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Guidance for Guidances

STATUS: OMB has proposed guidelines for guidance practices

In 1946, following the explosive growth of the federal government and its regulatory power during the New Deal and World War II eras, Congress passed the Administrative Procedure Act (APA) to calm fears over the number, scope, and power of federal agencies. The APA formally introduced public notice and comment requirements into the federal regulatory process and also made federal regulations subject to judicial review.

Of course, public criticism of the federal bureaucracy's interventionism did not end with the APA's passage. Though the law required public information about, and public input into, the rule-making process, critics claim regulators have found ways around the obstructions. One oft-criticized method is the issuance of "interpretive rules," sometimes referred to as guidances.

Guidances are intended to explain the gaps left in laws or regulations that inevitably arise as the rubber of the rule of law meets the road of real-life situations. Guidances are legally non-binding and can include policy statements, clarifications, directives, enforcement guidelines, inspection plans, opinion letters, question-and-answer bulletins, etc. They seem to include everything from rules of conduct for the Environmental Protection Agency's own break room to responses to public inquiries about gray areas involving the application of a statute or regulation. Concerning the latter, guidances can be quite helpful to persons or businesses struggling to

understand complex or overly technical laws and regulations.

Critics charge that some regulators have improperly used guidances to continue regulatory activity free of the APA's procedural and judicial restraints. Guidances may be legally non-binding, the critics say, but they have on many occasions been either dressed up to look like legally binding regulations or considered by members of the public as carrying the force of law.

These criticisms may have crystallized following the Occupational Safety and Health Administration's infamous

1999 guidance on employees working from home. Two years earlier, a Houston firm had written the agency, inquiring whether OSHA rules in any way affected such employees. The agency's resulting guidance asserted that "the OSHA Act applies to work performed by an employee in any workplace within the United States, including a workplace located in the employee's home." At that time, some 15 million Americans regularly worked from home. OSHA's claim resulted in a sharp political backlash, and the agency ultimately withdrew the guidance.

Despite that retreat, frustration with apparently overreaching guidances apparently reached a tipping point, and the Office of Management and Budget has decided to set some guidelines for guidances. In November of 2005, the OMB issued a Proposed Bulletin for Good Guidance Practices. The propos-



KEVIN TUMA

al would extend public notice and comment procedures to what OMB calls “significant guidance documents,” which the agency defines as guidances that may:

- reasonably be anticipated to lead to an annual effect of \$100 million or more or adversely affect the economy or a sector of the economy;
- raise highly controversial issues related to interagency concerns or important administration priorities;
- set forth initial interpretations of statutory or regulatory requirements, or changes in interpretation or policy; or
- concern novel or complex scientific or technical issues.

The proposal includes other provisions designed to protect the public from regulations dressed in guidance drag. For instance, it explicitly forbids government agencies from using language that might imply that a guidance represents a legally binding document. Agencies will have to watch their use of words like “shall,” “must,” “required,” or “requirement.” Unfortunately, the proposal stops short of mandating that guidances explicitly state that they are non-binding—a mandate that we at the Mercatus Center would like to see.

Although guidances are technically non-binding, their mere nature and the fact that they are written by the United States government all but guarantee that they will continue to be viewed as far from non-binding and remain a potential route to “backdoor” regulation. However, OMB’s proposal should diminish those threats or, at the very least, let us know that they are coming.

— Alastair Walling

Spectrum Commons

STATUS: FCC examining petitions for reconsideration of final rules

In polite society, dogmatism is a sign of an unsophisticated mind. This might explain the eager efforts of many to

establish a “third way” in politics, economics, religion, and other fields. So it is not surprising that a “third way” should come to federal spectrum policy, too.

Historically, the radio spectrum has been doled out to users by what the Federal Communications Commission calls a “command-and-control” process. The FCC first carves out a block of spectrum and decides to what use it will be put (e.g., television, mobile telephony). Then, the agency gives away, at no charge, the right to use the spectrum to applicants it deems appropriate. The FCC makes its choices based largely on a public record generated by a regulatory proceeding. The rationale for such a system has been that the radio spectrum is a scarce resource, that there are more people who would like to use it than there is space available, and thus that the government must apportion it lest there be chaos.

