterproductive Waste Disposal Policies

**Solid waste.** Much of the nation’s current solid waste policies follow an outdated, politicized, and government-centered model. State and local regulators focus on deciding how much waste should be recycled, placed in landfills, or burned in incinerators. This approach fails to discover the most environmentally and economically sound mix of options. Policy makers lack the necessary information and therefore focus on misplaced perceptions about the various disposal options. As a result, they produce recycling programs that cost more than they save and use more resources than they save. In contrast, private sector competition between recycling, landfilling, and incineration produces a market that reduces costs and saves resources.

- Federal policy makers should resist attempts to increase federal regulation in solid waste disposal.
- Local governments should seek ways to increase private markets in the waste disposal industry.
- They should change waste policies to allow market-driven competition between various disposal options—allowing recycling, landfilling, and incineration companies to compete so that the most environmentally and economically sound mixture of disposal options results.

**Electronic waste.** Increasingly, news reports and environmental activists claim that we are facing a new solid waste crisis. As a result of such rhetoric, Europe has passed several “e-waste” laws, U.S. states have begun looking into their own regulations, and members of Congress have proposed federal legislation. Unfortunately, misinformation and the misguided notion that government is positioned to improve electronic waste disposal is leading to misguided policies and legislation.

- Despite claims to the contrary, there is no “e-waste crisis.” E-waste risks and costs are manageable by allowing private recycling and disposal efforts to continue.
- Manufacturers should not be forced to take back electronic equipment, since they are in the manufacturing—not disposal—business. Some firms have voluntary programs for recycling computers, which offer a market-based approach for some products.
- Congress should avoid creating new government e-waste programs, as they promise to promote inefficiencies, increase environmental problems, and hinder market solutions.
- Consumers should not be taxed when they purchase computers or other electronics, but they should be responsible for disposing of discarded products in a safe and legal

fashion. Disposal may include paying somebody to dispose of the product via a voluntary private party agreement or disposal through local government trash collection.

**Hazardous waste.** Federal hazardous waste policy—as embodied in the Superfund law and the Resource Conservation and Recovery Act—has long been governed by federal mismanagement, perverse incentives, unjust liability schemes, and misuse of science. The Superfund regime of randomly taxing and suing parties not actually responsible for hazardous waste contamination needs reform. Policies should target those who have produced harm—an approach that rewards good behavior and discourages bad.

- Hazardous waste sites are exclusively a state and local concern. Given the demonstrated success of states in managing such sites locally, there is little reason for federal involvement. Thus, Congress should seek

ways to further devolve the program to the states.

- Absent devolution, hazardous waste programs should be reformed to provide regulatory relief by setting standards that consider the use of the land and that are not needlessly onerous.
- Liability schemes should be reformed to ensure that only the parties directly responsible for polluting should be held liable. Currently, the Superfund law holds anybody remotely connected to a disposal site liable even if they did not have any control over the site or the contamination. Parties unfairly held liable include generators of waste that was eventually disposed of at a site, parties that hauled waste to a site, and parties that gained ownership of polluted property.

*Angela Logomasini*

# Recognize the Elitist Nature of “Anti-Sprawl” Measures

For the greater part of the last century, many people have sought the American Dream by raising their families in suburbs. But today, anti-sprawl activists blame the suburbs for a host of environmental and social ills, and push initiatives to limit housing growth to high-density patterns. Such initiatives often end up raising housing prices while exacerbating the very problems they claim to fix, such as traffic and

pollution. Their main effect is to make suburban living accessible only to the well-to-do.

Federal programs that subsidize suburban development should be restricted or eliminated, but the same should be done to programs that boost urban development, whether via subsidies or outright coercion.

*Sam Kazman*

# Rethink Water Rights Policies

Battles over limited water supplies in the United States and around the world have long produced conflicts and costs to affected communities. While limited supplies are a problem in and of themselves, political management of water is the key problem. Government control of water allocation generally produces inefficient and unfair results.

