2013 POLICY GUIDE

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Mercatus scholars are available to further explain the results of their studies.

We hope the guide will prove to be a valuable tool in your evaluation of economic policy.

SPENDING, TAXES, AND ENTITLEMENTS

In order to put the United States back on a fiscally sustainable path, we need to fundamentally reform the country's budget process, tax system, Medicare, Medicaid, and Social Security.

Spending Reform

Spending more money is not the solution; stimulus doesn't work. Increasing taxes to the level necessary to stop US deficit spending is not feasible. In order to address our deficit and resume robust economic growth, we must cut spending.

- The effectiveness of stimulus spending has been greatly exaggerated. According to some estimates, ***every additional $1.00 in deficit-financed government spending destroys $3.80 in private-sector activity***. The short-term benefits of stimulus spending are uncertain, but the long-term costs are real: deficits hamper economic growth and, if left unchecked, threaten to push the United States into a fiscal crisis.[1]
- According to Keynesian theory, stimulus spending is counterproductive unless it is timely, targeted, and temporary. It is nearly impossible to simultaneously satisfy all three conditions with transportation and infrastructure spending.[2]
- The intent of the American Recovery and Reinvestment Act (ARRA) was to create jobs; instead, it has largely shifted jobs by moving workers from private sector jobs to public sector jobs or government contracting positions.[3]

- The US government has already undertaken several massive stimulus projects, including the Economic Stimulus Act of 2008 ***($152 billion)***, the American Recovery and Reinvestment Act of 2009 ***($862 billion)***, and the Hiring Incentives to Restore Employment Act of 2010 ***($20 billion)***, yet some are calling for further spending. Studies show that ***stimulus spending actually becomes less effective the more it is used***.[4]
- To make matters worse for working families, for every dollar in federal grants to states, state and local taxes increase by 40 cents.[5]

Government spending is a drag on economic growth. Government spending must be addressed in order to facilitate job and income growth.

- In light of the recent Standard & Poor's ratings downgrade and the threat of future downgrades, US policymakers must reduce government debt; cutting spending is the most effective way to eliminate deficits and shrink debt.[6]
- It is impossible to make accurate predictions of future interest rates and federal debt service payments. Continued expansion of government debt could lead to higher interest rates, placing additional pressure on economic growth and future private investment.[7]

- In the long run, government spending harms the larger economy as government "crowds out" the private sector, borrowing money that the private sector would otherwise borrow, and making business more expensive for everyone in the process.[8]
- Consumer and business spending falls in the quarters following a rise in government purchases.[9]
- Federal spending in the states causes the states' businesses to cut back rather than grow.[10]
- In the four years from 1944 (the peak of World War II spending) to 1948, ***the US government cut spending by $72 billion—a 75 percent reduction—and the economy boomed***. The US economy during the post–World War II years is exhibit A against the Keynesian view that economies will necessarily suffer high unemployment and slow growth when government makes big cuts in spending.[11]
- Peer-reviewed studies have concluded that among rich countries there is a strong negative relationship between the size of government and economic growth. In other words, ***the more that a government spends, the less its economy grows***.[12]
- The ***US budget can be balanced within 10 years*** by cutting one cent of every dollar of federal spending.[13]

TAX REFORM

Successful attempts to reduce government debt have historically followed focused plans for cutting spending. European austerity has consisted of raising taxes with few, if any, spending cuts. **Raising taxes in a weak economy, or the so-called "balanced approach," is a bad idea**. Debt reduction is more likely to be successful when governments implement large spending cuts, rather than large tax increases.

- Using data from 21 countries over 37 years, economists have identified 107 episodes of attempted fiscal reform. ***The analysis shows overwhelmingly that spending cuts, not tax increases, are more likely to reduce debt***. Greece, Italy, and Japan show that tax increases don't work; evidence from Canada, Germany, and Finland show that cutting spending and implementing structural reforms do.[14]
- Sweden's experience indicates that significantly cutting government spending without an equivalent increase in taxes can provide a path to fiscal sustainability. Sweden's finance minister, Anders Borg, successfully reduced welfare spending and pursued economic stimulus through a permanent reduction in the country's taxes, including a 20-point reduction in the top marginal income tax rate. Sweden's recent economic growth has trumped that of every other European country; **Sweden's commitment to reform has paid off in economic expansion**.[15]
- Many studies suggest that compared with tax increases, spending cuts are a better approach to austerity because they are not only more likely to reduce the debt, but less likely to harm the economy.[16]

- The federal budget can be balanced without tax increases by targeting federal government spending at 19 percent of GDP in order to be in line with the long-term average revenue as a share of GDP near 18 percent.[17]
- Canada succeeded by cutting spending and eliminating tax exemptions—not by raising individual income tax rates or pursuing more progressive taxation.[18]
- Most academic studies on the relationship between government size and economic growth find that the two are negatively correlated. In particular, tax on income and expenditures on entitlement programs have a negative relationship with economic growth.[19]
- High tax rates encourage avoidance and evasion, and increasing marginal income tax rates will reduce taxable income as workers and their employers change their behavior in response.[20]

Raising taxes hurts the economy. The United States' greatest fiscal challenge is unsustainable projected spending—and raising taxes will not fix the spending problem. Tax increases appear to have a significant and long-lasting negative impact on output.

- Raising taxes hurts economic growth: a tax increase of one percent of GDP reduces output over the next three years by nearly three percent.[21]
- Because taxes slow economic growth, tax increases limit revenue gains. This tradeoff limits the potential to stabilize a country's debt-to-GDP ratio with tax increases rather than spending cuts.[22]

- There is a negative tax multiplier of −1.1; ***taking resources out of the economy through taxation costs the economy more than the actual dollar amount taken out***.[23]
- Raising taxes enough to close the gap would require doubling everyone's tax rates.[24]

Government does a poor job of picking winners and losers—that is, giving special preference to one type of taxpayer over another. This approach damages the economy in the long run.