In the 1950s, however, Ronald Coase and others pointed out that the radio spectrum was no scarcer than wood or wheat, yet government did not routinely ration those items. Coase instead proposed the private ownership of, and a market in, spectrum, which would lead to a better allocation of the resource and avoid rent-seeking behavior by would-be users of the spectrum. In the late 1990s, it seemed like the property rights view might carry the day as Congress finally allowed the FCC to auction licenses to use spectrum.

At about the same time, however, a new school of academics and activists began to promote what they styled a “third-way” for spectrum. While they agree with Coase that command-and-control spectrum management is inefficient, they instead propose to make spectrum a commons. They claim that new spectrum-sharing technologies allow a virtually unlimited number of persons to use the same spectrum without causing each other interference and that this eliminates the need for either property rights in, or government control of, spectrum. The promise of a commons approach, as technologist George Gilder has put it, is, “You can use the spectrum as much as you want as long as you don’t collide with anyone else or pollute it with

high-powered noise or other nuisances.”

The FCC took note, and in its 2002 Spectrum Policy Task Force Report put the commons model alongside property rights as alternatives to command-and-control that should be pursued. Last year, the FCC designated a 50 MHz block of spectrum in the 3650 MHz band as a commons. Intel, Alvarion, and several others have challenged that designation and seek a more property-like designation for the spectrum. A decision on their petition for reconsideration is still pending at the FCC.

Despite the “third-way” rhetoric, however, the commons model is not an alternative to command-and-control regulation, but in fact shares many of the same inefficiencies of that system. In order for a commons to be viable, someone must control the resource and set orderly sharing rules to govern its use. If the government is the controller of a commons—as proponents of a spectrum commons suggest it should be—then in allocating and managing the commons the government will very likely employ its existing inefficient processes. A look at the 3650 MHz proceeding finds that in creating a commons, the government has not escaped the inefficiencies of command-and-control regulation.

In designating the 3650 MHz band a commons, the FCC made a series of tradeoffs based on no more information than what it acquired through the record and its own fact-finding. For example, in order to facilitate spectrum sharing, the FCC limits the power of transmissions in the band to 25 watts. While no doubt studied carefully, the decision to set the power limit at 25 watts is ultimately an arbitrary one. It precludes any use of the spectrum that requires a higher-powered signal, even if that use provided greater welfare gains. It also discourages low-powered uses because in order to ensure reception in the shared spectrum, the incentive is to always transmit at the maximum power level. In contrast, a spectrum market would yield the most valued use of the spectrum, at whichever power level that might be. Choosing a 25-watt power limit is a best guess

not unlike those of command-and-control policymaking.

The designation of the 3650 MHz band as a commons with a 25-watt power limit benefits rural wireless Internet service providers (WISPs) because it gives them new spectrum over which to serve their customers. WISPs have been using another spectrum commons—the one used by Wi-Fi, garage door openers, and baby monitors—but because entry to it is open, it has become crowded and unreliable. On the other hand, satellite operators who previously had access to the 3650 MHz band fear that the rules adopted for the new commons will not be stringent enough to protect them from interference. WISPs have claimed that the measures taken to protect existing satellite installations are too strict. In its sharing rules, the FCC has split the baby, but again in a best-guess, command-and-control-like manner that does not guarantee that welfare is maximized.

Additionally, high-speed data transmission over a commons works today in rural areas because they are not heavily congested with radio signals, and because competing users of a commons are few and can thus meet and coordinate their uses so as not to cause each other interference. In contrast, however, one can expect far more users of a commons in a large metropolitan area, increasing congestion and inhibiting the ability to coordinate. Designation of the 3650 MHz band as a commons nationally, as the FCC has done, is therefore a tradeoff favoring rural over metropolitan wireless data services made only by appealing to the “public interest standard” that underpins command-and-control decision-making.

Furthermore, some applications, such as Voice over Internet Protocol (VoIP) and streaming video, are latency-sensitive and require constant high-speed data transmission rates. Yet inherent in the nature of a commons is the fact that high speeds cannot be guaranteed because the number of band users is virtually unrestricted and also potentially uncoordinated. In effect, then, choosing a commons over a more property-like scheme—which can guar-

antee a definite quality of service—is a trade-off between allowing data services that can consistently provide a high quality of service and one that is precluded from doing so.

