Policy Priorities

FOR THE 114TH CONGRESS

CATO INSTITUTE

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INTRODUCTION

Pundits have lately been declaring the 112th and 113th Congresses the "least productive" in recent history. Why, they passed fewer than 600 laws between them! One leading writer even called the 113th "by just about every measure, the worst Congress ever," surely overlooking the Congresses that passed, for instance, the Fugitive Slave Act, the Indian Removal Act, the internment of the Japanese Americans, Prohibition, conscription, or indeed the income tax.

At the Cato Institute we take a different view. We propose that passing more laws—that is, more mandates, bans, regulations, taxes, subsidies, boondoggles, transfer programs, and proclamations—is at best a dubious accomplishment. In fact, given that the American people pondered the "least productive Congress ever" twice, and twice kept the government divided between the two parties, it just might be that most Americans are fine with a Congress that passes fewer laws.

Sometimes, indeed, the wisest course for Congress is to repeal a law, or to refrain from passing a proposed law. In part, that view reflects one major theme of this agenda: that even many vitally important things in American society are not the province of the federal government.

We stand firmly on the principles of the Declaration of Independence and the Constitution, on the bedrock American values of individual liberty, limited government, free markets, and peace. And throughout our 38 years we have been willing to criticize officials of both parties when they sought to take the country in another direction. But we have also been pleased to work with officials of both parties when they seek to expand freedom or limit government.

In this document, *Policy Priorities for the 114th Congress*, we outline modest and practical steps Congress and the administration could take in the next two years in that direction—reforms of health care, financial regulation, taxes, surveillance, marijuana policy, civil asset forfeiture, war powers, immigration, transportation, and more.

Those who are familiar with the *Cato Handbook for Policymakers* will notice that this is a much slimmer volume. This document is not intended to supplant the *Handbook*. Rather, *Policy Priorities* is intended as an updated supplement to begin a conversation among Cato scholars, members of Congress, and congressional staff about policy solutions to current challenges.

Is it possible that Congress will choose to pursue policies—tax increases, yet higher spending, continued subsidies for risky decisions, intrusion into corporate decisionmaking—that would slow down U.S. economic growth, perhaps make us more like France, with a supposedly kinder, gentler capitalism and a GDP per capita of about 75 percent of ours? Yes, it's possible, and clearly there are proposals for such policies. But if we want economic growth—which means more health care, scientific advance, better pharmaceuticals, more leisure opportunities, a cleaner environment, better technology—in short, more well-being for more people—there is no alternative to market capitalism. And if we want more growth, for more people, with wider scope for personal choice and decisionmaking, libertarian policy prescriptions are the roadmap.

Private property, free markets, and fiscal restraint are important foundations for liberty. But there are restrictions on liberty beyond the realm of taxes and regulations. We hope that elected officials of both parties will recognize the dangers of warrantless wiretapping, indefinite detention, censorship, drug prohibition, executive overreach, entanglement of church and state, and other such policies. Americans declared in 1776 that life, liberty, and the pursuit of happiness are inalienable rights, and in 1787 they wrote a Constitution that empowers a limited government to protect those rights.

For those who go into government to improve the lives of their fellow citizens, the hardest lesson to accept may be that Congress should often do nothing about a problem—such as education, crime, or the cost of prescription drugs. Critics will object, "Do you want the government to just stand there and do nothing while this problem continues?" Sometimes that is exactly what Congress should do. Remember the ancient wisdom imparted to physicians: First, do no harm. And have confidence that free people, left to their own devices, will address issues of concern to them more effectively outside a political environment.

By David Boaz

CHAPTER 1

HEALTH CARE REFORM

Congress should

- investigate (1) how the Obama administration, contrary to the clear language of the Patient Protection and Affordable Care Act (PPACA), decided to issue health-insurance subsidies ("tax credits") and impose the related employer- and individual-mandate penalties in states with federal exchanges; (2) why the administration is not informing HealthCare.gov enrollees that their tax liabilities and premiums could increase dramatically, while those subsidies and even their coverage could disappear, by mid-2015; (3) what steps the administration is planning for the contingency that the Supreme Court rules in *King v. Burwell* that those subsidies and penalties are invalid; (4) what steps the insurers who participate in HealthCare.gov are planning for that contingency;
- end the illegal health-insurance subsidies the Office of Personnel Management is issuing to members of Congress and congressional staff;
- repeal the PPACA and offer no lesser changes to the law until *after* the Supreme Court's ruling in *King v. Burwell*;
- replace the PPACA with expanded health savings accounts, a proven free-market reform, rather than "Obamacare-lite" proposals like health-insurance tax credits; and
- reject any attempt to ratify the Obama administration's illegal taxes and spending in federal exchanges, which would set a dangerous precedent of *rewarding* illegal taxation.

The 114th Congress faces a grim duty. The president has repeatedly violated the law to achieve what he could not achieve through the political process: a health care law that does not rely on state cooperation and an expansion of the entitlement state over the opposition of the American people. Congress must deal with the harm the president's actions have inflicted on millions of American families and must do so without rewarding his illegal behavior.

The Patient Protection and Affordable Care Act of 2010 is unpopular and unworkable. The PPACA gives states the power to veto its major taxing and spending provisions, and to reveal to consumers the full cost of the law's many mandates and regulations. Two-thirds of the states have exercised those vetoes. If the American people were allowed to see the full cost of those mandates and regulations—that is, if they had to live under the law as Congress enacted it—then Congress would have already repealed "Obamacare." Recognizing that political reality, President Barack Obama has taken numerous steps that have exceeded his lawful powers for the purpose of blocking that democratic process.

- Notwithstanding the president's many promises that "if you like your health plan, you can keep it," the PPACA imposes requirements that threw millions out of their health plans. President Obama unilaterally waived many of those congressionally imposed requirements in order to ease political pressure on Democrats in Congress, who would otherwise have voted with Republicans to reopen the law.
- The PPACA stripped members of Congress and congressional staff of a $10,000

(or so) "employer contribution" to their health benefits. President Obama has nevertheless been issuing those subsidies—which Congress itself eliminated—to members of Congress and their staffs since 2010. Again, the president unilaterally dispensed with part of the PPACA that would otherwise have impelled congressional Democrats to vote with Republicans to reopen the law.

- The PPACA imposes numerous duties on employers and health insurance companies. In a move that caused consternation even among supporters, President Obama unilaterally relieved those groups of their congressionally imposed duties—again to prevent congressional Democrats from voting to reopen the law.
- Most egregiously, the PPACA enables states to veto its health-insurance subsidies, employer mandate, and to a large extent its individual mandate, simply by not establishing a health-insurance exchange. Confounding expectations, 36 states exercised that veto power. Since the absence of those subsidies would expose consumers to the full cost of the PPACA's hidden taxes, President Obama is ignoring the clear language of his own health care law and is illegally issuing those subsidies and imposing those taxes in the 36 states that failed to establish exchanges. Once again, the president is reaching beyond his lawful powers to change votes in Congress.

These are but a few of many examples of the president reaching beyond his lawful powers *for the purpose* of thwarting the democratic process.

KING V. BURWELL

On March 4, 2015, the Supreme Court will hear *King v. Burwell*, a case on appeal from the Fourth Circuit that could put an end to that executive overreach and finally allow the democratic process to work. Two other lower courts have held that implementing exchange subsidies and the related taxes in federal-exchange states violates the clear and unambiguous language of the PPACA. In other words, those taxes and subsidies are, and always have been, unlawful.

The Supreme Court will rule on this issue by June 2015. If it agrees with the two other lower courts and overturns the Fourth Circuit's ruling, then more than 57 million taxpayers and employers will be freed from those illegal taxes and some 4 million Americans will lose the illegal health-insurance subsidies that have been shielding them from the full cost of the PPACA.

The Obama administration's decision to ignore the clear language of the PPACA has imposed substantial burdens on those 57 million taxpayers and created serious risks for those 4 million low-to-moderate income HealthCare.gov enrollees. Those risks include:

1. *A tax increase of up to $5,000.* The PPACA requires households who receive subsidies that "exceed the credit allowed" to repay the IRS as much as $2,500 per year. If the Supreme Court agrees with those two lower courts, HealthCare.gov enrollees who received subsidies of $2,500 or more each year would thus be required by law to repay the IRS $5,000. The Obama administration's defenders claim that the IRS would seek to waive that requirement, but the agency has announced no intention to do so.
2. *An enormous increase in their premium payments.* Exchange subsidies cover 76 percent of the premium for the average recipient. When they disappear, recipients will have to pay not 24 percent of the premium themselves, but 100 percent. Four million enrollees will thus see their premium payments increase by an *average* of 300 percent—a four-fold increase. Households near the poverty level will face larger increases.
3. *Potential cancellation of health plans, replacement plans uncertain.* According to

> one trade publication, "The agreements to participate in the federally-facilitated marketplace (FFM) that [the Centers for Medicare & Medicaid Services, or CMS] sent to issuers [for 2015] include a new clause assuring issuers that they may pull out of the contracts, subject to state laws, should federal subsidies cease to flow." HealthCare.gov enrollees could thus lose their coverage entirely and be unable to find a replacement plan.

The Obama administration is knowingly exposing millions of HealthCare.gov enrollees to these risks without their knowledge. More than 1 million of those enrollees were lured out of jobs that provide relatively secure health coverage and into HealthCare.gov by the promise of Exchange subsidies, according to estimates by the Urban Institute (see Figure 1).

One of those HealthCare.gov enrollees is Rebecca Murray, a Chicago resident and mother of two young children. Murray's husband, Tim Williams, suffers from chronic spinal arthritis. Murray left a secure job with good health benefits because the Obama administration promised her that she qualifies for subsidies through Illinois' federally established exchange. If the Supreme Court agrees with those two lower courts that such subsidies are illegal, Murray could see her tax liability and her premiums rise dramatically, and her family could lose its health coverage. *None of that would happen if the Obama administration had informed Murray of the risks of HealthCare.gov coverage.* Like a million other Americans, Murray would have stayed at the job where her family's coverage would have been protected from the Obama administration's false promises.

The false promise of subsidies led Chicago's mayor, Rahm Emanuel, to move tens of thousands of retired city workers off the city's health plan and onto HealthCare.gov despite protests from employee unions about the "uncertainty" of PPACA exchanges. Those retirees' coverage is now in jeopardy because the Obama administration did not follow the law and is not apprising them of the risks of HealthCare.gov coverage.

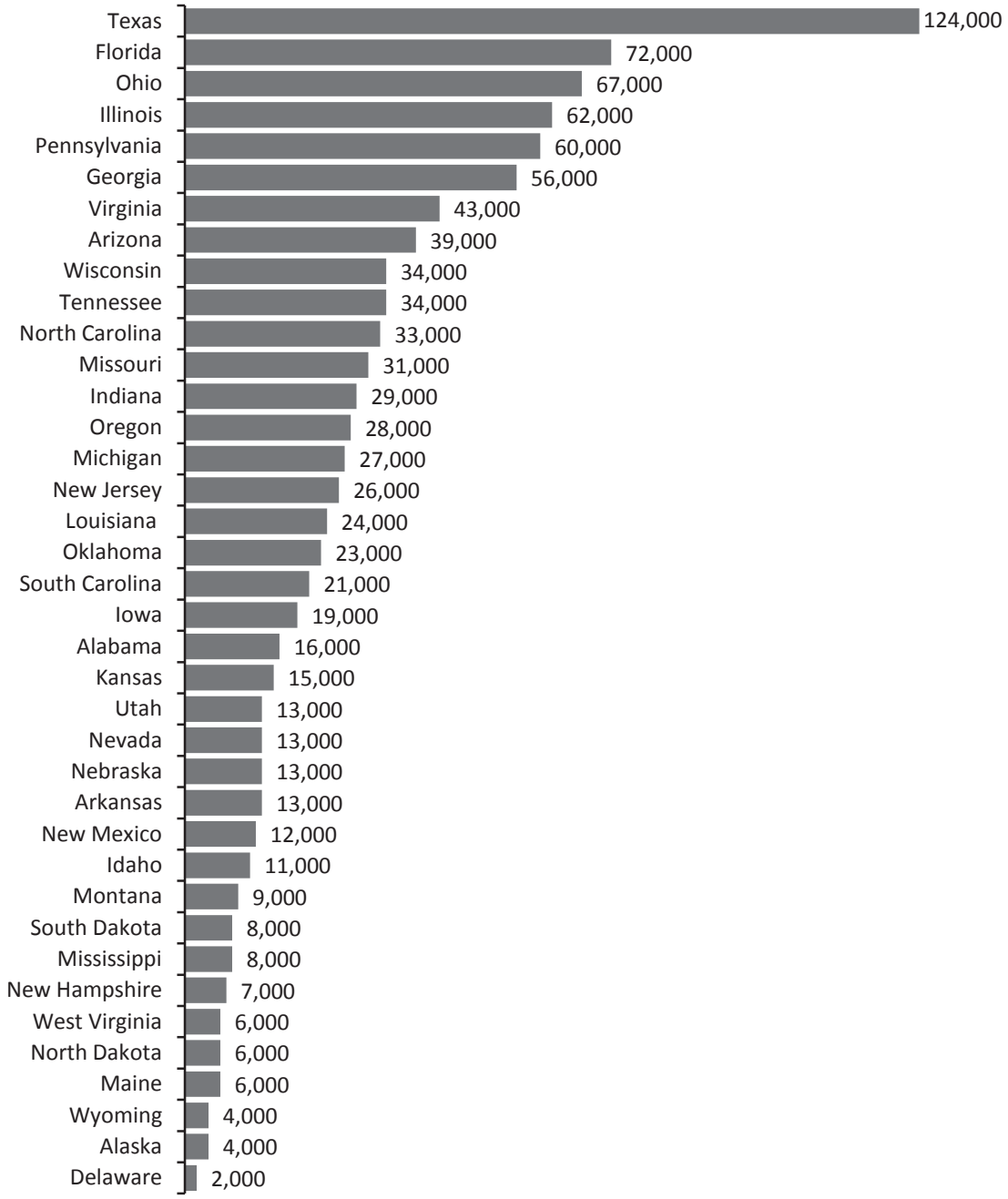
HealthCare.gov enrollees have a right to know about these risks. Indeed, the administration sold the PPACA as a way to increase transparency in health care:

> The Affordable Care Act is about letting people actually see what is happening in the health insurance market. Until now, too many Americans have lacked reliable information about coverage and faced confusing fine print and hidden limits when trying to sign up for or simply use their health insurance. [The PPACA] will shine some sunlight on the details of how these insurance options actually work. It's a huge step toward making the health care system more transparent.

The Obama administration has known that these risks are inherent in HealthCare.gov coverage since before it began selling plans for calendar year 2015. Yet the administration has adamantly refused to inform HealthCare.gov shoppers and enrollees about these risks. In press releases and congressional testimony, administration officials are telling millions of HealthCare.gov enrollees "nothing has changed." The administration *knows* that is not true, because it changed the agreements with insurers to allow them to terminate their relationship with HealthCare.gov if a court ruling puts an end to subsidies in federal exchanges. The administration is *protecting insurers* from these risks. It is not even *informing* consumers about them.

A president who once promised to "protect every American from the worst insurance company abuses" is instead exposing Americans to abuses greater than any insurance company ever has. The president complained that before the PPACA, "the average increase on premiums in this individual market . . . was double digits." Now, he is exposing HealthCare.gov enrollees to potentially triple-digit increases. The president once promised that under the PPACA, "insurance companies can no longer drop your coverage . . . due to a mistake you

Figure 1
HealthCare.gov Enrollees Who Left Job-Based Health Coverage



Source: Urban Institute, Georgetown University, Robert Wood Johnson Foundation.

made on your application." Now, millions may lose coverage due to the president's mistakes.