- International studies show that when governments extend privileges to particular firms, those countries experience slower economic growth.[25]
- If government wants to encourage economic growth and job creation, it needs to get out of the business of "helping" businesses by giving them preferential treatment.[26]
- The tax code favors select corporations and groups through exemptions and tax expenditures, including employer-provided health insurance, pension benefits, and the home mortgage-interest deduction.[27]
- In 1985, there were 25 expiring tax expenditures in the 1985 tax code; in 2010, this number had ballooned to 141 that were set to expire in the next two years. This expansion reflects the increasing influence of special interests on the tax code.[28]

There are a variety of ways that governments bestow privileges on particular firms or industries. These include

- monopoly status,
- favorable regulations,
- subsidies,
- bailouts,
- loan guarantees,
- targeted tax breaks,
- protection from foreign competition, and
- noncompetitive contracts.

Many say that the "rich" (individuals and corporations earning $250,000 and up) don't pay their fair share. According to the Congressional Budget Office, **10 percent of households with the highest incomes pay more than half of all federal taxes and more than 70 percent of federal income taxes.**

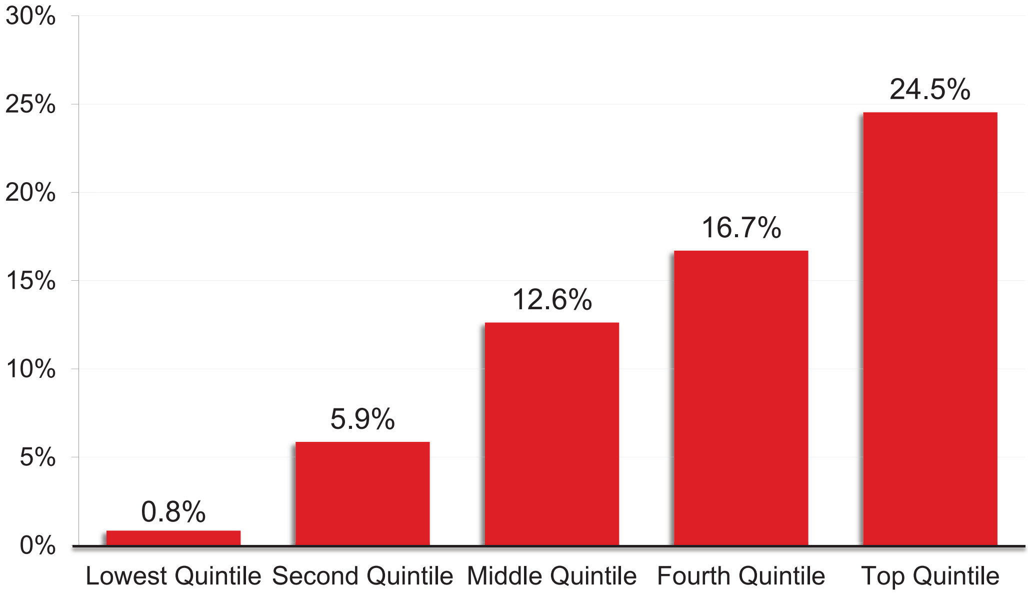
- Shifting the tax burden toward higher-income earners can exacerbate our fiscal problem by reducing a broad-based demand for fundamental spending and tax reform. The skewed distribution of the US tax liability toward upper-income earners is correlated with higher debt and greater entitlement spending.[29]

- According to studies of domestic migration, higher state income tax rates cause net out-migration of not only high-income earners, but residents in general.[30]
- Canada succeeded in shrinking its budget deficit and turning deficits into surpluses by cutting spending and eliminating tax exemptions and tax expenditures, not by raising individual income tax rates or increasing tax progressivity.[31]

Fundamental tax reform is needed to generate economic growth.

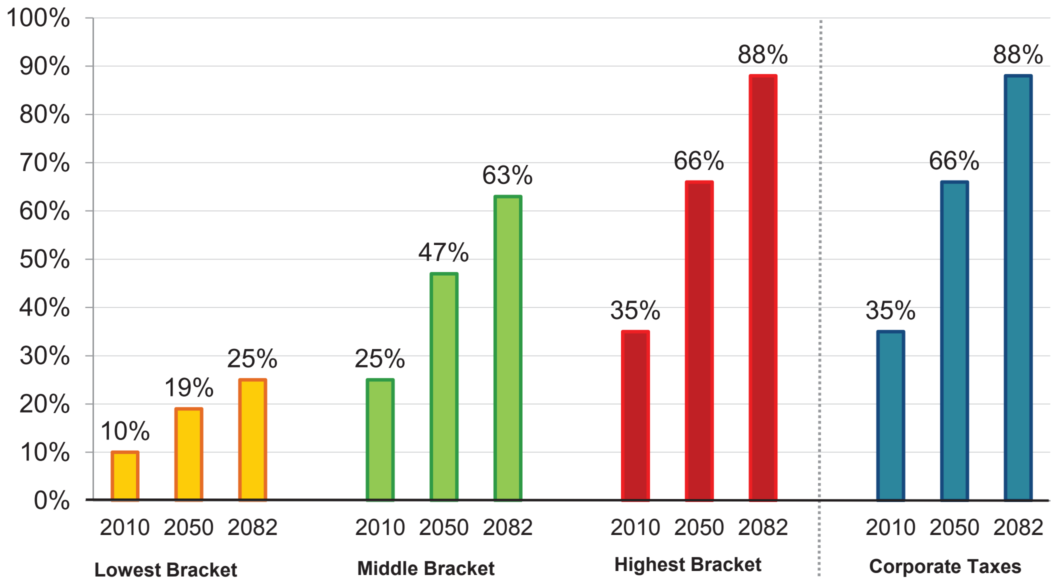
- Because increases in marginal income tax rates lead to slower economic growth, low, broad, and stable marginal tax rates are key for facilitating private sector economic growth.[32]
- One of the keys to successful fiscal reform is moving away from a spending system that depends upon an easily manipulated income tax system. **Tax reform should lower rates, broaden the tax base, and eliminate loopholes**. This will increase stability and lead to greater economic growth, added employment, and perhaps even increased revenues.[33]
- The United States' corporate tax rate is among the highest in the industrialized world; this drives some businesses to lower-tax countries, taking their jobs, money, and tax dollars with them.[34]