These and other tradeoffs made by the FCC in the 3650 MHz proceeding demonstrate that far from putting control of the spectrum outside the hands of government, a commons approach

relies on the very inefficient rule-by-fiat system it is trying to avoid. There is no third way for spectrum. In order to efficiently share spectrum, someone must set the rules—either private owners or the government. The petitions for reconsideration now before the agency give it the opportunity to reassess which method is more efficient and welfare maximizing. —Jerry Brito

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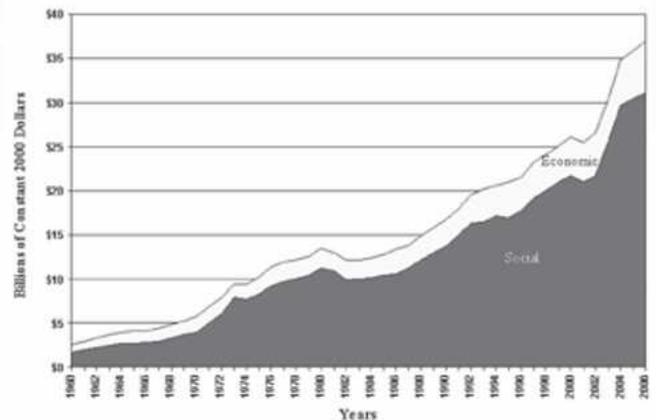
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The Katrina Success Story You Didn't Hear

BY ALASTAIR WALLING

ALL LEVELS OF GOVERNMENT, MUCH LIKE most of Louisiana, did not emerge from Hurricane Katrina looking very good. However, while the media fixated on the federal government's failures, they ignored the quiet successes achieved by the regulatory restraint shown in the wake of the disaster. At both the state and federal level, government waived or relaxed many regulations whose strict upholding would have imposed additional hardship on the people of the Gulf Coast and hindered recovery efforts. While these measures ranged in scope and magnitude from the Texas Board of Cosmetology's emergency decision to allow displaced cosmetologists to ply their trade in the Lone Star State to the Environmental Protection Agency's early approval of winter gasoline, their cumulative effect has been of immeasurable benefit not only to the inhabitants of the Gulf Coast but to the rest of the country as well.

PETROLEUM Hurricane Katrina threatened 8 million barrels per day (bpd) of refining capacity, which represents 47 percent of total U.S. capacity. Furthermore, 1.5 million barrels of crude oil—29 percent of domestic production—flow out of Gulf Coast wells, while an additional 1 million bpd of oil imports arrive through the Louisiana Offshore Oil Port (LOOP). Hurricane Katrina idled an estimated 2 million bpd in refining capacity, and 900,000 bpd of that remained down more than three weeks after the storm. Hurricane Rita's approach on Sept. 23 forced the precautionary idling of an additional 4 million bpd of refining capacity around Houston, Port Arthur, and Lake Charles—leaving the nation without 4.9 million bpd of refining capacity. As of the end of October, approximately 1 million bpd of refining remained out of commission.

Katrina hit one of the poorest regions of the United States. Combined, Louisiana and Mississippi account for only about 2 percent of GDP, which is roughly the same amount contributed by the city of Houston. However, that 2 percent includes a disproportionate amount of the nation's crude oil production and refining capacity.

A significant disruption could have had dire implications for the rest of the economy for three reasons:

- Prior to hurricanes Katrina and Rita, American refineries were already running at 95 percent

Alastair J. Walling is a legal fellow in the regulatory studies program at the Mercatus Center at George Mason University. He may be contacted by e-mail at awalling1@gmu.edu.

- capacity and struggling to keep up with demand.
- Environmental regulations limit how much foreign-refined gasoline can be imported into the United States.
- The demand for gasoline is extremely inelastic.