CONGRESS MUST PROTECT AMERICANS FROM THE WORST EXECUTIVE ABUSES

To protect Americans from these executive-branch abuses, Congress must immediately investigate the following questions.

1. How did the IRS come to issue subsidies in federal Exchanges contrary to the clear language of the PPACA?

Since 2011 the IRS has stonewalled attempts by Congress to ascertain how the

agency decided to depart from the text of the statute on the question of subsidies in federal Exchanges.

Despite the administration's lack of transparency, a congressional investigation found cause for concern about how the IRS reached this decision. As detailed in a joint report by staff for the House Committee on Oversight and Government Reform and the House Committee on Ways and Means, congressional investigators learned that

- The IRS's draft regulations initially included the statutory requirement that subsidy recipients must be enrolled in qualified health plans "through an Exchange established by the State."
- In March 2011 IRS officials learned PPACA opponents were considering legal challenges based on this provision.
- When IRS officials realized the language restricting tax credits to state-established exchanges might present a problem, they brought their concerns to the Treasury Department, which ultimately led to discussions with the White House and the Department of Health and Human Services.
- Around that time, IRS officials dropped the "through an Exchange established by the State" requirement from their draft regulations.
- Treasury and IRS officials who were involved in writing the tax-credit rule admitted to congressional investigators they knew the PPACA did not explicitly authorize subsidies in federal exchanges. The officials generally believed it was Congress's intent to offer tax credits in all exchanges, yet they failed to conduct a serious review of the PPACA or its legislative history to determine whether the law actually does authorize tax credits in federal exchanges, or to determine if their understanding of Congress's intent was correct.
- The IRS ultimately issued proposed and final rules offering tax credits in federal as well as state-established exchanges.

The joint committees' report is incomplete, because Treasury and IRS officials have repeatedly refused to release documents related to the development of the IRS's tax-credit rule. The agencies have gone so far as to ignore a congressional subpoena issued on September 23, 2014, by the House Committee on Oversight and Government Reform. The agencies' lack of transparency suggests they may be trying to hide information that would undercut its case before the Supreme Court.

2. Why isn't CMS informing consumers of the inherent risks of HealthCare.gov coverage?

Rebecca Murray and millions of other HealthCare.gov enrollees have an absolute right to know about the risks to which the Obama administration has exposed them. It is reckless and unethical for the Obama administration not to inform the public of those risks.

Congress should demand that CMS inform HealthCare.gov shoppers and enrollees of those risks, so they can prepare for any possible disruption.

3. What contingency plans has the administration developed?

The public further has a right to know what, if any, contingency plans the Obama administration is considering in the event the Supreme Court, in *King v. Burwell*, agrees with lower courts that have found the challenged subsidies and taxes to be illegal. If the administration has not developed any plans, that would be even more reckless and unethical. If it has, Congress and the public have a right to know what the administration has in mind. If the administration plans to vitiate other requirements of the law to keep those taxes and subsidies flowing, Congress has a right to know and a duty to stop such efforts.

Congress also has a right to know if the administration is planning to make one last massive transfer of taxpayer dollars to insurance

companies participating in HealthCare.gov before the Supreme Court rules such transfers illegal. The PPACA authorizes the Treasury to change the periodic basis on which the IRS makes "advance payments of tax credits" to insurers from monthly to annually. If Treasury does so, then sometime after oral arguments in *King* but prior to a ruling, the IRS could issue those subsidies to insurance carriers for the remainder of 2015. The *only* reason for the administration to even contemplate such a step is if it believes there is a reasonable chance the Supreme Court will find such transfers to be illegal, which would make such a move by the administration highly unethical.

4. What contingency plans have insurers who participate in HealthCare.gov developed?

HealthCare.gov enrollees have a right to know how their insurance company will respond to a ruling invalidating subsidies in federal Exchanges.

Insurers who participate in HealthCare.gov demanded (and CMS granted) a provision in their participation agreements that would allow them to withdraw from federal Exchanges if the subsidies disappear. Would they merely stop selling coverage through HealthCare.gov? Would they cancel all HealthCare.gov plans? If so, how much time would enrollees have before their coverage is cancelled? Even if they do not cancel those plans, would they participate in federal exchanges in 2016?

CONGRESS MUST REPEAL THE PPACA

Congress can head off the risks the Obama administration created by repealing the PPACA. Repealing the law would make coverage more affordable for the vast majority of those who would lose subsidies.

With the PPACA no longer on the books, all exchange subsidies—legal and illegal—would disappear. But so would the myriad price controls, regulations, and mandates that make exchange coverage so expensive in the first place.

A "clean" repeal bill is likely to secure a majority in both the House and Senate. That will be an important milestone, even if the bill does not clear a Senate filibuster. Majority support for a full-repeal bill will also enable members of Congress to remind the public they have tried repeatedly to head off the risks to which the administration is exposing HealthCare.gov enrollees and would signal to the Supreme Court that the PPACA's future is still a matter of legislative debate. This will create space for the Court to do the right thing and encourage the Court to leave the legislating to Congress.

Having held a full-repeal vote prior to oral arguments in *King v. Burwell*, Congress should shelve any lesser changes to the PPACA until after the Supreme Court rules on that case. It would make little sense for members of Congress to spend scarce time and effort amending the employer or individual mandates, for example, when a *King* ruling would *free* 57 million individuals and employers from those mandates and increase Congress's leverage to repeal those measures entirely. Whatever changes Congress wishes to make to the PPACA, it will have no less leverage—and possibly much more leverage—after a *King* ruling.

CONGRESS MUST REPLACE THE PPACA

Once the PPACA has been repealed, Congress must replace it with reforms that continuously make health care of ever-increasing quality available to an ever-increasing number of people.

Developing a "replace" plan in advance of oral arguments in *King v. Burwell* would signal to the Supreme Court that Congress is ready to address the PPACA's flaws and would create space for the Court to do the right thing.

Unfortunately, many current "replace" plans would preserve a variant of the PPACA's health-insurance tax credits, and would thereby reproduce many of the worst features of the PPACA: redistribution and government control of health care.

A far better approach would be to build on a proven free-market idea that is already part of the free-market lexicon: health savings accounts, or HSAs. Congress should

1. Convert the current tax exclusion for employer-sponsored health insurance (ESI) into an exclusion for HSA contributions, regardless of whether contributions come from an employer or the account holder.
2. Double or triple current HSA contribution limits to enable the vast majority of workers with ESI to exclude the same (or a greater) amount of their compensation from payroll and income taxes.
3. Remove the requirement that HSA holders enroll in a qualified high-deductible health plan, or any health plan.
4. Allow HSA holders to purchase health insurance tax-free with HSA funds.

Expanding health savings accounts to create such "Large HSAs" would make health care better, more affordable, and more secure, by giving workers greater freedom and choice. Large HSAs would

1. Make health *coverage* more affordable for the uninsured by giving Americans without access to ESI the same tax break available to those with job-based coverage.
2. Make health care more affordable for people with pre-existing conditions by giving them the same tax break on their out-of-pocket medical expenses that is available for the purchase of health insurance.
3. Make coverage more secure for people who develop expensive medical conditions.
4. Make health care and coverage even more affordable by creating incentives for 200 million Americans to demand lower prices and cost-reducing innovations.
5. Allow Americans to keep their existing coverage, if they and their insurers desire, without being thrown out of those health plans by government dictate.
6. Allow insured workers to control some $5,000 or $11,000 of their earnings that their employers now control, resulting in an *effective* tax cut of trillions of dollars for insured workers.
7. Allow workers to choose their own health plan, rather than have their employer (or the government) choose it for them.
8. Treat every health care dollar the same, whether it is spent on health coverage, medical care, or saved for future medical expenses
9. Cap the currently unlimited tax exclusion for health insurance.
10. Have zero effect on the deficit.

"Large" HSAs are more politically feasible than tax credits and would do more to bring health care within reach of those who cannot afford it.

A free-market "replace" plan would take several other steps to make health care better, more affordable, and more secure. It would allow individuals and employers to avoid unwanted regulatory costs by freeing them to purchase health insurance regulated by states other than their own. It would subsidize Medicare enrollees the way Social Security does: by giving them a cash subsidy and trusting them to spend it wisely. Medicare checks would be risk- and income-adjusted to ensure all enrollees could afford a standard package of health benefits should they choose to purchase one. It would freeze "old" Medicaid and State Children's Health Insurance Program spending at 2014 levels, to be distributed to states as flexible "block grants" with no strings attached. It would reform veterans' benefits by (1) making the costs of caring for wounded veterans more transparent to Congress and the public, (2) giving veterans a choice of health care plans and providers, and (3) making active-duty personnel and veterans stockholders in a privatized Veterans Health Administration.

STOP ILLEGAL SUBSIDIES TO MEMBERS OF CONGRESS

One way Congress can productively legislate without short-circuiting the Supreme Court's consideration of *King v. Burwell* is by eliminating the unlawful health-insurance subsidies the administration has been issuing to members of Congress since 2010.

It is inexcusable that millions of Americans should be made to suffer under the taxes imposed by the PPACA, yet members of Congress get a presidential dispensation from the provisions that harm them personally.

Members of Congress and congressional staff have little reason to fear ending those subsidies. The pay cut they suffer will last mere weeks if not days. That's because even if the legislation only passes with Republican votes, *all* members of Congress will work together to ensure the resulting PPACA-imposed pay cut is only temporary. Democrats will support legislation that makes even greater changes to the PPACA in order to reinstate their lost compensation.

Ending those illegal subsidies would also be consonant with *King v. Burwell*: it would stop the Obama administration from using illegal subsidies to thwart Congress's deliberations.

WHAT CONGRESS *CANNOT* DO FOLLOWING A *KING* RULING

A favorable ruling in *King v. Burwell* will give Congress more leverage than it has ever had to repeal the PPACA, because it would expose millions of voters to the full cost of the law's hidden taxes. What Congress must not and cannot do after a *King* ruling is ratify in any way the illegal subsidies the Obama administration created to hide those costs.

After a ruling for the *King* plaintiffs, the president would no doubt send Congress a one-page bill reinstating those taxes and subsidies that the Court held to be illegal. But because that ruling would require the Congressional Budget Office to adjust its revenue, spending, and deficit baselines downward, the impact of the president's one-page "amnesty" bill would be to

1. Expand the PPACA.
2. Expand the reach of the individual and employer mandates, by imposing them on an additional 57 million individuals and employers.
3. Increase federal spending by hundreds of billions of dollars over the 10-year window.
4. Increase federal taxes by more than a hundred billion dollars.
5. Increase federal deficits by hundreds of billions of dollars (because the additional spending would far exceed the additional tax revenue).

Worst of all, such a bill would

6. Establish a precedent under which the president can impose new taxes and entitlement programs on his own—breaking the law (and Congress will ratify his actions).

Approving any such effort to give permanent legal status to the president's illegal taxes and spending would mark a greater shift of constitutional power away from Congress and toward the executive than anything that has occurred in this or recent administrations.

The fact that the illegal taxes and spending in this case are so massive, and the disruption that could result from withdrawing them is so great, makes it *more* important that Congress not ratify them. To do otherwise would encourage executive-branch agencies to commit sweeping violations of federal law, because it would create a precedent where the greater the illegality, the more likely the executive branch will get away with it. Even providing transitional relief without first repealing the PPACA would reward the president's illegal behavior.

To prevent the creation of such a dangerous precedent, members of Congress and congressional staff must immediately begin edu-

cating themselves and the public about this abuse of executive power. They must immediately begin developing and promoting proposals that—once repeal becomes possible—can replace the PPACA with free-market reforms that effectively (and lawfully) address the need for better, more affordable, and more secure health insurance and health care.

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CHAPTER 2

FINANCIAL REGULATION

Congress should

- repeal the Dodd-Frank Act;
- short of repeal, make major modifications to Titles I, II, and X of Dodd-Frank, which covers the Financial Stability Oversight Council (FSOC), Orderly Liquidation Authority, and the Consumer Financial Protection Bureau (CFPB); and
- wind down Fannie Mae and Freddie Mac without establishing a new guarantee for mortgage risk.

From its earliest days, the American system of banking regulation has been characterized by a structure where state and federal authorities have bestowed market power on banks through restrictions on entry into the market by competing firms and limitations on acquisitions and diversification. These entry and structural barriers have created economic rents for existing market players and resulted in a more fragile banking system. Examples of such restrictions include limitations on the geographical and product diversity of bank portfolios.

The relative fragility of the U.S. banking sector, a direct result of these restrictions, led to the creation of government safety nets, such as the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC). Countries that have avoided these types of restrictions on geographical and product diversity, such as Canada and Australia, have exhibited greater stability and were much later in adopting government safety nets for their banking systems, if at all. Moreover, the creation of economic rents (via entry barriers) has not been ignored by politicians, and a significant portion of modern banking regulation involves the redistribution of these excess rents. Of course, the amount of these rents is not knowable ex ante and is difficult to measure. We are quickly reaching the point, and maybe have already passed it, where the redistribution of rents and the costs of other regulations outweigh the benefits received by banks from both the safety net and entry barriers.

Any credible attempt to reform our system of banking regulation must address all these factors. A free, competitive, and healthy banking system would be one with few barriers to entry, no safety net, and no redistribution of wealth/income. As long as safety nets are extensive, the resulting moral hazard will necessitate prudential regulation. Since prudential regulation is inferior to market discipline, an extensive bank safety net almost certainly will lead to a financial crisis.

The Dodd-Frank Act expands the bank safety net and continues using the banking system as an avenue to redistribute wealth. Dodd-Frank will likely increase both the frequency and severity of financial crises by further reducing market discipline and increasing the political control of our financial system. A first-best solution would be to repeal the entire Dodd-Frank Act. Short of that, focus should be on the following parts:

Title I—Financial Stability Oversight Council (FSOC)—FSOC is tasked with labeling companies, including nonbank financial companies, as "systemically important"—that is, "too big to fail" (TBTF). This gives regulators significant bank-like supervisory power over all large financial institutions and creates an implied government backstop for firms

so labeled. In order to end the perception of TBTF, we must end the labeling as such by government.

Title II—Orderly Liquidation Authority (OLA)—OLA empowers the federal government, via the FDIC, to take over and "resolve" failing nonbank financial companies and bank holding companies. This creates confusion and uncertainty in a crisis and codifies the potential for the regulators to discriminate between different classes of creditors or rescue creditors. The use of OLA is also at the discretion of the Treasury secretary, which means it is unlikely to be used, particularly if the Treasury can rely on other sources of funding to keep failing institutions afloat. All of the necessary tools to implement the resolution of a large systemic bank or other financial company can be achieved with some modifications to the bankruptcy code, such as creating a new Chapter 14.

Title X—Consumer Financial Protection Bureau (CFPB)—The CFPB promises to do for nonbank financial companies what the federal government has done for banks: subject them to political pressure to follow noneconomic lending standards. The CFPB will also attempt to do for other forms of finance what the federal government has done to the mortgage market, namely to turn them into a source of systemic risk. While structural changes, such as in board structure, would be modest improvements, they fall short of correcting the worst flaws of the CFPB, which is why full repeal is needed, along with repeal of the various "protection" statutes mentioned earlier. Short of abolishing the CFPB, Congress should place the CFPB within the Congressional appropriations process, change its governance structure to a board rather than a director, direct the CFPB to define "abusive" with a notice-and-comment rule-making process, require cost-benefit analysis for all CFPB rules, remove CFPB from the FDIC board, and require CFPB to include safety and soundness considerations in its rule-makings. All too often program and legal staff drive the agency's economic analysis. In order to improve the quality and independence of both its cost-benefit and economic analysis, the CFPB should restructure its management so that its Chief Economist reports directly to the politically appointed management.