Average Effective Federal Tax Rates under Current Law, by Cash Income Percentile, 2011



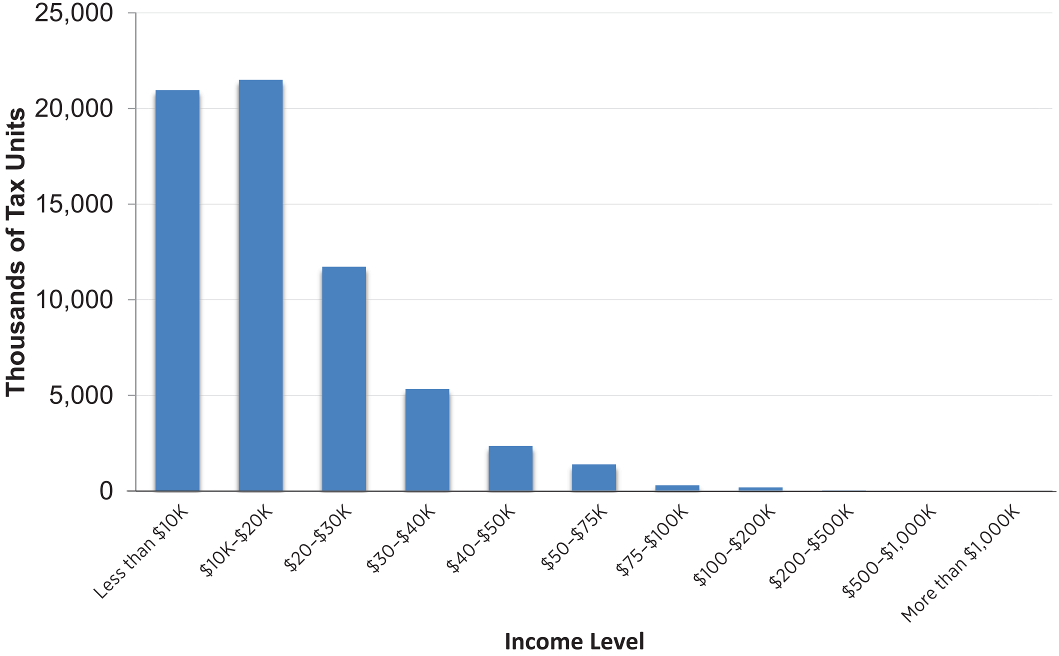
Source: Tax Policy Center, Urban Institute and Brookings Institution.
Produced by Veronique de Rugy, Mercatus Center at George Mason University.

Marginal Tax Rates Must Nearly Double to Fund Entitlement Spending

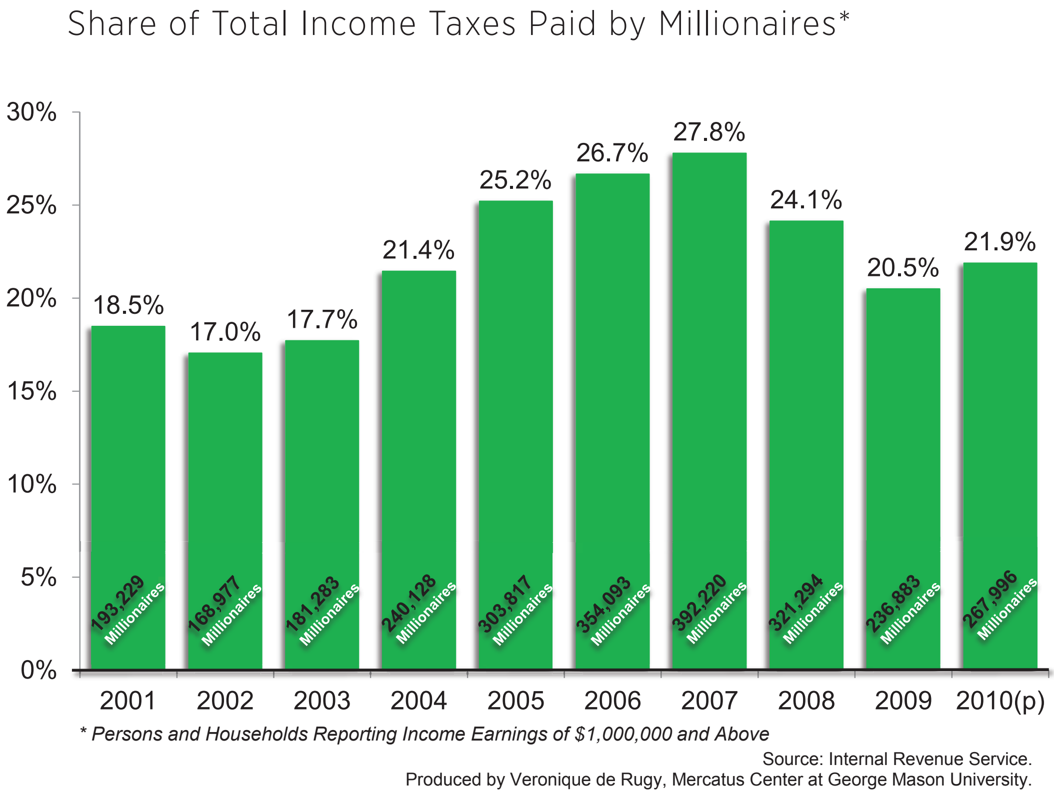


Source: Congressional Budget Office data via The Heritage Foundation.
Produced by Mercatus Center at George Mason University.