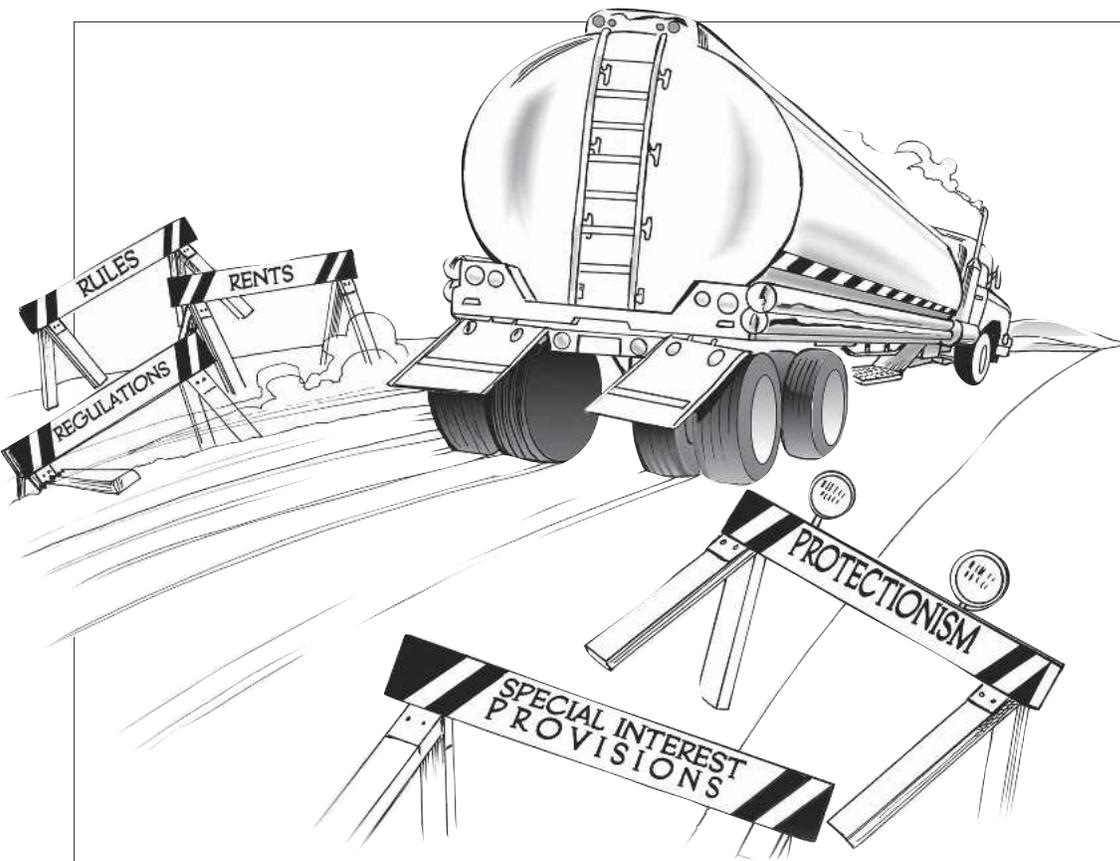
Simply put, Katrina and Rita dealt this nation two huge swift kicks in its petrochemical belly; yet, we managed to keep our feet. Yes, gasoline prices surged past three dollars a gallon but, aside from a few isolated instances of gas stations running dry because of panic buying, the nation as a whole did not lack for fuel.

How did the government prevent a national gasoline crisis? What emergency master plan did government planners pull from the shelves and implement? The truth of the matter is that the federal government did very little. In fact, it did the opposite of taking action, but found success by getting out of the way. Using a series of temporary regulatory waivers, the federal government made it possible for others to prevent the looming fuel crisis.

Gasoline evaporates easily during the warm summer months and, subsequently, produces more smog. In order to remain compliant with environmental regulations, refineries produce blends of summer gasoline that, although harder to make, evaporate less easily than winter gasoline. As Hurricane Katrina was knocking out refining capacity left and right, previously refined stocks of perfectly good, but at the time illegal, winter gasoline sat waiting. The EPA did not have to do much. It did not have to dispatch teams or formulate plans. It simply authorized the early use of winter gasoline, which instantly increased the gas supply available to the market.