Given their prominent role in the financial crisis, Fannie Mae and Freddie Mac should be wound down over a brief number of years, no more than six. This should be accomplished via the receivership mechanism established in the Housing Economic and Recovery Act of 2008 (HERA). As HERA does not abolish their charters, Congress should sunset those charters, while setting a path of reduced loan limits, higher down payments, and higher guarantee fees for Fannie Mae and Freddie Mac. The remainder of our financial system has sufficient capacity to absorb the activities of Fannie Mae and Freddie Mac and do so in a manner with significantly less leverage. Essentially Fannie Mae and Freddie Mac are avenues for banks to transfer mortgage credit risk from themselves to the taxpayers. As this increases the amount of credit risk in the system, those guarantees should be ended and not replaced.

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CHAPTER 3

REFORMING SURVEILLANCE AUTHORITIES

Congress should

- amend Patriot Act authorities to forbid indiscriminate bulk collection of citizens' sensitive communications and financial records,
- create greater transparency in the Foreign Intelligence Surveillance Act (FISA) Court review process,
- close the FISA Amendment's Section 702 "backdoor search" and "about search" loopholes,
- update the Electronic Communications Privacy Act to provide meaningful protection for stored communications and location data, and
- resist demands for legislation weakening privacy-protecting technologies.

The United States, perhaps uniquely among nations, owes its existence in no small part to its people's outrage against government invasions of privacy. The Founders' abhorrence of the general warrants and writs of assistance wielded by the British crown left its mark on our Constitution in the form of the Fourth Amendment's guarantee that our persons, homes, and papers shall remain secure against unreasonable government searches. In our more recent history, the systematic abuse of surveillance authorities uncovered by the Church Committee of the 1970s provides a sobering reminder of how readily the powers we grant government to protect our democracy can be perverted to threaten it.

As we face a daunting array of novel 21st-century threats, from violent global terror groups to sophisticated cybercriminals, Americans are being asked to accept that we can purchase our safety only by giving up essential liberty, that our Founders' resistance to government intrusions is a luxury we can no longer afford in a dangerous world, and that our commitment to liberty and limited government is a weakness and a source of vulnerability. In the coming years, legislators will confront that Faustian bargain in myriad forms—but a Congress guided by reason rather than fear will consistently reject it.

AMEND PATRIOT ACT AUTHORITIES TO FORBID BULK COLLECTION

In June 2013 Americans learned that for the past seven years, the secretive Foreign Intelligence Surveillance Court (FISC) had interpreted a controversial Patriot Act authority to acquire business records, known as Section 215, far more broadly than even the law's critics feared. Under the aegis of statutory language permitting the Federal Bureau of Investigation to acquire "tangible things" believed to be "relevant" to an authorized national security investigation, the Court had issued orders compelling the continuous, prospective production of nearly all domestic and international telephone records to the National Security Agency (NSA). Parallel language in another provision of the law, Section 214, had similarly been invoked to authorize a program of bulk collection of international Internet metadata, which was shut down in 2011.

As Rep. James Sensenbrenner, a coauthor and vocal champion of the Patriot Act, was quick to observe, this interpretation made a mockery of both the ordinary meaning of the term "relevance" and the intentions of legislators who had understood Section 215 as a grant of broad but nevertheless constrained

power to acquire specific records, not a license for unrestricted fishing expeditions through Americans' data.

Under both programs, moreover, subsequent releases of declassified FISC opinions showed that for years, court-imposed restrictions on the querying and dissemination of information in these bulk databases had been "so frequently and systematically violated," as FISC Judge Reggie Walton wrote in 2009, that a "critical element" of the oversight regime had "never functioned effectively." As a result, software tools routinely accessed the data without the required approvals: of the 17,835 phone numbers searched by one automated alert list from 2006 to 2009, only 1,935 had been vetted for "reasonable suspicion" as required by the FISC. Query results were also improperly shared with the CIA and FBI.

Contrary to initial assertions that the bulk collection of metadata had proven instrumental in "disrupting" numerous terror plots, two independent expert panels—The President's Review Group on Intelligence and Communications Technologies, and the Privacy and Civil Liberties Oversight Board (PCLB)—conducted exhaustive reviews of classified evidence and found that the bulk telephony program had yielded little or no uniquely valuable intelligence. Reviewing a dozen alleged "success stories," the PCLOB found that telephone numbers identified by NSA queries of the bulk telephony database and "tipped" to the FBI by NSA were, in nearly every case, duplicative of information the FBI had already obtained using traditional, targeted demands for telephone records.

Pursuant to the recommendations of the President's Review Group, President Barack Obama announced his intention to end the bulk collection of telephony metadata in February 2014. Director of National Intelligence James Clapper subsequently acknowledged that the proposed USA Freedom Act, which prohibited bulk collection under Section 215 and related authorities while providing a novel mechanism for the government to quickly obtain targeted records from carriers, would "accommodate operational needs while providing appropriate privacy protections."

Despite support from both the intelligence community and a broad array of civil liberties groups, the USA Freedom Act stalled in the Senate late last year. With Section 215 slated to sunset in June of this year, Congress now has only a few months to address concerns about bulk collection under this and other authorities—or risk a political stalemate that could result in the expiration of the authority.

Because several parallel authorities grant similar power to acquire telecommunications metadata, Congress should act to clarify that the indiscriminate bulk collection of data is proscribed not only under Section 215, but also the Section 214 "pen register" authority and, especially, under the National Security Letter statutes empowering the FBI to compel the production of records without advance court approval or oversight.

The most straightforward mechanism for doing so, reflected in the original House version of the USA Freedom Act, would be to amend each of the relevant statutes to require that records sought be both relevant to an investigation and connected in some concrete way to a person or group targeted in that investigation. On this approach, relevant records would be subject to compulsory production only if they pertain to a suspected terrorist or agent of a foreign power, to the activities of such a person or group, or to a person in direct contact with such a person or group.

An alternative approach, reflected in subsequent versions of the USA Freedom Act, would require that records sought under these intelligence authorities be particularly identified using "specific selectors," such as a suspect's name, telephone number, email address, or other similarly narrow identifier. Though this approach nevertheless carries substantial potential for overreach, it would at least preclude wholly indiscriminate, dragnet-style orders for data. Under either approach, Congress should establish a clear norm that in nonemergency situations, the records to be produced by a private entity should be identified in advance by a

court with reasonable particularity.

Because intelligence officials have identified scenarios in which somewhat broader initial collection of data may be necessary in specific cases to identify an intelligence target, Congress may wish to provide a narrowly tailored mechanism permitting the use of somewhat broader selectors upon such a showing of necessity. Any such mechanism should be coupled with "superminimization" procedures requiring the purging of all records not affirmatively determined to have some concrete nexus to the subject of an investigation within a limited time period to be determined on a case-by-case basis by the FISA Court.

Finally, Congress may wish to craft legislative language requiring specific classes of telecommunications carriers to provide such "technical assistance" as is necessary to ensure that records held by diverse providers can be cross-referenced and produced rapidly in response to court orders. Any such mandate should be narrowly restricted to the most operationally time-critical types of data and must explicitly disavow any obligation on the part of carriers to collect or retain data that would not otherwise be collected or retained for ordinary business purposes.

These common-sense reforms would safeguard the sensitive communications of millions of innocent Americans against potential misuse, and as the intelligence agencies themselves have conceded, create no significant obstacles to legitimate intelligence investigations.

CREATE GREATER TRANSPARENCY IN THE FISA COURT REVIEW PROCESS

It is an axiom of liberal democracy that the laws under which citizens live must be public in order to be legitimate. In a free society, "secret law" is a contradiction in terms. Yet over the past decade, the Foreign Intelligence Surveillance Court has accumulated a body of secret precedent, interpreting public statutes in classified opinions to grant the government sweeping powers that an ordinary member of the public—and even many legislators—could not reasonably understand to be authorized by the legislative text itself.

While it may often be necessary to conceal the operational details of intelligence programs from the general public, there can be no justification for such secrecy about the meaning of the law itself. Thus, Congress should require that the Department of Justice publish appropriately redacted versions of any FISC opinion containing a significant ruling on a question of law. In cases where the operational details of a collection program are too inextricably entangled with the legal questions to make such publication feasible, the attorney general may, in consultation with the FISC, opt to publish a declassified summary of the opinion instead.

Congress should also make explicit provision for independent experts to provide input on difficult legal or technical questions that may come before the FISC. One mechanism that has attracted broad support is the creation of a "special advocate" authorized to represent the privacy and civil liberties interests of ordinary citizens who may be affected by intelligence activities. Equally essential, however, is the creation of an independent panel of technical experts to advise the FISC.

As is clear from multiple declassified FISC opinions, the correct resolution of a legal question may in many cases depend pivotally upon a moderately sophisticated understanding of how either telecommunications technologies or intelligence tools function. By establishing a technical advisory panel, Congress can ensure that the FISC's legal decisions are not hampered by gaps in the court's understanding of the relevant technologies.

CLOSE THE FISA AMENDMENTS SECTION 702 "BACKDOOR SEARCH" AND "ABOUT SEARCH" LOOPHOLES

In 2008 Congress passed the FISA Amendments Act, empowering the director of nation-

al intelligence and attorney general to jointly authorize programmatic interception, at domestic communications facilities, of communications pertaining to foreign intelligence targets. Under Section 702 of that statute, the FISA Court approves only broad targeting and minimization procedures governing such collection, while the selection of specific targets and accounts to be tasked for collection is left to the discretion of NSA analysts.

While only non–United States persons located abroad may be formally targeted under these de facto general warrants, the massive scale of collection nevertheless ensures that enormous numbers of American communications are swept up by the NSA. In 2013 nearly 90,000 foreign "persons"—potentially including corporate entities or entire websites—were "targets" of Section 702 collection. A recent review by the Privacy and Civil Liberties Oversight Board noted that by 2011 the NSA was collecting more than 250 million Internet communications annually under this authority alone—and the current number is "significantly higher." Though collection must be conducted for some legitimate foreign intelligence purpose, there is no statutory requirement that the particular accounts tasked for interception belong to a terrorist or other foreign agent.

The PCLOB's review of Section 702 indicates that, in contrast to the bulk telephony program, such surveillance has yielded intelligence of significant value. Less clear, however, is whether the collection of identifiable U.S. person communications with targets, without specific court approval, is an essential component of Section 702's utility. Over the longer term, Congress should authorize a thorough inquiry into whether the value of Section 702 collection would be materially diminished by a requirement of additional judicial approval for the collection of communications to or from accounts known or reasonably believed to pertain to U.S. persons, even when such collection is incidental to the warrantless "targeting" of foreigners. The Fourth Amendment, after all, guarantees citizens a right to be secure against unreasonable *searches*, not unreasonable "targeting"—and it has never been suggested that general warrants are somehow less onerous because they fail to explicitly "target" the citizens whose privacy they violate.

In the interim, Congress should at minimum close the two loopholes which raise the most significant constitutional and practical concerns about the overcollection and potential misuse of U.S. citizen communications: the so-called "backdoor search" and "about search" loopholes.

Though Section 702 authorizes only the targeting of foreign persons for intelligence purposes, the subsequent querying and use of the data collected pursuant to that authority—including, of course, the communications of American citizens—is less stringently restricted. Databases containing the fruits of PRISM collection—that is, Section 702 collection directly from, and with the participation of, major U.S. telecommunications companies—are made available to cleared FBI analysts, and can be queried using U.S. person identifiers. The result is that FBI agents, even those conducting "threat assessments" not predicated on any hard evidence of wrongdoing, may deliberately search for and obtain the private communications of U.S. persons in these vast data stores, even though a warrant based on probable cause would be required to obtain such communications directly. Such queries now apparently occur with such frequency that officials have indicated it would be infeasible even to attempt to quantify these "backdoor searches." This becomes particularly disturbing in light of press reports that law enforcement agencies routinely engage in practice known as "parallel construction" to conceal from both courts and defendants the intelligence origins of electronic communications evidence introduced in criminal trials.

Congress should therefore act to ensure that broad powers justified by the exigencies of foreign intelligence cannot be surreptitiously used to circumvent the safeguards that properly govern criminal investigations. The FBI and any other agencies with access to intelli-

gence databases should be required to architect their computer systems to facilitate the automatic logging and classification of queries to those databases, so that Congress and other oversight bodies may be adequately informed about how the information collected is being used. Analysts should be informed when intelligence databases contain results responsive to a query on a U.S. person identifier. However, when a judicial warrant founded on probable cause would be required to directly target for interception a person or account related to a query term, the same requirement should apply before any law enforcement agency can access the contents of U.S. person communications returned by such queries.

The second major "loophole" Congress should address is the use of so-called "about searches," an element of the "upstream collection" NSA conducts by filtering traffic flowing over the Internet backbone. Until recently, the general public believed—and the government even falsely represented to the Supreme Court—that Section 702 authorized the acquisition of only communications either sent to or originating from an account reasonably believed to belong to a foreign target. In fact, as we now know, the NSA engages in mass filtering of the *contents* of international Internet communications, which it also uses as a basis for acquisition. Thus, for example, an email from an American citizen to any person abroad my be acquired by NSA if it merely *mentions* the email address or other electronic identifier of an intelligence target, even though neither the sender nor the recipient is designated as a target, and neither the sending nor receiving account has been tasked for collection. Though the FISA Amendments Act forbids the intentional acquisition of wholly domestic communications, the FISA court estimated in 2011 that, under the "upstream" procedures then in place, NSA would acquire some 56,000 wholly domestic emails annually—a result of the technical difficulty of segregating the domestic from the international emails that might be received or transmitted by the same user during a single online session. Those procedures were subsequently modified by order of the FISC, but the broader practice of "about" searching persists.

These searches raise especially acute constitutional concerns, because the legality of warrantless Section 702 collection is predicated on the idea—never explicitly endorsed by the Supreme Court—that such collection falls within a "foreign intelligence exception" to the Fourth Amendment's presumptive requirement that searches of the contents of Americans' communications be authorized by a particularized warrant founded on probable cause. Declassified FISC opinions articulate a two-pronged test that defines the limits of this exception: Surveillance must be conducted "to obtain foreign intelligence for national security purposes" *and* must be "directed against foreign powers or agents of foreign powers reasonably believed to be located outside the United States."

On the traditional understanding of these terms, the "target" of surveillance is the person or entity *from or about whom* information is sought—not necessarily a party to the surveilled communication—but surveillance is "directed against" the communications facility that either originates or receives an intercepted message. Because Section 702 does not require that its foreign targets be reasonably believed to be agents of foreign powers, it is not even clear that the exception covers the interception of U.S. person communications with all foreign person targets whose accounts are tasked for either upstream or PRISM collection. It does seem clear, however, that the exception cannot plausibly be stretched to accommodate searches directed at *neither* the sending nor receiving account, and indeed, conducted without regard to whether the sender or receiver is even an intelligence target, let alone a suspected foreign agent.