Tax Units Paying No Income Tax



Source: Tax Policy Center, Urban Institute and Brookings Institution.
Produced by Veronique de Rugy, Mercatus Center at George Mason University.


Share of Total Income Taxes Paid by Millionaires*
30%
25%
20%
15%
10%
5%
0%
18.5%
17.0%
17.7%
21.4%
25.2%
26.7%
27.8%
24.1%
20.5%
21.9%
193,229 Millionaires
168,977 Millionaires
181,283 Millionaires
240,128 Millionaires
303,817 Millionaires
354,093 Millionaires
392,220 Millionaires
321,294 Millionaires
236,883 Millionaires
267,996 Millionaires
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010(p)
* Persons and Households Reporting Income Earnings of $1,000,000 and Above
Source: Internal Revenue Service.
Produced by Veronique de Rugy, Mercatus Center at George Mason University.

ENTITLEMENT REFORM

The primary driver of unsustainable federal spending growth is federal entitlement spending. Medicare and Social Security are on the path to insolvency, and Medicaid is the biggest challenge to state budgets. Only fundamental reform will reduce the economic drag of entitlement programs. **We can't tax our way out of the entitlement funding problem**. Entitlement reform must not only rein in the rising costs of these federal programs but also remove barriers to labor force participation and disincentives to personal savings.[35]

Social Security

Social Security must be reformed to remain solvent so that those who need benefits can get them.

- Social Security reform must focus on reining in unsustainable program costs, encouraging personal saving and investment, and rewarding individuals who choose to extend their working careers rather than retiring at the earliest eligibility age.
- Further delaying reform threatens to severely limit our ability to sustain the program without drastic benefit cuts, massive tax increases, or some combination of the two.[36]

Medicare

The Affordable Care Act's total new spending well exceeds its cost-savings provisions.

- Over this decade (2012–2021), the ACA is expected to increase net federal spending by more than $1.15 ***trillion***, and to add more than $340 billion and as much as $530 billion to federal deficits over the same period, and increasing amounts thereafter.[37]

Medicaid

Like Medicare and Social Security, Medicaid adds significant strain on state budgets and worsens the federal fiscal outlook.

- Medicaid was estimated to account for 23.6 percent of total state spending in fiscal 2011, the single largest portion of total state spending, and 17.4 percent of state general fund spending, the second largest portion of state general fund spending after elementary and secondary education.[38]
- With the dramatic expansion of the program under the ACA, Medicaid promises to consume even more of state budgets in the future. State expenditures on Medicaid are expected to double between 2011 ($159 billion) and 2020 ($340 billion).[39]
- **The CBO estimates that by 2021, 17 million new people will be added to Medicaid (and CHIP) rolls under the ACA—an increase of nearly 30 percent**.[40]
- Medicaid should be moved from a state-federal matching system to a block grant system to give states greater flexibility.[41]
- The 1996 federal welfare reform, which transitioned funding for welfare benefits from a matching grant structure to a block grant structure, was a success: welfare rolls dropped, taxpayer costs were curtailed, and work requirements for beneficiaries were effective.[42]

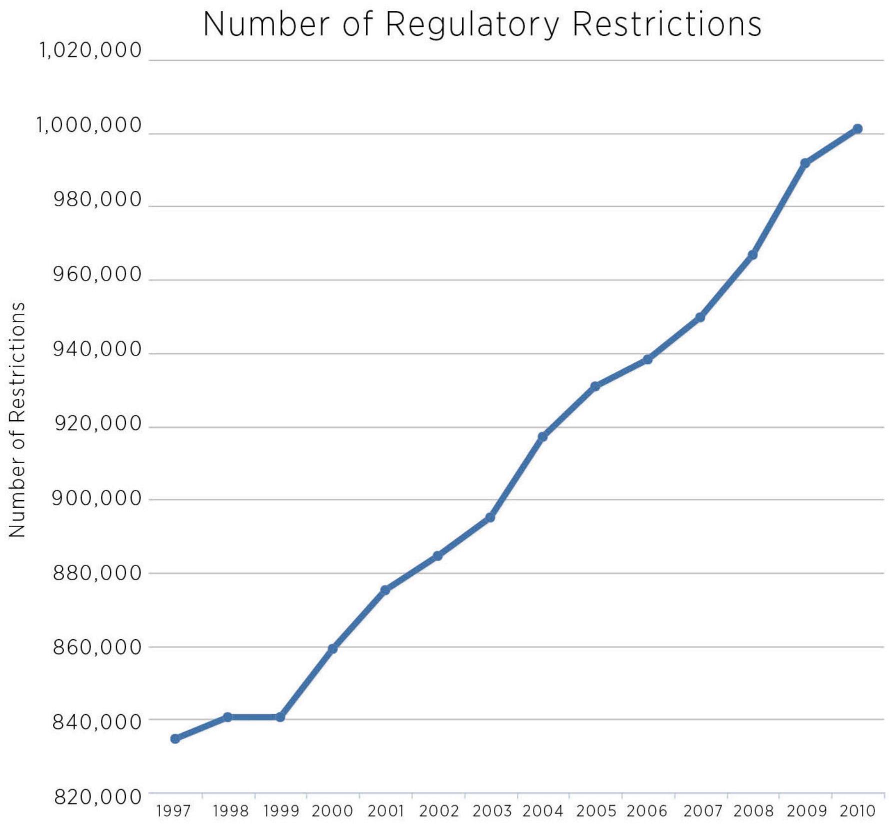
- The ACA uses federal grant money to incentivize states to expand Medicaid eligibility—but increased federal Medicaid funds are only promised in the short term. If states accept federal aid to create or expand public programs today, they will likely have to reduce benefits or commit to raising taxes to fund the program in the future.[43]
- It is hard to find successful state-level reforms that provide a combination of cost reduction and maintained or increased access; as a result, many state policymakers have chosen to increase Medicaid expenditures over time rather than to reduce eligibility.[44]
- The ACA establishes federal subsidies for lower-income individuals to buy health insurance in state-established exchanges. According to a 2011 CBO analysis, the exchange subsidies and related spending will total $777 billion from 2012–21, more than any other ACA provision.[45]
- Current cost projections for these subsidies are subject to at least two forms of significant financing risk: participation rates, the risk that participation by subsidy-eligible individuals will be higher than currently estimated, and program expansion, the risk that lawmakers will expand the growth of these subsidies relative to projections under current law.[46]
- To ensure the ACA does not worsen the federal fiscal outlook, either financing offsets need to be found or fully two-thirds of the ACA's new health-exchange subsidies must be repealed before benefits begin in 2014.[47]
- Under the current law, states face the complex decision of whether to expand Medicaid coverage—a decision that requires a careful balancing of powerful, conflicting considerations. In particular, states must weigh the burden of higher state Medicaid expenditures under expansion against the benefit of maximizing federally financed health benefits for their citizens. ***Medicaid expansion brings additional federally financed health benefits to the states but exposes state budgets to the risk that federal support will decline in the future***.[48]