The early release of winter gasoline may not have been enough if inadequate supplies of diesel fuel, combined with increased demand associated with trucking relief supplies to the Gulf Coast, ended up immobilizing the heavy-duty tanker trucks needed to transport it. Worried that a diesel shortage might immobilize transportation, the EPA also lifted restrictions on high-sulfur diesel fuel, which is often reserved for use by farmers and dyed red to catch truckers who are fond of procuring the cheaper fuel on the sly. The availability of the previously forbidden high-sulfur diesel fuel might have resulted in some additional pollution, but it guarded against the prospect of diesel fuel shortages stranding both relief supplies and the gasoline needed to keep the entire relief effort running. At this time of hardship and recovery, the nation needed all of its trucks running and could not afford to have any form of transport capacity sidelined by rules either well-intentioned or those created for the sole purpose of transferring rents to special interests.

BOUTIQUE FUELS Although it was the early release of winter fuel that provided the market with a much needed boost of supply, the suspension of boutique fuel requirements allowed for the temporary re-creation of a robust national gasoline market. Refiners design boutique fuels for use in markets that cannot meet federal air quality standards without specialty fuel. These markets may be as small as a single city or as large



only did this make gasoline fungible again, but it opened the American market to foreign refiners, who usually do not produce EPA-mandated fuels. While it is difficult to gauge the impact of these waivers, they arguably lessened confusion over supplies, allayed fears of shortages in boutique markets, decreased the incentive to hoard, and allowed the national gasoline market to function more efficiently and robustly.

NO PRICE CONTROLS Lastly, while it did not come in the form of a waiver or suspension, the regulatory restraint following Katrina cannot be adequately discussed without mentioning the federal government's refusal to implement price controls.

as most of Southern California, but the requirements of each unique market have led to the creation of dozens of different boutique fuels. For example, refiners brew five different fuels for use in different parts of Texas.

While boutique fuels may produce cleaner air, they have definitely fractured the national market for gasoline. If stocks of a particular boutique fuel run low in its given market, then suppliers cannot simply ship in non-conforming blends from other markets. This has led to numerous confusing regional price spikes over the past few years, as occasional production problems or pipeline ruptures have sometimes dramatically curtailed the availability of a particular blend of gasoline. These seemingly unwarranted spikes have fueled the usual speculations about conspiracies and price fixing, but the Federal Trade Commission has failed to find any culprit other than the presence of a boutique fuel requirement combining with some sort of unfortunate incident.

Despite the periodic problems, the boutique fuel arrangement does appear to work fairly well. Producers produce, consumers consume, and the air becomes noticeably cleaner without incurring the huge costs and inefficiencies that would result from mandating a one-size-fits-all boutique fuel for the entire country. While the American gasoline market still functions well (as most markets do), its fracturing has left it particularly vulnerable to disruptions. Boutique fuels may only cause periodic, annoying problems during periods of smooth sailing, but they do not mix well with major natural disasters—especially those that idle millions of barrels of refining capacity.

Following Hurricane Katrina, the EPA moved quickly to issue waivers suspending boutique fuel requirements. Not

In the early 1970s, an inflation-phobic Nixon administration imposed a series of price controls on gasoline and oil, resulting in scarcity, long gas lines, and shuttered stations. Those results underscore a basic lesson of economics: When a scarce commodity's price is constrained, the balance of its cost will be discharged in other—often unpleasant—ways. While not everyone in Washington has learned this lesson, there was no serious push for price controls in the aftermath of Katrina. The only political nod to higher prices on the federal level was a one-day congressional hearing into “price gouging” that was little more than a catharsis session.

Motorists may have had to pay three dollars a gallon, but at least there was gasoline to be had. Furthermore, virtual imprisonment in long gasoline lines would have deprived hurricane victims of valuable time needed to perform a wide variety of crucial activities, such as collecting food, ice, bottled water, or cutting down the tree threatening to crash through the living room.

It is inevitable and natural for people to look to government for help in times of crisis and disaster. However, we must recognize that while the federal government can marshal considerable resources, even these are dwarfed by the sheer strength and power of the American economy. The government's “hands on” response to Katrina may have been slow and ineffective, but the failure of a national gasoline crisis to materialize is testament to the success of the “hands off” policy of regulatory restraint. True, government may have a role in bringing relief and comfort to those affected by natural disasters, but it is equally important that government not impede the best efforts of individuals, organizations, and the market to do the same. **R**