Congress should therefore amend Section 702 to ensure that collection pursuant to this authority, at minimum, falls within the bounds of the warrant exception articulated by the FISC, and clarifying that the acquisition of content entering or leaving the United States

is limited to communications whose sender or intended recipient is a valid intelligence target. In cases where the sender or recipient of a message, whether acquired via upstream or PRISM collection, is a Section 702 target but has not been affirmatively determined to be an agent of a foreign power, NSA should be required to develop procedures designed to minimize, to the greatest practicable extent, the collection, retention, or dissemination of communications to or from identifiable U.S. person accounts.

UPDATE THE ELECTRONIC COMMUNICATIONS PRIVACY ACT TO PROVIDE MEANINGFUL PROTECTION FOR STORED COMMUNICATIONS AND LOCATION DATA

While intelligence surveillance has received the lion's share of public attention in recent years, our increasing reliance on digital communication technologies means that ordinary law enforcement agencies, too, depend increasingly on electronic data gathering in the course of criminal investigations. Yet in contrast to intelligence authorities, which have been amended many times since 2001, they do so largely under the aegis of the increasingly outdated Electronic Communications Privacy Act (ECPA) of 1986.

While the structure of ECPA may have made sense at the time of passage, the law is now dramatically out of step with the realities of 21st century communications practices. It makes unclear distinctions between "remote computing" and "electronic communications" services that are difficult for both government lawyers and technology companies to apply coherently to the vast array of online services Americans use, applying inconsistent levels of protections to different types of electronic data—and even to the same communication at different times. Perhaps most egregiously, ECPA authorizes law enforcement agents to obtain the contents of private emails without satisfying the requirements for a probable cause search warrant, depending on factors like the amount of time a message has been in storage, or even (according to one Justice Department interpretation) whether it has been read by the recipient. As a growing number of courts have already held, these provisions violate the Fourth Amendment.

Congress should amend ECPA to establish a uniform requirement, consistent with the Fourth Amendment, of a probable cause search warrant to obtain the contents of both private electronic communications and remotely stored personal data not available to the general public. Though major communications providers, backed by several appellate courts, have already successfully insisted that they will produce user content only pursuant to a warrant, that requirement should be codified in statute to ensure clarity and consistency for both police and providers. (This would not, of course, affect the ability of government agencies to continue serving subpoenas directly to the owners of stored data compelling its production.)

The warrant requirement should also apply to at least some forms of communications metadata, which both privacy advocates and many law enforcement officials acknowledge is increasingly as sensitive and revealing as communications content. Detailed Internet transactional logs, for example, will often effectively reveal a user's detailed reading habits, or vitiate the First Amendment right to speak anonymously online, as surely as any wiretap designed to capture the contents of those data transactions. Yet ECPA adopts the mechanical assumption that all transactional data stored by a third party—even data never normally reviewed by any human observer—falls outside the protection of the Fourth Amendment and is subject to compulsory production under standards far less stringent than probable cause. While some types of communications records, such as "basic subscriber information," should reasonably be available to law enforcement via subpoena or court order, judges should be afforded greater discretion to impose the higher Fourth Amendment

standard of probable cause when investigators seek Internet transactional data that is either functionally equivalent to communications content or otherwise implicates core privacy interests. The mere fact of third-party custodianship should not be the sole factor in determining whether government acquisition of such transactional data implicates citizens' reasonable expectations of privacy.

Geolocation data, whether obtained via prospective GPS tracking of a subject or from such sources as cellular connection records, similarly enables increasingly precise monitoring of Americans' physical movements and patterns of activity, in both public and private spaces. In 2012 a unanimous Supreme Court held in *U.S. v. Jones* that the installation of a GPS tracking device on a vehicle—especially when used for protracted monitoring—constitutes a search subject to the requirements of the Fourth Amendment. Congress should recognize that the privacy interest invaded by location tracking does not depend on the details of the technical mechanism by which the tracking is accomplished and should establish a uniform warrant standard for electronic location surveillance.

RESIST DEMANDS FOR LEGISLATION WEAKENING PRIVACY-PROTECTING TECHNOLOGIES

As high-profile cyberattacks regularly demonstrate the vulnerability of Americans' most sensitive data to malicious actors—from domestic criminals to foreign governments—we increasingly rely, whether we're aware of it or not, on the critical protection of strong data encryption. Indeed, the flourishing digital economy we all now take for granted is in significant measure a product of the government's decision, in the late 1990s, to ease restrictions on strong encryption software.

Recently, however, some law enforcement officials have issued renewed calls—wisely rejected when they were first heard two decades ago—for legislation requiring communications services and technology manufacturers to design deliberately insecure products, with built-in backdoors enabling law enforcement to unlock encrypted data. While unbreakable encryption has long been available for traditional personal computers—refuting dire prophecies that such software would quickly render criminal investigations all but impossible—the increasing deployment of default encryption on mobile computing devices, and in digital communications platforms, has resurrected the idea that companies must be prohibited from selling Americans "too much" privacy or security.

Such demands are not only abhorrent in principle, but would be futile and destructive in practice. The principal problem should be all too clear: A backdoor mandate effectively treats millions of law-abiding Americans as presumptive criminals who may be forced to store their own private data, not in a format of their own choosing, but in one dictated by the government. Such a proposal applied to more traditional forms of communication—a mandate that Americans tape their verbal conversations for the convenience of police, or ensure that their personal diaries are legible to government investigators—would be obviously offensive. It is no less offensive when our thoughts and conversations are mediated by digital bits rather than air or paper.

The practical pitfalls of backdoor mandates are nearly as obvious to technologists and security professionals. First, experts broadly agree that it is extremely difficult, if not impossible, to build a "backdoor" that opens for law enforcement officers without simultaneously rendering the technology less secure and more vulnerable to other attackers, including repressive foreign governments. Second, unbreakable encryption tools are already widely available, and sophisticated cybercriminals—those for whom such digital evidence is most likely to be critical to an investigation—will not rely on backdoor products to protect their private data. Third, such mandates would hobble American companies in the global technology marketplace, even as individual and

corporate consumers alike are increasingly demanding robust assurances of data security. Fourth and finally, any effective mandate would impose design constraints on programmers and manufacturers far more drastic than most nontechnologists recognize—creating pressure to adopt more centralized (and so more easily monitored) communications protocols, and to make device operating systems more opaque and resistant to modification by their own users and owners.

In short, Congress should recognize that any legislative attempt to deny Americans access to strong privacy technologies would be economically injurious, practically feckless, technologically uninformed, and morally offensive.

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Prepared by Julian Sanchez

CHAPTER 4

RECLAIMING THE WAR POWER

Congress should

- repeal the "Authorization for Use of Military Force against Iraq Resolution of 2002,"
- sunset the 2001 Authorization for Use of Military Force, and
- consider a narrowly tailored, time-limited authorization for military action against ISIS.

"The Constitution supposes, what the History of all Governments demonstrates," James Madison wrote to Thomas Jefferson in 1798, "that the Executive is the branch of power most interested in war and most prone to it. It has accordingly with studied care, vested the question of war in the Legislature." As James Wilson explained to the delegates at the Pennsylvania ratifying convention: "This system will not hurry us into war; it is calculated to guard against it. It will not be in the power of a single man, or a single body of men, to involve us in such distress; for the important power of declaring war is vested in the legislature at large."

The system the Framers envisioned bears little resemblance to the one that operates today. In the post-9/11 era, war—or "kinetic military action," in the Obama administration's preferred euphemism—is no longer a temporary departure from a baseline of peace; it's a continuous and enduring feature of American governance. Two successive presidents have treated the Authorization for Use of Military Force (AUMF) that the 107th Congress passed three days after the 9/11 attacks as a wholesale delegation of congressional war powers—a writ for war without temporal or geographic limits. Under the AUMF, Obama has launched eight times as many drone strikes as Bush; and the Pentagon envisions a war on terror that will go on "at least 10 or 20 years more." This system will not hurry us into peace.

Madison famously warned that "No nation could preserve its freedom in the midst of continual warfare." In the 21st century, "continual warfare" is fast becoming the post-constitutional norm.

Our latest war in the Middle East began last August 7 with airstrikes on positions held by the Sunni radical group known alternatively as the Islamic State of Iraq and Syria (ISIS), the Islamic State of Iraq and the Levant (ISIL), or, lately, "Daesh." In mid-October, two months into the bombing campaign, the Pentagon finally settled on a name for the war: "Operation Inherent Resolve." Finally, on November 5, the president announced, "I will begin engaging Congress over a new authorization for military force against ISIL," even while his administration insisted he had all the authority he needed under past resolutions passed by prior Congresses for wars against different enemies.

Four months and some 1,200 airstrikes after the start of the war against ISIS, we finally got something resembling a congressional debate. As the 113th Congress drew to a close, the Senate Foreign Relations Committee (SFRC) held a hearing on authorizing the use of force against ISIS. The measure the committee approved on a party-line vote on December 11 was largely symbolic; as expected, it never made it to the Senate floor.

Yet the SFRC AUMF includes several features that, if passed, could begin to right the constitutional balance and help bring an end to the "Forever War." It repeals the 2002 Iraq War AUMF and sunsets the 2001 AUMF—

both of which the administration has invoked as putative authorization for current operations in Iraq and Syria. It limits the use of ground forces, imposes new transparency requirements on presidential action, and rescinds the authority it grants after three years. Each of these measures is necessary, though not sufficient, to restoring congressional prerogatives over war and peace. The 114th Congress should pick up where the SFRC left off and impose additional limits on presidential authority.

REPEAL THE 2002 AUMF

In terms of war powers reform, rescinding the 2002 Iraq War authorization should be the easiest lift for the new Congress. For over a year now, the Obama administration has supported repealing the resolution the 107th Congress passed to authorize military action against the Saddam Hussein regime 12 years ago. In fact, just two weeks before the president started bombing ISIS targets in Iraq, President Obama's national security adviser told Speaker of the House John Boehner (R-OH) that "the Iraq AUMF is no longer used for any US government activity" and could safely be repealed.

That made it all the more perplexing when, a month into the war against ISIS, the administration advanced the theory that the 2002 Iraq War Resolution had enough life left in it to support a new war in Iraq—and Syria—against a different enemy more than a decade later. In a written statement to the *New York Times* on September 12, an unnamed "senior administration official" claimed that "the 2002 Iraq AUMF would serve as an alternative statutory authority basis on which the president may rely for military action in Iraq." "Even so," he continued, "our position on the 2002 AUMF hasn't changed and we'd like to see it repealed."

One might have hoped for greater clarity from an administration whose chief executive is so fond of the phrase "let me be clear." Still, in his December testimony before the Senate Foreign Relations Committee, Secretary of State John Kerry reaffirmed the administration's support for retiring the Iraq War Resolution. The 114th Congress should take them at their word, and repeal the 2002 AUMF, making it clear that any authority it granted expired with the end of the Iraq War.

SUNSET THE 2001 AUMF

The near-boundless authority the executive branch claims under the 2001 AUMF represents a far greater obstacle to restoring congressional control of the war power. Two successive administrations have turned a measure aimed at punishing and neutralizing al Qaeda into a blank check for permanent war.

The operative clause of the 2001 AUMF empowers the president to use "all necessary and appropriate force against those nations, organizations, or persons [who] planned, authorized, committed, or aided" the 9/11 attacks and those who "harbored" the perpetrators. It's proven to be an impressively stretchable sentence that, in the Obama administration's view, can be used to justify everything from "boots on the ground in the Congo" to drones over Timbuktu. But there's broad consensus among national security law scholars that it won't stretch far enough to provide legal cover for war against ISIS, a group that has been publicly denounced and excommunicated by al Qaeda leadership.

The problems with the 2001 AUMF go beyond the current conflict with ISIS, however. The AUMF has now been in effect over twice as long as the Gulf of Tonkin Resolution authorizing Vietnam, "America's Longest War"—up until the 21st century, at least. Thirteen years on, the executive branch continues to rely on an expansive interpretation of the AUMF's language to target so-called "associated forces" of al Qaeda, including groups that didn't exist on 9/11 and whose connections with "core" al Qaeda are ever more tenuous.

"A declaration of armed conflict against a long and/or open-ended list of emerging terrorist groups undermines the important distinction between war and peace," law pro-

fessors Jennifer Daskal and Stephen Vladeck warned in the *Harvard National Security Journal* last year: "Such an approach would change the default from peace to war." At this point, it seems appropriate to drop the conditional—we're already there.

Restoring the constitutional "default setting" will require sunsetting the 2001 AUMF. The SFRC AUMF includes a three-year sunset; an earlier resolution sponsored by Sen. Rand Paul (R-KY) would repeal the 2001 AUMF a year after passage. The longer time limit would leave the debate over what, if anything, should replace it to the 115th Congress and a new president; a shorter limit might put that debate in the middle of a presidential election year. Some analysts have objected to a shorter limit on that basis; still, perhaps there's something to be said for forcing presidential contenders to take a position on the most important issue Congress and the president can debate.

DEBATE AN ISIS AUMF

After half a year of unauthorized bombing in Syria and Iraq, attempting to limit executive authority in a new, ISIS-specific AUMF might seem like an exercise in futility: shutting the kennel gate after the president's already let slip the dogs of war. Still, it seems unlikely that repealing the 2002 AUMF and sunsetting the 2001 AUMF will be possible outside of a package deal retroactively authorizing the war that the president's been waging without Congress. A post hoc authorization of "Operation Inherent Resolve" may be a necessary precondition for war powers reform.

But if we know anything from the history of past AUMFs, it's that presidents will push the authority they're given as far as language will allow—and possibly further. Our last two presidents have warped the post-9/11 AUMF beyond recognition, using it to justify secret surveillance programs; military imprisonment, without charges, of American citizens on American soil; drone strikes against American citizens abroad; and other actions never contemplated by Congress. Any new authorization must be carefully crafted to reduce the potential for presidential abuse.

For example, the Senate Foreign Relations Committee's AUMF includes restrictions on the use of ground forces, except in certain circumstances such as protection or rescue operations, intelligence collection, and aiding targeted airstrikes. But, until it sunsets, the 2001 AUMF remains in effect. Unless an ISIS-specific AUMF clearly repudiates the president's expansive interpretation of the earlier resolution, he'll be able to do an end-run around any new restrictions by claiming his actions are being carried out under authority granted by the 2001 AUMF. The SFRC language—"the provisions of this joint resolution . . . shall supersede any preceding authorization" doesn't foreclose that possibility as clearly as the language in Senator Paul's draft AUMF, which says that the 2001 AUMF "does not provide any authority for the use of military force against the organization referring to itself as the Islamic State."

Worse, by including a fairly broad "associated forces" provision, the SFRC AUMF opens the door to the sort of endless target-list proliferation we've seen under the 2001 AUMF. In his testimony to the SFRC, when asked how the AUMF should treat groups that have pledged allegiance to ISIS, including "groups in Algeria, Libya, Egypt, Yemen, and Saudi Arabia," Secretary Kerry replied: "they should be associated forces. They fit into that category." The danger of "mission creep" could hardly be plainer. To foreclose that possibility, the 114th Congress should, at a minimum, tighten the "associated forces" language and restrict combat operations to Iraq and Syria.

The SFRC AUMF imposes much-needed transparency requirements on presidential action against ISIS, requiring the president to provide "a list of the organizations and entities targeted by military operations." Yet it does not extend those requirements to ongoing operations under the 2001 AUMF. As law professors Jack Goldsmith, Ryan Goodman, and Steve Vladeck have argued: "Any new AUMF

should require the president to identify the groups against which force is used, along with related details, regularly in a report to Congress. . . . Such transparency rules should also be imposed on the 2001 AUMF if it is not incorporated into the new one."