REGULATION & RULEMAKING

Good governance is the aim of every policymaker, and it is achieved by informed decision-making on when and how to employ regulation.

The question policymakers must ask is, does regulation actually solve problems, or does it unwittingly introduce new ones?

- Expanding regulation does not guarantee improved health and safety. Results, not assumptions, should determine regulatory policy.
- Research in the disciplines of psychology, economics, and organizational science warn that too many regulations—particularly highly detailed regulations—may make society less, not more, safe from "regulatory overload."[49]
- The problem of regulatory overload is quickly understood when you consider how, as a practical matter, no person should be expected to comprehend more than 170,000 pages of federal rules containing over 1 million restrictions.[50]



Source: Regulatory restrictions computed by RegData, Mercatus Center at George Mason University, regdata.mercatus.org.

Despite decades of presidential orders on retrospective review of regulations, agencies have consistently failed to produce useful measures of regulatory results. Instead, agencies have characterized changes in proposed rules and general housekeeping updates as substantive regulatory review. Two egregious examples:

- The largest source of savings in the EPA's 2012 retrospective review plan is changes the agency made to a proposed rulemaking, not changes made to a rule already on the books.[51]
- The FDA's 2012 retrospective review plan claimed savings from changes it would make in the normal order of operations, such as updates to recognize changing technology.[52]

Other options can produce better results than regulation. **According to 40 years of data, the Occupational Safety and Health Administration (OSHA) is unlikely to be the major cause of the decline in workplace fatalities and nonfatal injuries and illnesses**.[53]

- Improvements in workplace safety have been largely driven by the financial incentives for employers to expand expenditures on worker safety and health created by the labor market, states' workers' compensation insurance programs, and the legal system.[54]
- Empirical evidence from years of studies suggests that magnifying OSHA's enforcement powers, either by increasing the frequency of inspections or by raising the level of fines for noncompliance, will not improve worker safety and health dramatically.[55]

The cost of regulation can make it harder for society's most vulnerable individuals to mitigate risk.

- ***Regulations act like a regressive sales tax, with middle- and lower-income households bearing much of the cost of rules that focus on the risk preferences of wealthier households, since they all pay the same, higher prices***.[56]
- That means the most vulnerable households have less income on hand to make the choices that could actually make them better off.
- Cost of regulation as a share of income is estimated to be as much as six to eight times higher for low-income households than for high-income households.[57]
- Estimates indicate that households can mitigate the same level of mortality risks privately for about one-fifth of the cost of public risk-reduction strategies.[58]

QUALITY OF RULEMAKING

Claims that the benefits of regulation outweigh the costs are often unreliable and based on agency analysis that is incomplete and of poor quality—flaws that contribute to inflated benefits and misdirected policy.[59]

The top three weaknesses in agency analysis are

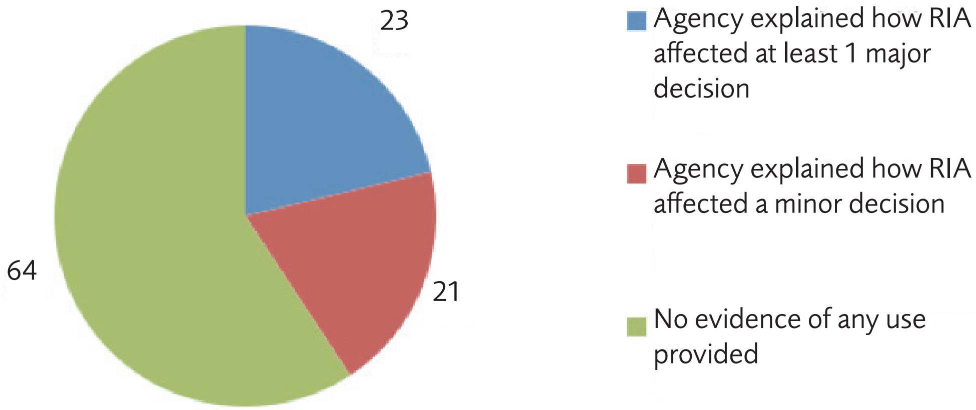
1. failing to define the problem,
2. failing to identify and evaluate options other than the proposed regulation, and
3. failing to establish the means to evaluate the regulation's outcomes.[60]

These weaknesses mean that too many regulations are imposed in a "ready, fire, aim" approach, without any credible examination of whether other approaches—market forces, actions by state or local authorities, or differently crafted rules—would be more effective or efficient at solving the problem. The result has been an **ill-informed, inefficient, and unnecessarily costly** regulatory state.