- A property rights-based system could alleviate water shortages and pollution prob-

lems by properly pricing water resources and giving parties a stake in ensuring water quality.

- Policy makers should rethink current approaches to facilitate water markets, which have developed in some areas and show great promise.

*Angela Logomasini*



# Reform Wetlands Policies

Wetlands regulations do a poor job of protecting wetlands habitat. Much federal regulation focuses on preventing development on lands that are dry most days of the year and that do not provide useful habitat for wildlife. In contrast, private initiatives have successfully ensured the protection, restoration, and creation of vital wetlands habitat around the nation. Yet federal wetlands regulations have seriously impeded such private wetlands protection initiatives, and even have forced some parties to abandon attempts to provide such habitat. Policies that can better ensure private wetlands protection, while eliminating destructive and needless red tape, include the following.

- Congress should replace the Section 404 regulatory program, which regulates the

dredging and filling of lands, with a non-coercive, incentive-based program.

- At a minimum, the federal government should provide financial compensation to property owners who lose the use of their land due to wetlands regulations.
- State efforts, non-regulatory federal programs, and private conservation would do a better job of protecting ecologically significant wetlands than could the existing federal regulatory approach. These steps would enhance the protection of wetlands and private property without increasing the costs of conservation to taxpayers or to landowners.

*Angela Logomasini and other CEI Staff*

**Improve Health and Safety**



# Reject the Precautionary Principle, a Threat to Technological Progress

Increasingly, governments and environmental activists are demanding that producers of both new and old technologies prove that their products are totally safe. Although this may seem like a reasonable approach—“better safe than sorry”—health and environmental risk issues are not so simple. Nothing is totally without risk, and the reason for adopting new technologies in the first place is that they often improve our well-being by protecting us from the risks of older, more established products and practices.

New medicines protect us from diseases, even though there is always a risk of side effects. Automobile innovations, from airbags to antilock brakes, make traveling safer, even though they pose their own risks. And food and agriculture technologies—such as preservatives, pesticides, and bioengineered crops—help make our food supply safer and less expensive, and lighten farming’s impact on the environment. So, by demanding perfect safety, a precautionary regulatory philosophy can actually make

our world *less* safe. Regulation’s proper goal should be to permit experimentation and the introduction of new technologies, while balancing the risk of moving too quickly into the future against the very real risk of lingering too long in the past.

Just as importantly, the precautionary principle too often is applied in a highly politicized manner to disadvantage technologies that are unpopular or viewed as controversial. Although many established practices—such as organic farming, “natural” and homeopathic remedies, alternative energy sources, and countless others—pose known risks that are often far greater than those posed by the new innovations that might supplant them, the precautionary principle has never been applied to rein in those risks. The principle contains no procedural protections for innovators, and it gives regulators nearly unbridled discretion to ban or burden technologies and practices they disfavor.

*Gregory Conko*

# Recognize the Deadly Effects of Over-Regulating Medicines and Medical Devices

Over the past century, American consumers have benefited from thousands of new pharmaceuticals and medical devices to help them combat disease, alleviate the symptoms of illness and infirmity, and improve their well-being. However, the public often demands that such treatments meet a near-perfect level of safety at bargain basement prices. In turn, Congress and the federal Food and Drug Administration (FDA) have steadily raised the regulatory hurdles that medical products manufacturers must clear before marketing a new treatment.

A strong dose of over-caution when the FDA approves new drugs and devices may sound like a virtue, but for patients in need of new treatments, regulatory over-caution can be deadly. Patients can be injured if FDA approves a treatment that is later found to be unsafe, but they also suffer when needed treatments are delayed by regulatory hurdles.