That requirement is vital because, astoundingly, the self-styled "most transparent administration in history" refuses to publicly identify who, exactly, we are at war with. In a Senate Foreign Relations Committee hearing in May 2014, the Pentagon's general counsel wouldn't name the groups the administration claims the power to target: "groups that we've not identified as groups we are currently operating against, the intelligence and applications of the standards under the AUMF is not something that we are prepared to discuss in an open session." In the administration's view, Congress shouldn't publicly debate where and with whom we go to war—and the American people don't need to know.

This is not how a democratic republic is supposed to approach the question of war or peace. Yet that's where we are—and where we'll remain, unless and until the 114th Congress begins to reclaim the most important responsibility entrusted to it under our Constitution.

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Prepared by Gene Healy

CHAPTER 5

ENDING LEGALIZED PIRACY
Civil Asset Forfeiture Reform

Congress should

- amend the Civil Asset Forfeiture Reform Act to require, in most cases, that a criminal conviction be obtained before assets may be forfeited to the government;
- prohibit federal agencies from "adopting" state or local asset forfeiture cases and engaging in the "equitable sharing" of any forfeited property in such cases;
- require that forfeited property be assigned to the federal treasury rather than to the agencies executing the forfeiture;
- short of those reforms, adopt stronger nexus and proportionality requirements for asset forfeitures and require proof by a clear and convincing standard; and
- require the government to have the burden of proof in establishing that someone is not an "innocent owner."

American asset forfeiture law has two branches. One, *criminal* asset forfeiture, is usually fairly straightforward, whether it concerns contraband, which as such may be seized and forfeited to the government, or ill-gotten gain and instrumentalities. Pursuant to a criminal conviction, any proceeds or instrumentalities of the crime are subject to seizure and forfeiture. Courts may have to weigh the scope of "proceeds" or "instrumentalities." Or they may have to limit statutes that provide for excessive forfeitures. But forfeiture follows conviction, with the usual procedural safeguards of the criminal law.

Not so with *civil* asset forfeiture, where most of the abuses today occur. Here, law enforcement officials often simply seize property for forfeiture on mere suspicion of a crime, leaving it to the owner to try to prove the *property's* "innocence," where that is allowed. Unlike in personam *criminal* actions, *civil* forfeiture actions, if they are even brought, are in rem—brought against "the thing" on the theory that it "facilitated" a crime and thus is "guilty."

In Volusia County, Florida, police stop motorists going south on I-95 and seize any cash they're carrying in excess of $100 on suspicion that it's money to buy drugs. New York City police make DUI arrests and then seize drivers' cars. District of Columbia police seize a grandmother's home after her grandson comes from next door and makes a call from the home to consummate a drug deal. Officials seize a home used for prostitution and the previous owner, who took back a second mortgage when he sold the home, loses the mortgage. In each case, the property is seized for forfeiture to the government not because the owner has been found guilty of a crime but because it is said to "facilitate" a crime, whether or not a crime was ever proven or a prosecution even begun. And if the owner does want to try to get his property back, the cost of litigation, to say nothing of the threat of an in personam criminal prosecution, often puts an end to that.

Behind all of this are perverse incentives since the police themselves or other law enforcement agencies usually keep the forfeited property—an arrangement rationalized as a cost-efficient way to fight crime. The incentives are thus skewed toward ever more forfeitures. Vast state and local seizures aside,

according to federal government records, Justice Department seizures alone went from $27 million in 1985 to $556 million in 1993 to nearly $4.2 billion in 2012. Since 2001 the federal government has seized $2.5 billion without either bringing a criminal action or issuing a warrant.

Grounded in the "deodand" theories of the Middle Ages when the "goring ox" was subject to forfeiture because "guilty," this practice first arose in America in admiralty law. Thus, if a ship owner abroad and hence beyond the reach of an in personam action failed to pay duties on goods he shipped to America, officials seized the goods through in rem actions. But except for such uses, forfeiture was fairly rare until Prohibition. With the war on drugs, it again came to life, although officials today use forfeiture well beyond the drug war. And as revenue from forfeitures has increased, the practice has become a veritable addiction for federal, state, and local officials across the country, despite periodic exposés in the media.

There will be some cases, of course, in which the use of civil asset forfeiture might be justified simply on the facts, as in the admiralty case just noted. Or perhaps a drug dealer, knowing his guilt but knowing also that the state's evidence is inconclusive, will agree to forfeit cash that police have seized, thereby to avoid prosecution and possible conviction. That outcome is simply a bow to the uncertainties of prosecution, as with any ordinary plea bargain. But the rationale for the forfeiture in such a case is not facilitation—it's alleged ill-gotten gain. By contrast, when police or prosecutors, for acquisitive reasons, use the same tactics with *innocent* owners who insist on their innocence—"Abandon your property or we'll prosecute you," at which point the costs and risks surrounding prosecution surface—it's the facilitation doctrine they're employing to justify putting the innocent owner to such a choice. In such cases, the doctrine is pernicious: it's simply a ruse—a fiction—serving to coerce acquiescence.

Because it lends itself to such abuse, therefore, the facilitation doctrine should be unavailable to any law enforcement agency once an owner challenges a seizure of his property. And once he does, the government should bear the burden of showing not that the *property* is guilty but that the *owner* is and, therefore, his property may be subject to forfeiture if it constitutes ill-gotten gain or was an instrumentality of the crime, narrowly construed (e.g., burglary tools, but not cars in DUI arrests or houses from which drug calls were made). In other words, once an owner challenges a seizure, *criminal* forfeiture procedures should be required. Indeed, "civil" asset forfeiture, arising from an allegation that there was a *crime*, is essentially an oxymoron in such cases. The government should prove the allegation, under the standard criminal law procedures, before any property is forfeited.

Many of these abuses take place today at the state level, of course, yet Congress can take steps not only to reform federal law—which often serves as a model for state law—but to affect state law as well. The Civil Asset Forfeiture Reform Act of 2000, brought to fruition by the efforts of the late Henry J. Hyde of Illinois, made several procedural reforms, but it left in place the basic substantive problem, the "facilitation" doctrine. The abuses have thus continued, so much so that two former directors of the Justice Department's civil asset forfeiture program recently wrote in the *Washington Post* that "the program began with good intentions but now, having failed in both purpose and execution, it should be abolished."

If that is not possible, Congress should make fundamental changes in the program. In particular, if a crime is alleged, federal law enforcement officials should have power to seize property for subsequent forfeiture under only three conditions: first, when in personam jurisdiction is not available, as in the admiralty example above; second, when, in the judgment of the officials, the evidence indicates that a successful prosecution is uncertain but there is a high probability that the property at issue is an ill-gotten gain from the alleged crime *and the target does not object to the forfeiture*, as in the drug-dealer example above; and third, when the property would be subject to forfeiture

following a successful prosecution and there is a substantial risk that it will be moved beyond the government's reach or otherwise dissipated prior to conviction—but such seizures or freezes should not preclude the availability of funds sufficient to enable the defendant to mount a proper legal defense against the charges, even though some or all of the assets may be dissipated for that purpose.

Those reforms would effectively eliminate the facilitation doctrine, except for a narrow reading of "instrumentalities" and would largely replace civil forfeiture proceedings with criminal proceedings. But the doctrine may continue to be employed by state and local officials. Because of that, and from respect for federalism more broadly, Congress should prohibit the practice of "adoption" or "equitable sharing" whereby federal agencies adopt cases brought to them by state and local enforcement agencies, then share the forfeited assets with those agencies. The usual motive is to circumvent state restrictions aimed at stopping abuses by requiring, for example, that forfeited assets be directed to state education departments rather than kept by the state or local law enforcement agencies. Thus, here again, forfeiture's perverse incentives drive this practice while undermining state autonomy in the process.

Consistent with that reform, Congress should put an end to the underlying incentive structure by requiring that forfeited assets be assigned to the federal treasury rather than to the enforcement agencies—which should not be allowed, in effect, "to police for profit." In 2013 the federal Asset Forfeiture Fund exceeded $2 billion, having more than doubled since 2008 and increased twentyfold since it was created in 1986. Not coincidentally, the growth in civil asset forfeiture closely parallels the ability of law enforcement agencies to profit from their activities. In fact, a veritable cottage industry has arisen that instructs officers how to stretch their legal authority to the absolute limit and beyond. It's a system that more resembles piracy than law enforcement.

At the least, if the reforms above are not made, Congress should require the government to show, if challenged, that the property subject to forfeiture had a significant and direct connection to the alleged underlying crime, not simply that it was somehow "involved" in the crime, as now. And the standard of proof should be raised from a mere preponderance of the evidence, again as now, to clear and convincing evidence. Similarly, a proportionality requirement should be imposed to ensure that the government does not seize property out of proportion to the offense. Congress should require officials to consider the seriousness of the offense, the hardship to the owner, the value of the property, and the extent of a nexus to criminal activity. If a son living in his parents' home is convicted of selling $40 worth of heroin and officials try to take the home, as recently happened in Philadelphia, a proportionality requirement ensures that prosecutors cannot take a home for a $40 crime.

Finally, assuming that the facilitation doctrine is not eliminated, current law affords an innocent owner defense, but the burden is on the owner to prove his innocence by a preponderance of the evidence. Just as people enjoy the presumption of innocence in a criminal trial, property owners never convicted or even charged with a crime should not be presumed guilty in civil asset forfeiture proceedings. The burden of proof should be on the government to prove, by clear and convincing evidence, that the owner knew or reasonably should have known that the property facilitated a crime and he did nothing to mitigate the situation or that the property reflected the proceeds of a crime.

The Civil Asset Forfeiture Reform Act of 2000 has proven inadequate for curbing abuses as countless Americans across the nation, having done nothing wrong, continue to lose their homes, businesses, and, sometimes, their very lives to the aggressive, acquisitive policing that this law encourages. There is broad agreement today that Congress should act quickly and decisively to fix a system that is badly in need of reform.

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Prepared by Roger Pilon and Trevor Burrus

CHAPTER 6

STOPPING POLICE MILITARIZATION
Reforming the 1033 Program

Congress should

- stop transfers to local law enforcement agencies (LEAs) of any military equipment listed on either the Department of State Munitions Control List or the Department of Commerce Control List, so-called "controlled property";
- repossess from LEAs all currently distributed controlled property;
- ensure that any distributed controlled property is subject to extensive reporting requirements and randomized audits (noncompliant departments should have their property repossessed);
- mandate that the use of controlled property against misdemeanors or "Part II index crimes" (as described in the Uniform Crime Reports)—that is, nonviolent, less-serious crimes, including drug use and possession—requires a secondary report listing the articulable reasons for believing the specific situation posed a particular threat. Drug possession, cultivation, and distribution should not be presumed to constitute dangerous situations; and
- require LEAs with a track record of using extreme force against Part II index crimes, including and especially drug possession and use, to be subject to further investigation, discipline, and controlled property repossession.

Started in 1990 (as the 1208 program), the 1033 program authorizes the Department of Defense to transfer to LEAs property that is "excess to the needs of the Department." In 1990 the department transferred $1 million worth of gear; in 2013 it was $450 million.

The bulk of the gear is not dangerous—including office furniture, computers, and personal protective equipment. But the program also transfers high-powered military gear—so-called "controlled property"—that has few justified uses in domestic law enforcement. Congress must primarily focus on ending the profligate transfer of such excessive military gear. If controlled property is to be transferred, however, Congress should ensure that LEAs use it rarely and responsibly.

Controlled property includes such things as armored vehicles and troop carriers, high-caliber firearms, and grenade launchers. While such items can improve officer safety—officers who approach a crime scene in an armored carrier are marginally safer than those using other modes of transportation—it is now clear that the costs have outweighed the benefits. During a period of rapidly declining violent crime, the number of violent Special Weapons and Tactics (SWAT) raids has skyrocketed.

In 1980, when the violent crime rate was approximately 40 percent higher than it is now, there was an average of three SWAT raids per day; now there are about 120. Shockingly, the vast majority of those SWAT raids are merely to execute search warrants, 60 percent of the time for drugs. According to the American Civil Liberties Union (ACLU), only 7 percent of SWAT deployments were for hostage situations or barricaded shooters, the original purpose for creating SWAT teams. In short, each day local police are violently raiding homes ap-

proximately 120 times, mostly for nonviolent offenses. In the process, they destroy property, often kill pets, sometimes injure or kill innocent people, and generally create an unhealthy atmosphere of fear and distrust.

These raids occur because federal transfers have given LEAs the necessary equipment and because there is little to no accountability for misusing that equipment. Ending police abuse of controlled property will require seemingly drastic steps to ensure that LEAs do not persist in believing "if we have it, we might as well use it." A federal fix to this problem must focus on both stopping the transfer of controlled property and repossessing the property already distributed.

There are currently over 600 Mine-Resistant Ambush Protected vehicles (MRAPs) in the hands of LEAs, as well as hundreds of grenade launchers and tens of thousands of high-powered assault rifles. Overall, there are approximately 460,000 pieces of controlled property in the hands of local law enforcement. No serious attempt at reforming police militarization can commence until this gear is removed from their possession and its distribution is reassessed. Watertown, Connecticut (pop. 22,514), does not need a MRAP, nor does Bloomington, Georgia (pop. 2,713), need four grenade launchers.

If Congress decides to continue distributing controlled property and to leave distributed property in the possession of LEAs, however, Congress must ensure that it is used responsibly and justifiably. After all, a rarely used armored troop carrier gathering dust in a police department parking lot should be seen as a good thing—it speaks to a safe and well-policed community. Rather than adopt a "if we have it, we might as well use it" attitude, LEAs should be encouraged to have a "we have it, and I hope we never use it" philosophy.

By requiring extensive reporting on the use of distributed controlled property, Congress can help ensure that SWAT teams are used rarely and only in exceptional circumstances. Reporting requirements should include when the equipment was used, which suspected crimes or crowd-control situations it was used against, whether shots were fired, whether suspects allegedly brandished a weapon, whether any person or animal was killed or injured in the process, whether forced entry was used, whether a warrant was served under either no-knock or knock-and-announce circumstances, whether any children or elderly were on the premises, whether the possible presence of children or the elderly was investigated, and a copy of the warrant (if used) explaining the probable cause for the action. Moreover, audits of LEA compliance should be periodically and randomly carried out. Noncompliant LEAs should be immediately stripped of their property.

Finally, using SWAT teams to address nonviolent crimes, such as drug use, possession, and distribution, should be strongly discouraged. Nonviolent crimes—generally described as "Part II index crimes" in the FBI's Uniform Crime Reports—almost never deserve a violent response. Exceptional circumstances, such as a suspected drug producer with an arsenal and a history of violent crime, might justify a militarized response, but such a justification should never be presumed. LEAs should be required to report specific and particularized facts that require the use of controlled property to address a nonviolent crime. Consistent violation of these requirements should result in investigation, discipline, and property repossession.

America's police forces have become too militarized, and it will take strong and unapologetic action from Congress to fix the problem.

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Prepared by Trevor Burrus

CHAPTER 7

THE FUTURE OF THE EXPORT-IMPORT BANK

Congress should

- allow the Export-Import Bank of the United States to expire by not reauthorizing its charter.