- As an example, the regulatory analyses for eight interim final ACA rules issued in 2010 usually ***underestimated costs***, in some cases by ***billions of dollars***; overestimated the number of people who would benefit; and presented no monetary estimates of benefits.[61]
- Based on these analyses, it appears that the ***federal government does not know the likely effects of the rules on the economy***—or on Americans' health care.[62]

- As another example, agency estimates show that energy-efficiency standards issued in the last two years have a relatively minor effect on greenhouse-gas emissions, which means these rules cannot pass a benefit-cost test based solely on their environmental benefits.[63]
- To justify these regulations, agencies characterized limiting consumer choice to only those products that complied with the energy-efficiency standards as a ***benefit***.[64] ***Limited choice is a cost, not a benefit, to consumers***. Agencies ought to count it as such.

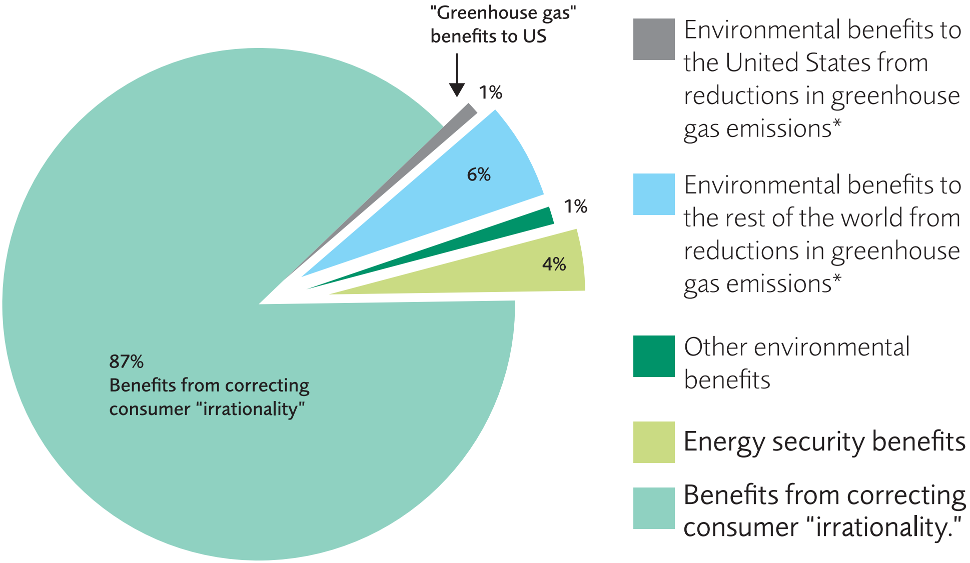
Use of Regulatory Impact Analyses (RIAs) in 108 Economically Significant Regulations, 2008–12



Source: Jerry Ellig and James Broughel, "How Well Do Regulatory Agencies Use Regulatory Impact Analysis?" (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, July 2013), http://mercatus.org/sites/default/files/Ellig_FedAgenciesRIA_MOP_071513.pdf.

ENVIRONMENTAL BENEFITS FROM ENERGY EFFICIENCY REGULATIONS ARE NEGLIGIBLE

Regulatory Agency's Claimed Benefits from CAFE Standards for Passenger Cars and Light Trucks



Source: EPA and NHTSA, "2017 and Later Model Year Light-Duty Vehicle Greenhouse Gas Emissions and Corporate Average Fuel Economy Standards," Federal Register 76 (December 1, 2011): 74854, table III-82; and EPA, "Draft Regulatory Impact Analyses: Proposed Rulemaking for 2017–2025 Light-Duty Vehicle Greenhouse Gas Emission Standards and Corporate Average Fuel Economy Standards," November 2011, table 1.

* Assumes 15% of benefits from reductions in greenhouse gas emissions are attributed to the United States. This is the midpoint of 7 and 23, the range estimated by the Interagency Working Group on Social Cost of Carbon, "Technical Support Document: Social Cost of Carbon for Regulatory Impact Analysis under Executive Order 12866," February 2010.

Note: Percentages don't add up to 100 percent due to rounding.

REGULATION AND EMPLOYMENT

Agency estimates about the employment impact of a new regulation are rarely accurate because agencies often ignore evidence of job displacement.

Agencies implicitly assume that workers displaced by regulation simply find identical work in other industries. As a result, federal agencies ignore the economic cost of job loss in regulated industries, despite strong evidence that job displacement of any type is very costly for individuals, families, and communities.

- Even after reemployment, it can take as long as ***20 years for workers to catch up on lost earnings***, largely due to skill mismatches between the jobs lost and the new jobs created in the economy.[65]
- These losses occur in ***all major industries*** and ***with workers of any age*** and different levels of seniority.[66]
- Recent estimates of earning losses range from ***1.4 years of earnings*** in times of low unemployment to ***2.8 years during times of high unemployment***.[67]

Second, agencies ignore the economic cost of indirect job loss in other industries resulting from higher prices and other costs generated by new regulation.