FDA, however, is predominantly focused on the first of these two risks, for political reasons. Agency approval of a drug or device that turns out to be unsafe will lead to front-page headlines and congressional hearings, while delay or denial of a needed new treatment stirs little public notice. Patients may suffer or die as a result of FDA delays—without them or their families ever knowing that a possible treatment exists, let alone that it was blocked by the FDA. As a

result, FDA is under constant pressure to assure the safety of new medical products, but under little pressure to speed up their availability.

Many doctors, patient groups, and public policy experts recognize that FDA's lengthy process for approving new drugs and devices often costs lives by denying patients potentially beneficial new treatments. Polls of medical specialists commissioned by the Competitive Enterprise Institute over the past decade have consistently found that majorities of doctors in various specialties believe that FDA is too slow in approving new medical products.

When making safety evaluations, FDA is required, by statute, to determine the appropriate balance between patient safety and medical product effectiveness. But more-thorough study of drugs and devices during clinical trials (both pre- and post-approval) has its own weaknesses. First, even very large clinical trials generally cannot include enough subjects to detect rare side effects. Second, large trials involve diverse populations with many subgroups that often are not easy to identify. Consequently, a few individual adverse events do not necessarily mean that a product is inherently unsafe for all patients. A given adverse event may not have been caused by the treatment, or if it was, it may be confined to a small subpopulation.

Ultimately, each patient is necessarily different from all others, both in physiology and in risk-level preference. Not only will a given drug or device affect each patient slightly differently, but each patient will place a different value on the product's benefits and the attendant risks associated with it. Therefore, treating the entire population of the United States as identical means that FDA inevitably makes regulatory decisions that will be too cautious for some and not cautious enough for others. Unfortunately, significant political pressure generally pushes the agency toward over-caution, and the end result is fewer new drugs and devices, as well as greater loss of life to what should be treatable illnesses.

Beginning in the early 1990s, the tremendous social cost of FDA overregulation had become apparent, so Congress and the agency took several steps to streamline the approval process. The 1997 FDA Modernization Act, for example, granted the agency authority to reduce the number of clinical trials needed for approval and to expedite the review of treatments for serious conditions. But, a decade later, FDA again came under tremendous pressure from Congress and self-styled consumer groups to slow down the approval process and

to reject drugs that appeared to offer only modest benefits or benefits for only small patient sub-populations.

In 2007, Congress passed the FDA Amendments Act, which provided the agency with additional authority to make pre- and post-market safety studies and clinical trials stricter. The Act also requires FDA to announce publicly even very minor or hypothetical safety concerns—which tends to raise undue alarm among patients—and to consider using Risk Evaluation and Mitigation Strategies for each new approved drug—which can restrict which doctors may prescribe new drugs, which patients may use them, and which pharmacies may fill certain prescriptions.

Rather than increase drug safety, these changes, combined with the FDA's innate risk aversion, tend to harm patient health by reducing the availability of new medical products. Individual patients and their doctors are in a far better position than FDA to balance the risks and benefits of individual new treatments. FDA should focus on providing them with information, rather than on restricting their choices.

*Gregory Conko and Sam Kazman*

# Purify Federal Water Policies

**Drinking Water.** Drinking water policy should focus on how best to ensure that Americans have clean and safe water to drink. Currently, many communities are forced to spend limited resources to meet misguided and scientifically questionable federal mandates. States and localities are better able to set priorities based on their particular needs. Moreover, drinking water policy would benefit from a more market-driven model, one that allows for more private innovation in the provision of drinking water services:

- Congress should return to the states full authority to set standards, allowing them to work with localities to meet their specific needs.
- Should the federal government remain involved, there are ways to help empower localities within a federal framework. Congress should engage in greater congressional review of safe drinking water rules to ensure that EPA has employed the “best available science” as demanded under the law. If large questions remain over science, and standards are likely to impose considerable costs, Congress should preempt the overly stringent standard.
- Congress should consider ways to grant states discretion on how to regulate the naturally occurring contaminants, such as radon and arsenic, to reflect localized levels of risk.