BACKGROUND

The ostensible purpose of the Export-Import Bank is to support American jobs by facilitating the export of U.S. goods and services to international markets. Between 2007 and 2013 Ex-Im authorized 24,366 transactions valued at $167.8 billion, or about $24 billion per year and $6.9 million per transaction. Those authorizations consisted of direct loans (to foreign buyers), loan guarantees (to primary financiers), working capital (to build capacity to export), and insurance against default. Manufactured exports accounted for $107.1 billion and 14,101 transactions or about $15 billion per year and $7.6 million per transaction. Aircraft accounted for nearly $57 billion of the manufacturing total (more than half), which was spread over 722 authorizations or about $80 million per transaction. Producers in all 21 broad manufacturing industries (defined at the 3-digit level of the NAICS) received subsidies. Producers in 225 of 236 manufacturing sub-industries (6-digit NAICS) received subsidies. However, approximately 75 percent of the value of all transactions was for the benefit of just 10 large companies.

ANALYSIS

Ex-Im and its supporters deploy a simple but misleading logic: Ex-Im creates exports, and exports create growth and jobs, thus shuttering the bank will hurt the economy. But there is more to the story. Ex-Im facilitates exports for some businesses, but at great cost to unsuspecting companies throughout the economy and across the 50 states.

Ex-Im's claim that it provides benefits to the U.S. economy by way of increased exports and the jobs those exports support implies that the exports in question would not have occurred without Ex-Im. However, it is not clear in these cases that financing could not have been found elsewhere. What touts itself as a lender of last resort is frequently the first place certain companies look for their export financing. Moreover, the claim implies that Ex-Im financed transactions don't crowd out other exports— those of unsubsidized companies—and result in net export growth of zero.

Ex-Im contends that the bank fills a void left by private sector lenders unwilling to finance riskier transactions and, by doing so, contributes importantly to U.S. export and job growth conflicts with some of its other claims. The objectives of filling gaps in trade financing passed over by the private sector and expecting a reasonable assurance of repayment are mutually exclusive—unless the threshold for "reasonable assurance" is more risk-permissive than the private sector's most risk-permissive financing entities. Therefore, Ex-Im is either putting taxpayer resources at risk or it is competing directly with private-sector lenders. If the latter, then, as it seeks to create the proverbial "level playing field" for the U.S. companies whose customers it finances, Ex-Im is un-leveling the playing field for the finance industry, as well as for the U.S. firms in industries that compete globally with these U.S-

taxpayer-financed foreign companies. Either way, Ex-Im is assuming a portion of the cost of doing business for companies that ought to be covering their own costs.

Ex-Im's contention that it is not a burden to U.S. taxpayers because its operations generate profits for the Treasury is disingenuous. That Ex-Im is currently self-financing and generating profits skirts the issue; it tells us that, on average, loans made in the past are being repaid. Prospectively, however, Ex-Im's profits depend on whether foreign borrowers are willing and able to service their loans, which is a function of fluid global economic conditions that might not have been properly risk assessed, given the primacy of political, rather than economic, considerations. Given the large concentration of aircraft loans in its portfolio, for example, Ex-Im is heavily exposed to the consequences of a decline in air travel. Recall that Fannie Mae and Freddie Mac also showed book profits for years until the housing market suddenly crashed and taxpayers were left holding the bag.

The claim that Ex-Im helps "level the playing field" for U.S. companies competing abroad with foreign companies backed by their own governments' generous export financing programs portrays the United States as a hapless follower, caught in a sweeping whirlwind of global subsidization, with no options but to ramp up subsidies like everyone else. Realistically, the United States is a major instigator in this global subsidy war and has the capacity to end the madness by disavowing export subsidies and then watching the rest of the world follow voluntarily or under the added pressure of a formal World Trade Organization complaint. Moreover, the notion that Beijing, Brasilia, and Brussels subsidize their exporters so that Washington must, too, is a rationalization that discounts the fact that there are dozens of criteria that inform the ultimate purchasing decision, including product quality, price, producer's reputation, local investment and employment opportunities created by the sale, warranties, after-market servicing, and the extent to which the transaction contributes toward building a long-term relationship between buyer and seller. U.S. companies have some profound advantages with respect to many of these factors.

Ex-Im supporters speak only of the Bank's benefits, as though there were no costs. But there are three distinct sets of costs imposed on the economy by Ex-Im's operations. First, there are opportunity costs, representing the growth that would have occurred had Ex-Im's resources been deployed optimally—or at least more efficiently—in the private sector. Though difficult to measure, it is a good bet that when government agencies make financing decisions based upon non-economic criteria, resources are not being used optimally.

Second are the intra-industry costs—the relative disadvantages imposed on direct competitors as a result of export subsidies flowing to a particular firm in the industry. If Ex-Im provides a $50 million loan to a foreign farm-equipment manufacturer to purchase steel from U.S. Steel Corporation, the transaction may benefit U.S. Steel, but it hurts firms like Nucor and the dozens of other domestic steel producers competing for the same customers at home and abroad. The $50 million "benefit" for U.S. Steel is a $50 million cost to the other steel firms. When government tilts the playing field in favor of a particular firm, it simultaneously penalizes the other firms in the industry and changes the competitive dynamics prospectively.

Third, the downstream industry costs are those borne by U.S. producers who compete with the subsidized foreign customer or who merely require the subsidized export for their own production. Ex-Im diverts domestic supply, possibly causing domestic prices to rise, and rendering U.S. customers less important to their U.S. suppliers. This is especially likely in industries with few producers and limited substitute products.

Consider an Ex-Im subsidy to a U.S. supplier who sells to both U.S. and foreign customers. Those customers compete in the same downstream industries in the U.S. and foreign markets. The U.S. supplier is thrilled

that Ex-Im is providing his foreign customer with cheap credit, because it spares him from having to offer a lower price or from sweetening the deal in some other way to win the business. The foreign customer is happy to accept the advantageous financing for a variety of reasons, including that his capital costs are now lower relative to what they would have been and relative to the costs of his competitors.

Delta Airlines has been vocal in its objection to Ex Im–financed sales of Boeing jetliners to foreign carriers such as Air India. Delta rightly complains that the U.S. government, as a matter of policy, is subsidizing Delta's foreign competition by reducing Air India's cost of capital. That cost reduction enables Air India to offer lower prices in its bid to compete for passengers, which has a direct impact on Delta's bottom line. This is a legitimate concern not limited to this example.

According to a recent Cato Institute study, these downstream costs exceeded the benefits of Ex-Im subsidies for 189 of 236 manufacturing industries by an aggregate total of $2.8 billion per year between 2007 and 2013. The five industries incurring the largest net costs were producers of electrical equipment, appliances, and components; furniture; food; non-metallic mineral products; and chemicals. Collectively, these industries account for 50 percent or more of manufacturing gross domestic product in seven U.S. states, and the top 10 industry victims account for at least two-thirds of manufacturing GDP in 22 states.

CONCLUSION

Ex-Im financing helps two sets of companies (in the short run): U.S. firms whose export prices are subsidized by below-market-rate financing and the foreign firms who purchase those subsidized exports. However, those same transactions impose costs on two different sets of companies: competing U.S. firms in the same industry who do not get Ex-Im backing and U.S. firms in downstream industries whose foreign competition is now benefitting from reduced capital costs courtesy of U.S. government subsidies.

Allowing the Export-Import Bank to expire will help reduce these unfair cost impositions and encourage more companies to abide economic—rather than political—signals, which is more likely to spur innovation, growth, and job creation.

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Prepared by Dan Ikenson

CHAPTER 8
CORPORATE TAX REFORM

Congress should

- cut the federal corporate income tax rate from 35 percent to 25 percent, and
- cut the rate further to 15 percent and offset the revenue loss with spending cuts.

Policymakers in both parties say that they favor corporate tax reform and cuts to the corporate tax rate. With Republican majorities in Congress and new leadership on the House and Senate tax committees, now is a good time to take a fresh crack at reform.

Corporate tax reform is important because corporate investment is a major driver of investment and innovation in the U.S. economy. High corporate tax rates reduce the incentive to build new factories and buy new business equipment. If investment is suppressed, economic growth will slow, fewer jobs will be created, and wages will stagnate.

Globalization has increased the power of corporate taxes to drive investment. As industries have become more mobile, international competition to attract investment has increased. Unfortunately, America has been sitting on its hands while other nations have slashed their tax rates. America has the highest general corporate tax rate in the world at 40 percent, which includes the federal rate plus the average state rate. The average global rate is now just 24 percent, according to KPMG.

A large body of academic research confirms that corporate investments and reported profits are sensitive to differences in international tax rates. And frequent news stories highlight the movement of investment and profits to lower-tax countries such as Ireland. By retaining a high tax rate, America is shooting itself in the foot. U.S. businesses and workers lose, but so does the government, because the corporate tax base is being eroded by our high rate.

These issues are highlighted by the trend toward inversions, which occur when U.S. companies merge into foreign parent companies. Inversions are designed not only to reduce the harm of our high corporate tax rate, but also to avoid the punitive U.S. treatment of corporate foreign earnings. While we tax the global profits of U.S. companies, most countries have territorial tax systems that tax their firms' domestic profits but do not tax foreign active business income. Suppose that a U.S. company is competing in the Chinese market against a firm based in Britain. Britain has a 21 percent corporate tax rate and a territorial system, so the U.S. company will be at a disadvantage and may lose sales.

That is important for the U.S. economy because domestic jobs depend on U.S. corporations succeeding in foreign markets. As U.S. firms expand abroad, they tend to boost exports from their U.S. operations, and they tend to employ more high-paid people in headquarters-related activities, such as management, marketing, and research. By adopting a territorial tax system and a lower tax rate, policymakers would make the United States a better place for corporations to locate their headquarters, to build factories, and to hire high-skilled workers.

All this points to the need for Congress to slash the corporate tax rate. The first step should be a simple rate cut from 35 to 25 percent. That step would probably not lose the federal government any revenue over the long run, as discussed below. The second step

should be to cut the rate further to 15 percent. This second step should be matched with reductions to unjustified tax breaks and with spending cuts.

THE PROBLEM WITH REVENUE-NEUTRAL REFORM

President Obama and members of Congress agree that the U.S. corporate tax rate should be cut. However, reform has been stalled by the idea that legislation should be "revenue neutral" on a static basis, meaning that the growth benefits of reform should not be taken into account. Thus, a rate cut must be matched by legislated changes to broaden the tax base, such as by reducing various deductions and credits.

The problem is that policymakers never find any tax breaks to reduce that they can agree on. Most ideas for base broadening cause corporations to line up against reform. Furthermore, some of the proposed ways to broaden the tax base—such as reducing depreciation deductions—are bad policy. So legislated base broadening is a dead-end approach that is blocking a needed rate cut.

The good news is that the corporate tax base will broaden automatically as the rate is cut. Because the corporate tax base is so responsive in the modern economy, reductions in the rate will generate substantially higher investment and larger reported profits over time. Statistical studies have found that the government would raise as much at a 25 percent corporate rate as it currently raises at 35 percent. Cutting the tax rate would reduce tax avoidance and evasion, while generating greater corporate investment and economic growth. The added growth would boost all forms of federal tax receipts.

Evidence on these dynamic effects of corporate tax cuts come from Canada. Canada cut its federal corporate tax rate from 28 percent in the 1990s to just 15 percent today. Remarkably, there has been no obvious loss in corporate tax revenues as a share of gross domestic product. The government raised 1.7 percent of GDP, on average, from the corporate tax during the 1990s, and it raises 1.9 percent today. Businesses apparently responded to the lower rate by shifting more reported profits into Canada and boosting domestic investment.

The U.S. federal government collected 1.8 percent of GDP in corporate taxes in 2014. Thus Canada generates the same amount of revenue with a 15 percent rate as we do with a rate more than twice as high at 35 percent. Clearly, our high tax rate is scaring away investment and reported profits. If we cut the rate, businesses, the economy, and the government would all gain.

The Canadian experience is not unique. In a Cato Institute study, Chris Edwards looked at a sample of 19 high-income industrial countries. He found that corporate tax revenues rose from about 2.5 percent of GDP in the 1980s to about 3.0 percent today for these countries, even though the average corporate rate fell from more than 40 percent to just 25 percent during that period. This is evidence that a lower tax rate in the United States would generate higher tax revenues.

So in the near term, policymakers should not worry about changing deductions, credits, and other narrow tax breaks. Those tax base items are a policy quagmire. The first reform step should be to simply slash the federal corporate tax rate to 25 percent. That would move the U.S. economy to a higher growth path and create broad economic benefits. The many breaks in the corporate tax base that create distortions ought to be eventually repealed, but in the short run the distortionary effects of such breaks would be reduced as the rate fell.

A second round of reforms should tackle unjustified tax breaks. Those breaks would be easier to repeal once the rate was lower because they would be worth less to the beneficiaries. Congress should aim to cut the federal corporate rate further to 15 percent. That further rate cut should be offset by reductions to unjustified tax breaks, and also by cuts to business subsidies on the spending side of the federal budget.

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Prepared by Chris Edwards

CHAPTER 9

FAIRNESS, THE INTERNET, AND STATE TAXING POWER

Congress should

- not give states the power to impose taxes on out-of-state sales, and
- suggest that states with sales taxes reform their systems by lowering rates and eliminating preferences, including the nontaxation of goods and services sold to out-of-state consumers.

One of the liberating features of the Internet is that it gives people more options. They have more choices about what information to access and what sellers to patronize. This latter feature is disquieting news for politicians, who oftentimes like to know about—and tax—what people are buying. And it's not easy for politicians at the state level to impose high sales taxes when consumers have the freedom to go online and buy things sold in other states. Politicians do impose "use taxes," which supposedly require people to pay taxes on out-of-state purchases, but an overwhelming majority of people ignore this little-known tax, and it is very difficult to enforce the levy.

As a result, politicians are fearful that online shopping deprives them of revenue. To address this supposed problem, they are pushing for legislation—the Marketplace Fairness Act (MFA)—that would create privacy-threatening databases so that state and local governments would be able to track and tax these transactions.

Unsurprisingly, they don't justify the MFA by asserting they want more money to spend. Instead, they argue that the tax is needed for fairness. More specifically, they claim it is unfair if Internet sales escape taxation while other purchases are hit. As such, they say the goal is to create a level playing field between online sellers and "brick-and-mortar" merchants.

To be sure, it is good policy for all economic activity in a state to be taxed at the same (ideally low) rate. Indeed, one of the attractive features of the flat tax is that it would apply this rule to the entire nation. Simply stated, there should not be special favors or special penalties in the tax code.

But this issue isn't about whether Internet sales should be taxed. Instead, the fight is really about whether a state government has the right to force out-of-state merchants to act as deputy tax collectors. If you believe that borders should limit the power of governments, the answer is no.

Here's an example to show why governments should be constrained by borders. Let's assume you live in Utah, Hawaii, or South Carolina, and you go to Nevada for a vacation. While in Las Vegas, you spend some money in the casinos. Gambling is illegal in the state where you live, so should the cops in your home state be able to track your activities and arrest you for what happened in Nevada? Or should Nevada casinos be forced to create a database and inform other states if any of their residents dropped by on a visit to Las Vegas? The answer, needless to say, is no. Common sense tells us that state laws should only apply to things that happen inside a state's borders. But this sensible principle would be tossed out the window if Congress approved a proposal that would give states the ability to impose their taxes on out-of-state sellers.

This legislation also has very troubling implications for privacy. It can only work by

requiring companies and software providers to set up massive databases that match online purchases with the state and local sales tax rates for every consumer. Yet it's unlikely that this untested system will be secure. We've already seen major leaks of confidential data from both government and private companies. This database will be a magnet for identity thieves and other hackers looking for credit card information.