- For example, the EPA found that its proposed Toxics Rule would raise the price of electricity by nearly four percent and, as a result, higher energy prices would raise prices and reduce sales in 19 associated industries. A more complete analysis by the EPA would have found that ***for every job lost in the electrical industry, 11 jobs would have been lost in other industries***.[68]

Third, agencies typically do not account for certain long-term effects of regulations on the labor market, such as

- how regulations can impact labor force participation, the potential unemployment rate, and relative wages;
- how regulations can create fairness issues when certain types of jobs are favored at the expense of others;
- how income inequality could be affected if basic production occupations lost at the expense of compliance jobs require higher or lower levels of education and training; and
- how mismatches between a worker's skills and those needed for the jobs available can result in lower labor force participation and higher unemployment rates in the long run.[69]

REGULATORY REFORM

Regulatory reform is necessary to ensure that regulatory policy actually solves problems, rather than perpetuating them.

We can greatly improve regulatory policy if agencies consistently apply basic decision-making principles:

- Define the problem and its root causes.
- Identify the desired outcome.
- Consider all the options that could achieve the outcome.
- Assess the trade-offs of each option.
- Define how to measure progress—and actually measure it.[70]

Research indicates that a sound foundation for regulatory reform begins with:

- applying the same regulatory analysis standards to the executive branch and independent agencies,
- requiring agency regulatory analysis by statute, and
- requiring congressional approval of major regulations.[71]

To truly address concerns about overregulation, policymakers cannot focus exclusively on the growth of new regulations. The lack of an efficient and effective regulatory review process for existing rules requires attention. One option is to use a BRAC-style commission to identify the regulatory costs associated with an existing piece of legislation and create a target for reducing those costs.[72]

HOUSING AND GOVERNMENT-SPONSORED ENTERPRISES

A government-sponsored enterprise (GSE) is a financial services corporation created by the United States Congress with the express intention of increasing the flow of credit to targeted sectors of the economy.

Federal housing and mortgage finance policies contributed to the 2008 financial crisis and require more substantial systematic reform to restore market discipline to the housing sector.

- GSE legislation enacted in 1992 explicitly included a goal of supporting “affordable housing.” ***In issuing regulations to implement this legislation, the US Department of Housing and Urban Development (HUD) set goals that led the GSEs to equate “affordable housing” with low-down-payment lending or lending to borrowers with poor credit histories***. These policies helped fuel an increase in demand, which contributed to a massive increase in housing prices.[73]

These federal policies didn't just contribute to the financial crisis; they saddled taxpayers with a load of debt. We need to rescue further generations from this debt and wind down the biggest culprits, Fannie Mae and Freddie Mac.

- By the end of 2009, Fannie and Freddie's total debt and mortgage-backed securities obligations climbed to ***$5.5 trillion***.
- Fannie Mae's conforming loan limit is currently $417,000 for a single unit property (and as high as $625,500 for a "high-cost area").
- If the government reduced the conforming loan limit each year until it reached zero, the private mortgage market would have time to adjust.
- The conforming loan limit could be removed from the largest mortgages first to avoid hitting low-income homeowners hardest.[74]
- Despite fears that the end of Fannie Mae and Freddie Mac would signal the end of the fixed-rate mortgage (FRM), other mechanisms, like private-label securitization and covered bonds, have proven capable of funding FRMs, both in the United States and abroad.[75]

CONSUMER FINANCE

The unintended consequences of consumer finance regulation often hurt those it's designed to protect, leaving many consumers with little to no access to credit when they need it most.

Regulation designed to protect consumers is actually harming consumer choice in three key areas:

Prepaid Cards

- There are as many as ***10 million unbanked and 24 million underbanked households*** in the United States, suggesting a need for alternatives to traditional financial products.
- A variety of increased regulations (including the Durbin Amendment) have contributed to eligible free checking accounts declining from ***76 percent of bank accounts in 2009*** to ***39 percent in 2012***.
- Demand for prepaid card use implies that they meet crucial consumer needs. Prepaid card use increased 21.5 percent per year by volume between 2006 and 2009.[76]

Overdraft Protection

- Approximately 90 percent of overdraft revenues are generated by a relatively small percentage of frequent users.
- A strong majority of those who use overdraft protection are happy that the service is available.
- 96 percent of consumers who recently paid an overdraft fee acknowledge that they wanted the payment covered.
- A median rate of 75 percent of customers opt-in to overdraft protection when it is offered for their debit card.[77]

Payday Lending

- Payday lending is an important source of emergency, short-term credit.
- In one survey of payday loan borrowers, 86 percent of respondents "strongly" (70.8 percent) or "somewhat" (15.7 percent) agreed that their loan was to cope with unexpected expenses.
- Customers are usually well informed of the costs of consumer finance products.
- Only 2 percent of payday loan customers report that they do not know the finance charge for their most recent loan.[78]

THE CONSUMER FINANCIAL PROTECTION BUREAU

With Dodd-Frank, Congress created the Consumer Financial Protection Bureau (CFPB). The flaws in its structure could lead to increased costs and reduced access to credit for consumers. In addition, the CFPB's designers removed the most common and effective forms of oversight found in other government agencies. The result is **a largely unaccountable new federal bureaucracy** with little constraint from any constitutional authority.