**Water Quality.** Waterways throughout the United States have suffered from various pollution problems because they have long been held in common—so no one was in charge of keeping them clean. Congress passed the Clean Water Act in the 1970s, which has been a mixed blessing. While many waterways have seen improvements, the program is very bureaucratic, and it has promoted too much expensive litigation that focuses on paperwork violations rather than on improving water quality. The science underlying many of the regulations is weak. In addition, parts of the Act have proven ineffective, such as programs addressing non-point source water pollution (water run off from lands). Policy makers would be wise to look at innovative, market-based systems for advancing water quality:

- Instead of focusing on paperwork violations, policy makers should hold polluters liable for the actual harm they cause to other persons or to their property.
- States need flexibility. Because the science of water pollution control is evolving, and because each state and watershed has different needs and problems, Congress should give states flexibility in water quality management approaches.

*Angela Logomasini and other CEI Staff*

# Ensure Consumers' Access to Bottled Water

Bottled water offers many important benefits—including portability, emergency applications, and convenience. The bottled water industry had been particularly valuable during major crises, such as the September 11, 2001, terrorist attacks, Hurricane Katrina, and other calamities. Nonetheless, recent attacks against bottled water by environmental activists are undermining this industry and impeding consumer freedom. Congress has even held hearings on the alleged bottled water “problem.”

Some states have enacted regulations and taxes largely on the basis of unfounded claims about bottled water. For example, some environmental groups claim that most bottled water is simply re-bottled tap water. Yet only 25 percent of bottled water comes from municipal sources—the rest comes from springs and underground sources—and most of the municipal-source water undergoes extensive treatment before bottling that involves additional purification and other processing to improve flavor and quality.

In addition, all bottled water must meet specific standards before bottling, and unlike pipe delivery systems for tap water, sanitary packaging enables transport of bottled water with a very low risk of contamination. All bottled

water must also meet FDA regulations, most of which mirror EPA tap water regulations, and some of which exceed those regulations. Accordingly, the EPA and the Centers for Disease Control and Prevention recommend bottled water as a safer alternative to tap water for individuals with compromised immune systems.

Because of the hype, Congress may consider regulation of bottled water such as new labeling mandates. Yet most bottles of water contain information on water source. Consumers who care to do so can choose bottles with such information on the market, thus creating demand for specific types of labeling. Currently, FDA regulates the terminology to prevent fraudulent claims. Regulations requiring additional information are unlikely to change consumer purchasing habits and could simply increase confusion and costs.

Bottled water is popular with the public for its convenience, freshness, and healthfulness. Congress should not impose new regulations that will impede consumer choice and raise costs. Consumers who do not want to drink bottled water can choose other alternatives rather than regulate options for others.

*Angela Logomasini*



# Enhance Auto Safety

Automotive safety is the primary mission of the National Highway Traffic Safety Administration (NHTSA). In recent decades, however, NHTSA's mission has increasingly become distorted by political correctness. For example, the agency has focused on the alleged safety hazards of SUVs while paying little attention to the safety risks of subcompact cars. Moreover, NHTSA has moved to mandate safety features that are already becoming widely adopted due to consumer demand, such as electronic stability control systems. Such mandates end up limiting design flexibility and constitute little more than an exercise of regulatory muscle.

Finally, while NHTSA has moved to reduce the deadly effects of its fuel economy standards through its Reformed CAFE program (corporate average fuel economy), CAFE's lethal effects will likely accelerate due to Congress' enactment of far more stringent fuel economy levels in the future. At this point, the single most important task that NHTSA could undertake regarding CAFE is to come up with a comprehensive estimate of the deaths attributable to this program, both on a yearly basis and over its 30-year history.