Let's return to the issue of a level playing field. The real problem is that governors and state legislators want a "destination-based" sales tax system, which means that the tax is levied where a consumer lives. That system, if enforced by the MFA, would address an inequity, albeit in a way that undermines tax competition and extends state government powers.

But there's an alternative approach, known as an "origin-based" sales tax system, which is based on the simpler concept of taxes being imposed on sellers. This approach limits the power of government and allows for tax competition. The supposed drawback of this approach is that many states don't bother imposing any tax on sales to out-of-state consumers.

In other words, there isn't a level playing field, but only because state governments have created exemptions. And the exemption for out-of-state sales is just the tip of the iceberg. The 45 states that impose sales taxes have created thousands of special rules that give preferences to various product and sectors. For them to complain about declining sales-tax bases is sort of like the old joke about the guy who murders his parents and then asks the court for mercy because he's an orphan.

There are two major Internet-related tax issues that attract congressional attention. The relatively noncontroversial issue is the Internet Tax Freedom Act, which prohibits taxes on Internet access or taxes on Internet use (bandwidth taxes, email taxes, etc.). There's also the issue of how to tax goods and services sold online, and this is the topic that generates considerable controversy.

But complaints by state and local government officials, or by brick-and-mortar merchants, are not a good reason for Washington to impose a set of rules that have so many drawbacks.

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Prepared by Daniel J. Mitchell

CHAPTER 10
TRADE PROMOTION AUTHORITY

Congress should

- grant Trade Promotion Authority (TPA) to the executive branch for a period of four years with the possibility of extending its term, through a supplemental vote, for another three or four years;
- Articulate congressional trade policy objectives, specific parameters, and other conditions that it expects the executive branch to meet in order for trade agreements to receive fast-track treatment;
- refrain from granting any blanket exclusions of domestic products, services, or industries, from the liberalizing terms of any trade agreements;
- refrain from including any language requiring sanctions to be imposed on trade partners considered to be engaging in "currency manipulation"; and
- refrain from conditioning passage of TPA on passage of Trade Adjustment Assistance legislation.

Free markets are essential to our prosperity. Expanding free markets enhances that prosperity. By widening the circle of people with whom we can transact under the same rules to include those living in other countries, trade benefits consumers through lower prices, greater variety, and better quality, and it allows companies to realize the gains from innovation, specialization, and economies of scale that larger markets afford. Study after study has shown that countries that are more open to the global economy grow faster and achieve higher incomes than those that are relatively closed. Moreover, any condition short of free trade unjustly impairs our freedom.

U.S. trade barriers are regressive taxes that raise the cost of living for American consumers and the cost of production for tens of thousands of businesses. In our globalized economy, nearly 60 percent of the value of U.S. imports consists of intermediate goods and capital equipment—the purchases of U.S. value- and job-creating businesses. The real benefits of trade are the imports we obtain, not the exports we give up, and those benefits are measured by the value of imports that can be purchased for a given unit of exports—the more, the better. Domestic barriers worsen those terms of trade. Removing those barriers is imperative regardless of whether other governments remove their own barriers.

Although it is in our interest to achieve this state of openness unilaterally—without regard to what other countries do—reciprocal trade agreements are today the most politically practicable approach to trade liberalization. They also provide mechanisms to discourage protectionist backsliding, while facilitating economic and political reform at home and abroad. With the Trans-Pacific Partnership (TPP) negotiations reported to be nearing completion and the Transatlantic Trade and Investment Partnership (TTIP) talks expected to kick into higher gear in 2015, Congress should prioritize crafting and passing legislation to grant Trade Promotion Authority (TPA) to the president.

TPA allows the executive branch to negotiate trade deals with foreign governments on the basis of guidance from Congress, to be ap-

proved or not, under expedited legislative procedures, by a subsequent up-or-down congressional vote on legislation to implement the agreement after it has been completed. That congressional guidance includes articulation of congressional trade policy objectives, specific parameters, and other conditions that it expects the executive branch to meet in order for trade agreements to receive the fast-track treatment of guaranteed, timely, up-or-down votes in both chambers without scope for amendments or filibusters.

Though technically not necessary to begin or conclude trade negotiations, TPA is a pragmatic solution to both mechanical and constitutional conundrums. Absent a grant of TPA, the executive branch would have difficulty concluding any negotiations because foreign governments would be unlikely to put their best offers on the table under the cloud of uncertainty that the agreement wouldn't be unraveled by what could be, effectively, 535 trade negotiators in Congress. Put another way, TPA gives the president additional negotiating leverage by assuring trade partners that any agreement reached is final.

Meanwhile, under the U.S. Constitution, Congress has the express authority to regulate international trade. Article I, Section 8, gives Congress the power to "regulate Commerce with foreign Nations" and to "lay and collect Taxes, Duties, Imposts, and Excises." While the executive is given no specific constitutional authority over trade, Article II grants the executive exclusive authority to negotiate treaties and international agreements. Accordingly, the formulation, negotiation, and implementation of trade agreements require the involvement and cooperation of both branches.

As testament to the importance of TPA, every U.S. president since 1974 has been granted this authority by Congress to negotiate agreements with other nations to expand trade. On July 30, 2013, President Obama requested that Congress reauthorize TPA, which lapsed on June 30, 2007. On January 9, 2014, legislation to renew TPA—the Bipartisan Congressional Trade Priorities Act of 2014—was introduced in the House and Senate. The 113th Congress did not act on this legislation, so new legislation will be required in the 114th Congress. Although support for renewal of TPA appears to be stronger in the 114th Congress, there is likely going to be considerable debate and negotiation as to the list of congressional objectives, conditions, and parameters to include.

Congress should avoid including conditions that are not germane or specific to trade or that would be a poison pill that U.S. trade partners would be unable to swallow. Specifically, Congress should not condition passage of TPA on passage of a Trade Adjustment Assistance (TAA) bill. Since its inception in 1962, TAA has failed in its stated goal of providing useful retraining and redeployment of workers who have lost jobs for trade-related reasons. While TAA is widely considered to be the price for organized labor's agreement to suspend opposition to trade agreements, the program has been referred to as a check to cover funeral expenses by Sen. Sherrod Brown. There are better ways for workers to acquire new skills, and there is no reason to treat those who have allegedly lost jobs on account of increased trade to be treated differently than those who lose jobs for other reasons.

Congress should avoid including any blanket exclusions of domestic products, services, or industries from the liberalizing terms of any trade agreements. There should be no de facto carve-outs or special exemptions granted and all domestic barriers should be on the table.

Congress also should avoid including any language requiring sanctions against trade partners who have been accused of manipulating their currency. The inclusion of such a provision could very likely kill the TPP, which explains why some interests are pushing hard to include one.

The 114th Congress, in its first session, should move swiftly to craft and pass legislation granting Trade Promotion Authority (TPA) to the executive branch for a period of four years with the possibility of extending its term, through a supplemental vote, for anoth-

er three or four years. The legislation should articulate congressional demands, but those demands should not be impossible to meet.

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Prepared by Daniel J. Ikenson

CHAPTER 11
IMMIGRATION

Congress should

- create a large guest worker visa program for lower skilled migrants in zones 1–4 occupations,
- reform the H-1B visa program for highly skilled migrant workers by eliminating the cap and by not relying on the prevailing wage methodology for approving Labor Condition Applications (LCAs),
- turn the H-2A visa for seasonal agricultural workers into a year-long visa,
- remove the numerical caps on the H-2B visa for seasonal non-agricultural workers and turn it into a year-long visa,
- turn the Department of Labor's (DOL) approval for LCAs into a veto-only power,
- expand legal immigration opportunities by deregulating and expanding the employment-based green card system, and
- restrict noncitizen access to means-tested welfare.

From 1790 to 1875 the federal immigration policy was essentially one of open borders. Any immigrant from any country could legally enter, live in, and work in the United States. During that period the only regulations related to immigration controlled who could become a citizen. However, beginning in 1875 and accelerating through the Progressive era, Congress increasingly regulated legal immigration so that by the early 1920s virtually all legal immigration from outside the Western Hemisphere was impossible. During the Great Depression and World War II, immigration was not an important issue, but after the end of hostilities a new phenomenon arose: illegal immigration.

Although immigration was increasingly regulated after 1875, very little of it was illegal because legal immigration was still relatively easy. After the United States ended the period of open immigration in the 1920s, illegal immigration did not increase very much because the Great Depression eliminated U.S. economic demand for immigrants and then World War II effectively prevented all illegal immigration from Europe and Asia. The booming post-war economy demanded laborers. Because immigration was closed off, American employers began to hire illegal immigrants who were willing to enter unlawfully. By the early 1950s there were over two million illegal immigrants in the United States, mostly from Mexico, but by 1955 their numbers had been reduced by over 90 percent. What happened?

Two new policies drastically reduced the population of illegal immigrants. The first affected the economic demand for illegal workers by expanding the supply of legal workers through deregulating the Bracero guest worker visa program for agricultural workers. The Bracero visa allowed an uncapped number of Mexicans to work temporarily in agriculture in the United States. The workers could go back and forth so long as they did not violate the terms of the visa or commit serious crimes. Mexicans could acquire the visa easily, and American farmers faced very few hurdles in hiring Braceros. As a result, farmers began to favor Braceros.

The second policy was a stepped up enforcement program. Because of the creation of

the Bracero visa, Border Patrol and immigration enforcement became far more effective at identifying illegal immigrants in the United States. Farmers were guaranteed legal migrant workers, so they cooperated with the government in identifying illegal immigrants. The government deported many illegal workers but also legalized many on the spot and drove others down to the border to allow them to reenter legally on a Bracero visa—often times on the same day. As a result, the supply of illegal immigrants dried up because Mexican workers were now able to enter legally.

Like the Bracero visa, any new guest worker visa program needs to be large, easy to apply for, and minimally regulated to incentivize employers and migrants to use it. Some changes will need to be made to make a modern guest worker visa program effective. First, the migrant workers should be legally mobile among employers, a policy called portability. Second, migrants need to be able to work sectors of the economy that actually employ illegal immigrants, like construction, manufacturing, and other non-seasonal occupations. Third, the number of migrant visas needs to be uncapped to guarantee that migrants use the legal system. Fourth, the regulations governing the visa need to be as inexpensive and unobtrusive as possible. These policies will decrease the supply of illegal immigrants and employer demand for them.

The employment-based green card, largely designed for highly skilled workers, has an annual cap of 140,000 green cards but it imposes enormous fees and country-of-origin regulations that make the system costly to use for both immigrants and their prospective American employers. Worse, the government's interpretation of unclear statutory language guarantees that fewer than half of these green cards issued actually apply to workers, while the rest are allocated to their family members. Congress should guarantee that all employment-based green cards go to the actual workers without denying their families entry to the United States. Arbitrary country-of-origin quotas that cause enormous backlogs for skilled immigrants from India and China should also be removed. Furthermore, the types of workers that can enter on an employment-based green card should be expanded and the numbers removed. Since employers have to prove that it is infeasible for them to hire similarly skilled Americans for the jobs they are offering, they should not face a numerical cap.

The employment-based green card is not the only way for highly skilled immigrants to work in the United States. The H-1B visa provides another avenue. The H-1B is a temporary visa that allows American firms to hire skilled foreign workers in specialty occupations. The number of H-1Bs issued annually for American firms is capped at 85,000–65,000 from abroad and 20,000 for foreign graduates of American universities. When the economy is growing, these few H-1B slots frequently fill up within days of becoming available. The duration of the H-1B visa is three years but it can be renewed for an additional three-year term. Unlike with other guest worker visas, H-1B holders can apply for a green card while they are working in the United States if they find an employer willing to sponsor them. If the green card approval process takes longer than the maximum six-year duration of the H-1B visa then the worker is allowed to work until the green card is approved or denied. The number of H-1B visas should be uncapped, the workers should be perfectly portable among occupations without ex ante government approval, their foreign-born spouses should be able to work, and the onerous H-1B wage and labor market regulations should be significantly reformed.

In 1952 the government created a labor certification system to guarantee that migrant workers did not affect the wages of native-born American workers. Under the original system, the DOL had to prove that the migrant worker would adversely impact the economic prospects of similar American workers in order to deny the worker a green card on labor market grounds. This institutional arrangement created a passive approval process where the DOL

only denied 10 green card applications from 1952 to 1962. The Immigration Act of 1965 reversed the process by replacing the DOL's passive veto over green card applications based on the labor certification to forcing them to certify that every immigration worker issued a green card would not adversely impact an American worker and the immigrant was entering an occupation where there was an insufficient number of able, willing, and qualified Americans to do the job. This reversal of DOL tasks was lobbied for by labor unions who were concerned about immigrants competing with their members for jobs. The reformed labor certification approval procedures made labor immigration far more expensive and de facto limited green cards only to highly skilled foreign workers. Removing the DOL's active approval role for labor certifications and Labor Condition Applications and replacing it with a passive veto would cheapen labor immigration and streamline the current system.

Estimates of the fiscal impact of immigration on the United States hover around zero. In the long run, immigrants and their descendants tend to pay for the government-provided services that they consume. However, this fiscal calculus can be improved by building a higher wall around the welfare state that denies means-tested welfare benefits to noncitizens. As we explained in a Cato Institute policy analysis entitled "Building a Wall around the Welfare State, Instead of the Country," doing so is perfectly constitutional, relatively easy to accomplish, and politically popular. Currently, poor immigrants are much less likely to consume means-tested welfare than poor Americans, but non-citizens should not have access to begin with. This Cato article provides a clear legislative path forward to achieving that goal.

Immigration is an important issue for today's economy and for the future of the United States. It is imperative that market-based immigration reform tackle these issues in a fiscally prudent way that reduces illegal immigration and allows for peaceful immigrants to become American.

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Prepared by Alex Nowrasteh

CHAPTER 12
SURFACE TRANSPORTATION POLICY

Congress should

- authorize spending out of the Highway Trust Fund to be no more than revenues into that fund;
- eliminate competitive grant funds, including but not limited to New Starts, CMAQ, and TIGER and convert the monies that would have gone into these programs to formula funding;
- refrain from creating any new competitive grant programs;
- decouple long-range transportation planning from air-quality goals;
- allow states to toll existing highways that have been built with federal funds, provided the tolls are exclusively dedicated to reconstruction and improvement of those highways; and
- restrict the use of any federal funds for rail transit improvements by agencies that are failing to maintain their existing transit lines.

One of the first issues to confront the 114th Congress will be the federal surface transportation law—most recently known as the twice-extended MAP-21—as it expires in May 2015. Historically, most of the spending authorized by this law has come from gas taxes and other highway user fees that go into the Highway Trust Fund. But in recent years Congress has spent far more than the revenues to the Trust Fund, requiring it to supplement the Trust Fund with tens of billions of dollars in general funds.

Fifty years ago, there were virtually no federal subsidies to surface transportation. Railroads and most transit systems were private and funded out of user fees. Highways were funded by states and some federal funds, but nearly all federal and state funds came out of gas taxes, tolls, or other highway user fees. Today, almost all transportation is subsidized, leading to wasteful spending, poor facility management, and special interests lobbying for programs and projects that make no economic sense.

In the long run, we would like to see devolution to the pre-1964 era, when most transportation decisions were made privately and those that were made by government were made at the state or local level. Such a major change in course in 2015 would almost certainly be vetoed by the president. Yet in 2015 Congress can improve the existing law in many ways that would improve the effectiveness and health of our transportation system without increasing subsidies.