- The CFPB's automatic funding from the Federal Reserve makes the agency largely unaccountable to Congress.
- Because Dodd-Frank instructs courts to defer to the CFPB on its interpretations of federal consumer finance law, the CFPB is largely unaccountable to the judiciary.
- The high bar for removing the single director of the CFPB makes the agency largely unaccountable to the president.[79]

US FINANCIAL SYSTEM

One of the lessons of the financial crisis was the danger of "systemic risk." While this lesson has primarily been used to support more expansive regulatory authority over the financial system, research suggests that many of the underlying causes of the crisis were, at least in part, **the result of a mindset that more involvement from central regulators will lead to less risk in the financial system.** Research suggests that not only may regulators fail to solve the problem of systemic risk, **they may potentially make the system less safe.**[80]

Systemic Risk

- Owing to the complexity of the US financial system, systemic risk ***cannot be effectively regulated by a centralized regulatory authority***.
- ***Dodd-Frank enshrined "too big to fail"*** by creating a legal class of institutions known as "Systemically Important Financial Institutions" (SIFIs).
- Anticipation of government bailouts encourages financial institutions to make riskier investments.[81]

Deposit Insurance

- Though the theory underlying deposit insurance suggests it should be "free," it has real costs in practice; the FDIC expends real resources administering and operating the Deposit Insurance Fund.
- The Deposit Insurance Fund averages ***$2.67 billion*** in expenses each year, with a total of $208.33 billion spent to date (2008$).
- Bank capital regulations may have been ***the most important causal factor*** in the financial crisis of 2008, which may have ***cost the US economy more than $10 trillion***.
- Risk-based capital requirements increase systemic risk by encouraging banks to hold the same or similar types of assets.
- The better way to stabilize the financial system is to replace risk-based capital requirements with simple capital ratios.[82]

RESPONSIBLE RULEMAKING FOR FEDERAL FINANCIAL REGULATORS

Independent financial regulators face fewer requirements to do economic analysis than most executive agencies. As a result of this lax oversight, they fail to do good economic analysis.[83]

- Benefit-cost analysis is just bipartisan common sense, which financial regulators ignore.[84]
- Every president since Ronald Reagan has asked independent agencies to conduct meaningful benefit-cost analysis, yet these agencies choose not to do so.
- In one example, the SEC originally estimated compliance costs for a rule implementing Section 403(b) of Sarbanes-Oxley at approximately $91,000 per publicly traded company. SEC later revised this estimate to roughly $2.87 million per company.[85]

CYBERSECURITY

Those whose property and information are at risk are in the best position to develop and maintain cybersecurity solutions. A top-down approach to cybersecurity can never identify and prioritize the many factors that are relevant to achieving effective cybersecurity, especially considering the pace at which technology develops.

- Companies and firms, on their own, are best able to solve cybersecurity issues because they have quickest access to information about relevant threats. The best evidence shows that private firms do, in fact, spend quite a bit on securing their assets.[86]
- Policy solutions should take into account the current best practices present in specific industries, rather than impose sweeping static solutions that could disrupt the functioning rules. ***Formal legal rules would be less dynamic, induce less cooperation, raise costs, be less effective internationally, and limit peering, especially for smaller ISPs.***[87]
- There are many different types of cyberattacks, and the rhetoric surrounding cybersecurity legislation should reflect those realities. The current rhetoric has exaggerated the existing threat.[88]

ONLINE PRIVACY

Privacy policy debates often assume regulations are needed to ensure that privacy—especially children's privacy—is protected online. But in reality, **parents and families are responsible for determining which websites and what content is suitable for themselves and their children.** It is an individual choice to visit certain websites.

- People's expectations of privacy differ wildly, which makes uniform privacy legislation difficult.
- Websites' use of personalized information in targeted ads allows them to provide services for free.
- The costs of regulations may outweigh the benefits, especially in regard to free speech and the proven multistakeholder governance model of the Internet. ***We live in a world of trade-offs, and regulation is not costless***.[89]

INTELLECTUAL PROPERTY RIGHTS

Intellectual property rights—like copyrights and patents—are foundational to the success of multiple sectors in the American economy. The Constitution grants Congress the power to protect intellectual property to incentivize innovation and creation for the public good. What framework then best promotes innovation and the public good?

- ***The Constitution allows the enforcement of intellectual property rights to spur innovation, not to secure sources of revenue for special interests***.
- Those who promote a limited government should then seek to reform the current copyright system because it grossly overreaches the bounds originally intended.
- Intellectual property is inherently different from physical property and thus should be treated accordingly.[90]

REGULATING THE INTERNET

Regulation of the Internet is a topic currently discussed at international conferences, like the United Nations World Conference on International Telecommunications. Rather than being centrally operated, the Internet comprises all the users combined with a few nonprofit organizations. This scattered organization is known as multistakeholder governance. **The US government is uniformly against international regulation of the Internet because the benefits of a free and open Internet are unmistakable**.

- The multistakeholder model should be upheld domestically as well as internationally.[91]
- Any proposed regulation of content on the Internet should be weighed against the impact such regulations would have on the current free and open model that has been central to the success of the Internet.
- Some countries propose a system of tolls on the sources of Internet content in order to bolster poorer countries' lagging telecommunications infrastructure. However, Mercatus research shows that ***collecting fees or tolls from foreign countries does not correlate to infrastructure investment***.[92]

TELECOM REGULATION

Telecom regulations, enforced primarily through the Federal Communications Commission and state and local governments, impact the means through which we receive information technologies like the Internet, television, and phone services. It is important to remain mindful of what those impacts are and how they can be reformed to allow greater, more affordable access to the American people.

- The renewal of broadcast licenses should be considered against the market forces at work in the rapidly changing video marketplace.
- There are few alleyways of the administrative state more obscure or more ***littered with obstacles to efficient markets and improvements in consumer welfare*** than the interventions regulating ownership and licensing of TV stations and programs.[93]
- Broadband usage-based pricing and data caps—whether delivered wirelessly, or through cable, fiberoptic, or phone line—do not necessarily harm the consumer and halt the current model of lower bandwidth users supporting higher bandwidth users.
- Absent a specific market failure, which critics have not yet shown, broadband providers should be free to experiment with usage-based pricing and other pricing strategies as tools in their arsenal to meet rising broadband demand.[94]
- The government currently controls a majority of wireless spectrum and gives unused spectrum to companies via licenses. Spectrum is the means through which we receive signals and data on our cell phones. ***Applying market practices to this scarce resource will lower prices and promote accessibility***.[95]

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