*Sam Kazman*

# Improve Food Safety and Quality through Greater Information, Consumer Choice, and Legal Accountability

Few issues are as important to consumers as the safety and quality of their food—from microbial contaminants to pesticides, and from organics to obesity. Recent health scares—from *E. coli*-contaminated spinach and tomatoes to melamine-contaminated infant formula and pet food—show just how fragile the food chain can be. But, while these tragic events have led to calls for greater government regulation of the food supply, the nature of these scares shows that additional regulations or inspections are likely to do little to improve food safety. Indeed, poorly conceived government regulation often does as much to compromise food safety, affordability, and choice as to promote it—especially when the regulatory framework is focused on a fear-driven activist agenda rather than on basic principles of science and genuine safety.

Too often, the government’s regulatory agenda favors politically expedient outcomes over those that would actually promote safety and availability. For example, the U.S. government maintains outmoded “poke and sniff” food inspectors whose methods are incapable of preventing food-borne illnesses, while making it difficult to introduce such technologies as irradiation that could cut the incidence of those illness by half or more. Americans consume nearly 1 billion meals every day. Merely adding additional inspectors cannot realistically be

expected to prevent future contaminations. Instead, the legal system should punish producers and sellers who are negligent in the handling or purchasing of the foods we eat. Food companies should be allowed the flexibility to adopt technologies and practices that can cut the incidence of food-borne contaminants.

In addition, regulators control the content of food labels so stringently that sellers are often forbidden from informing consumers of many beneficial product attributes. Food safety and labeling regulations should be designed with maximum flexibility, to allow food producers to use the production methods and labeling information that best meet their customers’ demands. Government studies have shown that reduced labeling and advertising restrictions on food products actually leads producers to supply healthier and more nutritious products, increasing consumer well-being.

- *Lawmakers should eliminate regulatory barriers that make it harder to adopt new food production technologies, such as irradiation and crop biotechnology, which can improve food safety.* For example, mandatory labeling of irradiated food provides no useful or material information to consumers, but it does scare consumers and retailers away from safe irradiated foods. Existing USDA rules make it impossible for cattle

ranchers to voluntarily test their herds for mad cow disease and then advertise the attribute to consumers.

- *Policy makers should abandon the misguided notion that natural products are inherently safe and synthetic products inherently dangerous.* Synthetic compounds, as a class, are no more toxic or carcinogenic than compounds that exist in nature. The dose makes the poison—many substances that are dangerous at very high levels are totally harmless at lower levels. This is true for both natural and manmade substances. Rules that mandate labeling of even trace amounts of certain synthetic chemicals are

based on a faulty understanding of science and are therefore bad public policy.

- *Government should not make lifestyle choices for consumers regarding the foods they eat.* All foods, whether they contain large amounts of fat, calories, sugar, sodium, or other constituents, can be a part of a healthy diet. Consumers may benefit from having accurate information about nutrition, calories, and fat content, but government should not ban or otherwise limit consumer access to foods simply because public health officials believe that some consumers overindulge.

*Gregory Conko*

# Protect Incentives for Pharmaceutical Innovation

In recent years, Congress has faced mounting public pressure to “do something” about the rapidly rising prices of prescription drugs and to rein in what are believed to be excessive industry profits. Although prescription drug spending comprises just 10 percent of overall health care costs, it has been one of the fastest growing components of overall health care spending during the past two decades—rising by an average of 11 percent annually during the 1990s and by 9 percent in 2006, compared to just 6 percent for spending on physician services, according to the Kaiser Family Foundation.

Faced with this public pressure, as well as mounting federal and state government expenditures on drug purchases, members of Congress have proposed a variety of measures to cut the price of prescription drugs. These include reimportation of lower-priced drugs from foreign countries with price controls, integrating cost-benefit and comparative-benefit analysis into government-run drug purchasing programs such as Medicare’s Part B and Part D plans, and direct negotiation of reduced drug prices by the Centers for Medicare and Medicaid Services.