Some of the most wasteful parts of recent transportation bills have been discretionary funds such as the Fixed Guideway Capital Investment Grants (New Starts) and the Transportation Investment Generating Economic Recovery (TIGER). Rather than being efficiently spent, these become political funds, used by the administration to reward its supporters. They also encourage state and local governments to propose the most expensive, rather than the most efficient, projects in order to get "their share" of federal grants. The 2012 reauthorization converted the Bus and Bus Facilities program, Congestion Mitigation/Air Quality, and Ferry and Ferry Facilities funds to formula funds, and the 2015 reautho-

rization should finish the job by converting New Starts and other discretionary funds to formula funds to ensure they are more fairly distributed to states and local areas.

Another poorly performing part of the law is long-range transportation planning, particularly as it relates to air pollution. Under the law, states and metropolitan areas in violation of the Environmental Protection Agency's increasingly stringent air quality standards have to show that their plans are in conformance with the standards.

In practice, this leads to perverse results, as many long-range plans have sought to reduce driving by increasing traffic congestion. Congested traffic produces far more pollution than free-flowing traffic, but most transportation planning models fail to account for this. Since passage of the original Clean Air Act of 1970, automotive air pollution has been reduced by more than 90 percent, yet all of that reduction has come from cleaner cars, while none has come from long-range transportation planning.

A third issue has to do with the state of transportation infrastructure. Contrary to some claims, there is no infrastructure crisis. The number of bridges considered "structurally deficient," for example, has declined by about 50 percent since 1990. Still, much of the Interstate Highway is at or near the end of its design life. One source of funds to reconstruct and improve the interstates and other highways is tolls. While tolls on existing roads are controversial, Congress should give states the right to collect tolls provided the tolls are dedicated to reconstruction and improvement of the roads being tolled and any feeder roads into those highways that would be impacted by highway improvements.

Another infrastructure problem is rail transit, as these systems have at least a $60 billion maintenance backlog that is growing because transit agencies aren't spending enough to keep their systems in even their current poor state of repair. Unlike highways, there is no hope that this maintenance cost could ever be covered by user fees. Congress should restrict the use of any federal funds for rail transit improvements by agencies that are failing to maintain their existing transit lines.

Two major changes in surface transportation seem inevitable in the long run. One is to convert from paying for public roads with gas taxes to using some form of mileage-based user fee that fully funds roads and streets while protecting personal privacy. The second is the introduction of self-driving cars and their eventual replacement of human-driven cars. Congress should do nothing that would discourage either of these trends.

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Prepared by Randal O'Toole

CHAPTER 13
INFRASTRUCTURE INVESTMENT

Congress should

- cut federal spending on highways, transit, and other types of state and local infrastructure;
- privatize federal infrastructure, such as the passenger rail and air traffic control systems;
- encourage state and local governments to privatize infrastructure, such as by repealing the tax exemption on municipal bonds; and
- slash the corporate tax rate to spur private infrastructure investment.

Many federal policymakers argue correctly that America should have better infrastructure to encourage stronger economic growth. But the mistake that policymakers often make is to assume that the federal government should lead the way on funding and allocating infrastructure investment.

Experience shows that federal involvement in infrastructure often leads to waste and inefficiency. Federal funds get misallocated because of political factors, and federal projects get bogged down in mismanagement and cost overruns. These sorts of problems have plagued federal infrastructure for decades. At the same time, federal regulations and taxes create hurdles to state, local, and private sector infrastructure investment.

Congress should privatize federal infrastructure, reduce aid for highways, transit, and other types of state and local infrastructure, and pursue tax and regulatory reforms to encourage greater infrastructure investment by the states and the private sector.

SPURRING PRIVATE INVESTMENT

Most of America's infrastructure is provided by the private sector, not governments. There is no hard definition of infrastructure, but gross fixed private nonresidential investment in the United States was $2.1 trillion in 2013, according to the Bureau of Economic Analysis. That includes investment in factories, pipelines, refineries, cell phone towers, and many other facilities. By contrast, total federal, state, and local government nondefense investment was $443 billion. Thus, private infrastructure investment is more than four times larger than government investment.

The data indicates that if policymakers want to support infrastructure, they should pursue reforms to spur private investment. One reform would be to cut the U.S. corporate income tax rate, which is the highest in the world, according to KPMG. Businesses invest in infrastructure to earn profits, so when profits are siphoned off by the government it suppresses investment. Cutting the 35 percent federal corporate tax rate to 25 percent or less would spur greater infrastructure investment in every sector, including energy, utilities, telecommunications, and manufacturing.

Another tax reform would be to adopt expensing—or first-year write-off—for business investment in structures and equipment. Currently, investments must be depreciated over time, which creates a bias against long-term assets. Congress has enacted some partial and temporary expensing provisions in recent years, but it should put expensing into perma-

nent law to give businesses certainly in their long-term investment planning.

FEDERAL INVESTMENT IS INEFFICIENT

While private infrastructure investment is much larger than government investment, the latter is important in certain areas, such as transportation. However, most government investment should be funded and managed at the state and local levels because federal involvement creates large inefficiencies:

- *Federal investment is misallocated.* Investments are often based on political factors rather than marketplace demands. Amtrak investment is spread around to states where passenger rail makes no economic sense. Federal highway aid creates consistent loser states, some of which have fast population growth and higher investment needs, such as Texas. A recent study by Pengyu Zhu and Jeffrey Brown found that the highway trust fund redistributes money from lower- to higher-income states, which also makes no sense.
- *Federal projects are mismanaged.* Federal agencies do not construct and operate infrastructure projects efficiently, and projects often have large cost overruns. The Army Corps of Engineers is known for its boondoggle infrastructure projects. The Bureau of Reclamation underprices water from its dams, which causes overconsumption. And the bureaucratic Federal Aviation Administration (FAA) is not up to the challenge of running the increasingly high-technology air traffic control system.
- *Federal aid distorts state policy.* For the states, federal aid for infrastructure seems like "free money," and so it encourages waste. Federal aid also biases state and local investment choices. For example, federal aid for urban transit mainly covers capital costs, not operating costs. That tilts local governments toward buying expensive rail systems rather than more efficient bus systems. Without federal subsidies, the states would make more efficient infrastructure decisions based on local needs.

THE STATES AND PRIVATE SECTOR SHOULD LEAD

The answer to America's infrastructure challenges is not federal ownership or federal subsidies, but rather more reliance on investment by state and local governments and the private sector.

The federal government should privatize its own infrastructure, such as the air traffic control system, the postal system, passenger rail, and federal water infrastructure. Since the 1980s, nations around the world have privatized hundreds of billions of dollars of infrastructure assets, and in many cases have privatized types of assets that are still in government hands in the United States. Germany, Britain, and the Netherlands have privatized their postal systems, for example, which would be a good reform for our troubled U.S. Postal Service.

Canada privatized its air traffic control system in 1996 with very favorable results. The system is now run by a nonprofit corporation, Nav Canada, which raises revenues from its customers to cover its operational and capital costs. Nav Canada is a "global leader in delivering top class performance," says the International Air Transport Association.

One advantage of privatization is that private organizations can tap capital markets to add infrastructure capacity and meet market demands—without having to rely on unstable government budgets. Our air traffic control system, for example, needs major upgrades, but the FAA cannot count on stable federal funding. The threatened disruptions to air traffic control from the budget sequester in 2013 illustrated the hazards of having infrastructure depend on federal funding.

In addition to privatizing its own infrastructure, the federal government should cut

aid for state and local infrastructure, such as highways and transit. The states should be laboratories of infrastructure innovation, and they can perform that role best without federal subsidies and regulations.

Consider transportation spending. Congress faces important decisions regarding the Highway Trust Fund (HTF), which spends about $53 billion a year and takes in about $39 billion, leaving a gap of $14 billion, according to the Congressional Budget Office. Some policymakers are proposing to fill the gap with federal gas tax increases, while the Obama administration has proposed an HTF fix based on corporate tax revenues.

But higher federal taxes without spending reforms would perpetuate the inefficiencies of the current system. A better solution would be to reduce HTF spending to match revenues. State governments should be free to fill the void as they choose—by adjusting their state budgets, raising their own fuel taxes, adding electronic tolling to some highways, or pursuing more infrastructure privatization.

The federal government can help the states by reducing regulations. Congress should repeal Davis-Bacon labor rules, which raise wage costs on highway projects by more than 20 percent, according to the Joint Economic Committee. And Congress should repeal restrictions on the tolling of interstate highways because the highways are owned by state governments. In general, federal regulations impose one-size-fits-all solutions on the states, even though the states have diverse infrastructure needs.

One option for transportation infrastructure that holds promise is public-private partnerships (P3s) or partial privatization. P3s differ from traditional government contracting by shifting elements of design, finance, operations, maintenance, and project risks to the private sector. There has been a worldwide trend toward P3s, as many countries have taken advantage of the private sector's greater efficiency and innovation. Unfortunately, the United States lags behind nations such as Canada, Britain, and Australia in P3s and privatization.

Nonetheless, a number of U.S. states have moved ahead with P3s, including Texas, Florida, California, and Virginia. Virginia has successfully completed a number of P3s, such as the $2 billion widening of the Capital Beltway. The state is also home to a number of fully private infrastructure projects, including the Dulles Greenway highway in Northern Virginia and the South Norfolk Jordan Bridge over the Elizabeth River.

There are numerous steps Congress should take to spur more privatization. It should cut corporate tax rates to increase returns on private infrastructure investment. It should repeal the federal income tax exemption for state and local bonds, which biases state and local governments in favor of public provision. And it should repeal regulations, such as those that require states to repay past federal aid if public facilities are privatized.

CONCLUSION

America needs top-notch infrastructure to best compete in the global economy. The way forward is for Congress to cut federal subsidies and devolve control over infrastructure to state and local governments and the private sector. To meet demands for new infrastructure capacity, the states should innovate with privatization and P3s.

Private infrastructure is not a new or untried idea. Urban transit in America used to be virtually all private. And before the 20th century, private turnpike companies built thousands of miles of roads. America has always been a land of entrepreneurs looking for new opportunities. We should give entrepreneurs a crack at improving the nation's infrastructure by reducing subsidies and regulations and encouraging market-based efforts to tackle our investment challenges.

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Prepared by Chris Edwards

CHAPTER 14
FEDERAL MARIJUANA POLICY

Congress should

- pass legislation requiring the Drug Enforcement Administration to reschedule marijuana from Schedule I to Schedule II under the Controlled Substances Act.

Marijuana policy in the United States is contradictory and confusing. Federal law outlaws marijuana for all purposes. Many states, however, have legalized possession, or production and use for medical purposes, or production and use for recreational purposes. The federal government maintains that its federal law preempts state law, implying federal authorities can enforce federal prohibition everywhere, regardless of state law. Yet federal authorities currently take a hands-off approach to marijuana purchase and sale when these acts do not violate state laws. Cross-border traffic between legalized and non-legalized states creates further ambiguity. This situation means that federal law applies differently across different states; more generally, it means the federal government is choosing not to enforce a federal law.

The federal government has several options for addressing this ambiguity and incoherence. At one extreme, the Drug Enforcement Administration (DEA) and other federal authorities could resume vigorous enforcement of federal marijuana prohibition throughout the country. At the other extreme, Congress could eliminate federal marijuana prohibition by removing marijuana from the list of federally controlled substances.

The first approach—re-escalating federal marijuana prohibition—is ill-advised for many reasons. Such an approach would require substantial new expenditure and yet have limited impact on marijuana use, based on past experience. Re-escalation would drive the marijuana market back underground, with the attendant violence and corruption of black markets. And re-escalation is inconsistent with growing popular support for marijuana legalization.

The second option—repealing marijuana prohibition—is appealing to libertarians and is the only approach that would eliminate the conflicts and contradictions in existing law. But federal legalization may not yet be politically feasible, so intermediate approaches merit consideration.

A reasonable compromise is for Congress to force the Drug Enforcement Administration to reschedule marijuana under the Controlled Substance Act (CSA), the federal law that currently governs federal marijuana prohibition.

The CSA puts known drugs into one of five schedules, with Schedule I being the most restrictive and Schedule V the least. Marijuana is currently in Schedule I. According to DEA's website:

> Schedule I drugs, substances, or chemicals are defined as drugs with no currently accepted medical use and a high potential for abuse. Schedule I drugs are the most dangerous drugs of all the drug schedules with potentially severe psychological or physical dependence. Some examples of Schedule I drugs are: heroin, lysergic acid diethylamide (LSD), marijuana (cannabis), 3,4-methylenedioxymethamphetamine (ecstasy), methaqualone, and peyote.

In contrast:

> Schedule II drugs, substances, or chemicals are defined as drugs with a high potential for abuse, less abuse potential than Schedule I drugs, with use potentially leading to severe psychological or physical dependence. These drugs are also considered dangerous. Some examples of Schedule II drugs are: cocaine, methamphetamine, methadone, hydromorphone (Dilaudid), meperidine (Demerol), oxycodone (OxyContin), fentanyl, Dexedrine, Adderall, and Ritalin.

Current scheduling of marijuana is thus bizarre; few observers believe either that marijuana has "no currently accepted medical use" or that it has "a high potential for abuse," at least compared to numerous other drugs in Schedules I and II.

The DEA has the power to reschedule marijuana on its own, but it has so far refused to do so. In fact, in 1988, DEA administrative law judge Francis Young ruled that

> Marijuana, in its natural form, is one of the safest therapeutically active substances known to man. By any measure of rational analysis marijuana can be safely used within a supervised routine of medical care.

Further, Young wrote that

> the marijuana plant considered as a whole has a currently accepted medical use in treatment in the United States, that there is no lack of accepted safety for use of it under medical supervision and that it may lawfully be transferred from Schedule I to Schedule II [of the federal Controlled Substances Act].

But DEA administrator John Lawn overruled Young's decision, and two Court of Appeals decisions have upheld the DEA's authority to maintain the current classification. Thus congressional action is likely necessary to force the DEA's hand.

Rescheduling marijuana from Schedule I to Schedule II would mean that medical provision in current or future medical marijuana states would not be inconsistent with federal law. And if federal authorities allow physicians reasonable leeway in prescribing marijuana, consistent with current practice in medical marijuana states like California and Colorado, the black market for marijuana would shrink substantially. Rescheduling does not conflict with international drug treaties, since many substances covered by those treaties are in Schedule II or higher. And federal medicalization would reduce existing barriers to research on the possible health benefits of marijuana.

Federal medicalization is far from a perfect policy. Under medicalization, the federal government might still practice de facto prohibition by interfering with physicians' ability to prescribe marijuana, as occurs now with other Schedule II drugs. And if federal prescribing restrictions were substantial, the black market for marijuana would re-emerge. Further, treating marijuana as medicine, rather than like other commodities, might impede taxation (as occurs now, partially, in Colorado).

Rescheduling marijuana into Schedule II would also not eliminate conflict between federal and state marijuana laws; full legalization, as in Colorado, Washington, Oregon, Alaska, and the District of Columbia, would still be inconsistent with federal law.

Most importantly, federal medicalization is imperfect because it still restricts legal access to marijuana, rather than respecting the right of every individual to consume marijuana or not. Relatedly, federal medicalization will appear hypocritical to some observers, who see it—understandably—as backdoor legalization.

But medicalization via rescheduling is nevertheless a substantial improvement over current policy: it reduces the black market for marijuana, scales back enforcement expenditure, and rationalizes current law, all while freeing many marijuana users from ill-advised legal threats and penalties. Congress should act now.

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