Unfortunately, most advocates of such policies have a tunnel-vision dedication to reduce drug costs, with little concern for the effect that forced price reductions would have on industry incentives for innovation. Pharmaceutical

prices are high because drug development is expensive, many new drugs treat relatively small patient populations, and most pharmaceuticals fail in laboratory tests or clinical trials before ever making it to market. A 2006 study by U.S. Federal Trade Commission economists concluded that the average cost to develop and test a new drug is between \$839 and \$868 million. Thus, policies such as reimportation and comparative-benefit analysis would, in the short run, result in lower prices for drugs already on the market, but in the long run reduce both the number of treatment options available and the flow of new drugs entering the marketplace.

Although the prices of off-patent and generic drugs—which comprise more than half of all prescriptions filled in the U.S.—are typically higher in other countries, the prices of the latest on-patent drugs is often much lower in countries that impose direct or indirect price controls. Consequently, reimportation advocates promise to relieve high drug costs by allowing American consumers to free-ride on other nations’ price controls. But allowing reimportation would effectively import foreign price controls, resulting in less revenue for the industry and a reduction in the capital available to drug companies for continued research and innovation.

Permitting Medicare to negotiate directly for price discounts would have a similar effect.

Under the statute creating Part D drug plans, the Medicare program is explicitly precluded from bargaining with pharmaceutical companies to secure lower prices. Instead, Medicare must accept the prices negotiated by private sector health insurers. Supporters of government price negotiation argue that some federal programs, such as the Veterans Affairs (VA) health system, already have the authority to bargain directly and therefore pay substantially less than do Part D plans. However, the VA's demand for lower prices means that beneficiaries have a substantially reduced choice of drugs. The only way for Medicare to provide the same broad range of choice as currently available would be to force drug firms to sell at the steeply discounted price, effectively applying direct price controls for Medicare's substantial patient population, while forcing higher prices on private purchasers. In the end, price controls result in lower profitability and less capital to invest in drug production and future research.

More recently, drug industry critics have suggested integrating cost-benefit and comparative-benefit analysis into government-run drug purchasing programs such as Medicare's Part B and Part D plans, or into the FDA approval process. They argue, for example, that many expensive new drugs offer little therapeutic advantage over older drugs, but that they cost far more than the closest comparable older drugs. If government health programs paid for only the "best in class" medicine for each therapeutic category, the higher volume of purchases would justify significant price reductions. How-

ever, while on average the therapeutic benefit of various drugs in a particular class may be similar, individual patients will often respond quite differently—even to very similar drugs. While it is advisable for public programs to trim excessive costs, implementing cost-benefit or comparative-effectiveness analysis in purchasing or approval decisions would negatively affect patient care.

Finally, it is not true that drug industry profits are "excessive" by any honest measure. Pharmaceutical industry critics like to point out that, in 2005, pharmaceutical firms in the Fortune 500 placed ninth out of the 50 industries ranked by return on assets, 12th in 2004, and second in 2003. However, as the Congressional Budget Office (CBO) notes, "those figures misrepresent the industry's actual profits." Standard accounting measures overstate profitability for R&D-intensive industries by treating most research spending as an expense rather than as a capitalized investment that increases the company's value. "Not accounting for that value overstates a firm's true return on its assets," says the CBO.

Ultimately, high pharmaceutical retail prices reflect the vast expense of developing those products and getting them approved for sale. Without correspondingly high prices, few investors would be willing to take the risks inherent in supplying capital to the pharmaceutical industry. The result would be fewer and fewer lifesaving medicines.

*Gregory Conko*

# Resist Over-Caution on Nanotechnology and other Frontier Sciences

Nanotechnology is the cutting-edge science and business of very small-scale manufacturing. Fears about nanotechnology's safety abound in ways that echo those regarding biotechnology and other frontier technologies. Some critics favor a "precautionary principle" approach, arguing that the first hint of risk warrants government regulation and risk-management; others have already called for outright bans.

While the oft-cited "gray goo" scenario of out-of-control nanotechnology belongs in the realm of science fiction, concern about the potential risks posed by nanotech is not entirely misplaced. For example, there are novel homeland security and defense issues that policy makers must consider—yet ill-considered regulation of nanotechnology consumer applications may prevent the promise of this nascent technology from ever being realized.

Rather than give in to the temptation to regulate nanotechnology simply for the sake

of "doing something," Congress should monitor scientific understanding of potential risks. Congress should also allow the private sector time to develop new strategies to cope with any credible risks, through innovations like insurance, liability, and safety ratings systems geared toward nanotech and other frontier technologies.

Policy makers should not disrupt market responses through political stopgaps or regulation that pre-empts private risk-management innovation in its tracks. Lawmakers should be cautiously skeptical of claims that nanoparticle manipulation poses serious threats to the environment. Indeed, if the promise of nanotechnology holds, it offers hope for a cleaner, not dirtier, environment and a vastly wealthier society.

*Wayne Crews*

# Recognize the Role of Private Enterprise in Protecting Critical Infrastructure and Cybersecurity

In both the physical and cyber worlds, the line between government protection and private security is not necessarily a bright one. The government's role is rooted in its defense function, a power delegated to it by citizens. We rely upon the government's courts, police, and military to protect us; yet at the same time, we rely upon a complementary and indispensable private sector *security* function. While government's primary reason for being is the protection of society, we nonetheless require private strategies—such as security guards, gated communities, door locks, burglar alarms, firewalls, and anti-virus software—to be really secure.

Better appreciation of distinct public and private roles is warranted in the critical infrastructure and cybersecurity debates, particularly since the September 11, 2001, terror attacks. To safeguard critical and information-age assets exposed to physical or cyber-attack, we ought to not automatically assign security roles to government that would best be carried out by private parties. Critical infrastructure is privately owned, after all, and private sector leadership and responsibility for still-uncertain cyber and physical security needs should not be lightly overruled. For example, technical matters involving secure infrastructure design, such as backup, redundancy, and duplication of data and network pathways, are the province of the private sector.

A close look at alleged market failures involving large-scale enterprises often reveals heavy government regulation, and thus *government failure*. Franchise laws and network regulation, like open access requirements, interfere with competitive incentives to improve products or services and invest in infrastructure and maintenance.

Security policy should avoid rigidities like those that characterize airport security, where the federal government has taken over the entire baggage checking function, for example, with unfavorable implications for future private luggage delivery efforts, the ability for airlines and airport operators to adapt to changing threats, and longer term airport privatization efforts.

Private identity systems managed and protected by answerable firms—in which owners reserve the right to refuse to admit anybody who is not a member—may often be preferable whether the issue is access to a piece of critical infrastructure, such as an airport or power plant, or access to a computer network. In some cases, owners seem to have no interest in matching faces against a database of terrorists, for example, preferring instead to know exactly who you are, rather than whether you are on a list of criminals. Biometric technologies and other forms of authentication offer significant

promise for securing both critical infrastructure and electronic networks.

Following the 9/11 terrorist attacks, America faced a choice of whether to seek private or government security strategies.

Privately, security could have been beefed up by private sector mechanisms and technologies like IDs and biometrics, and even non-technical means like private sector-mandated background checks and insurance innovations like premium adjustments. While a new government role was probably unavoidable after 9/11, to further government's entrenchment in security is not necessarily a good thing.

Entrenching government on behalf of critical infrastructure security is a step backward

toward viewing large enterprises as "utilities," hampering both industry growth and security. In electricity, for example, mandates to supposedly enhance "reliability" can impair operation of the infrastructure itself. The blackouts of 2003 served to justify renewed calls for enhanced eminent domain powers to seize land for transmission lines. In such cases, we see the idea of central regulatory control of critical infrastructure proposed in the name of security and reliability without sufficient regard for the broader consequences to either security or industry viability itself.

*Wayne Crews*



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