The ‘Smart Road’ Scam

By Jerry Werner
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TOLLROADSnews

KEVIN TUMA (5)

So-called “intelligent transportation systems” (ITS) combine information and communications technologies with vehicles and public infrastructure in order to manage congestion, traffic routing, travel times, and fuel consumption. For years, ITS supporters have called for the technologies to be mainstreamed, that is, made part of the normal state and federal government funding process, rather than being treated as something exotic that is fit only for small pilot projects. And now, indeed, ITS has been mainstreamed. But mainstreaming is not always pretty. Just as paving and bridge contractors have often been chosen by less than the most ethical criteria, so at least one ITS offering is coming under some serious scrutiny.

Poster child for ITS-under-scrutiny is the Transportation Technology Innovation and Demonstration program, managed by the Federal Highway Administration’s Office of Operations. Critics say the program has been used to steer taxpayer money to a private company — we will use its present name “Traffic.com,” although its name has changed twice over the years — chosen not by competitive bids but in behind-closed-doors political deals. They allege that the program maintains Traffic.com’s monopoly control over traffic data and that federal grants are improperly used to “sell” the private monopoly’s offerings to states and municipalities. And they accuse the U.S. Department of Transportation of evading legislative provisions intended to open the program to competition.

The Traffic.com story has been long in the making. It goes back 10 years to the TEA-21 transportation authorization legislation, one of the six-year mega-funding bills that finances not only general categorical grant programs to the states for roads and transit, but also “earmarked” grants that specify in detail not just their purpose and amount but who shall receive the money and under what terms.

The Traffic.com monopoly arises out of a provision in TEA-21 that authorized an “intelligent transportation infrastructure program” for the “measurement of various transportation system activities” to aid in planning and analysis. The law specified that the program would:

- be initiated in Philadelphia and Pittsburgh. Pennsylvania, of course, is home to Bud Shuster, who was the Republican chairman of the House Transportation and Infrastructure Committee when TEA-21 was being hammered out, and a well-known dealmaker.

- provide data from an expanded “infrastructure of the measurement of various transportation system metrics” in more than 40 metropolitan areas at a cost of $2 million each.

- support private technology commercialization initiatives to generate revenues to be shared with local departments of transportation.

- “aggregate data into reports for multipoint data distribution techniques.”

- “utilize an advanced information system designed and monitored by an entity with experience with the Department of Transportation in the design and monitoring of high reliability, mission critical voice and data systems.”

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Out of this early language grew a government-funded and -supported monopoly for traffic information data.

SOLE SOURCE PROVIDER In a June 2001 notice in the *Federal Register*, the Transportation Department announced that two other cities would be included in the program and invited additional state and local government entities representing additional large cities to apply for grants. The notice said that the department was "interested in working with State and local governments and an existing private sector partner to develop an ability to measure the operating performance of the roadway system at a regional and national level and to produce other valuable streams of information."

The notice asked for state and local transportation agencies that were willing to form so-called "public/private partnerships" with "a private partner preselected" by the Transportation Department. In other words, the "preselected" firm, Traffic.com, would be the sole source provider for the new cities, and the company's competitors would effectively be locked out of business there. This filing was just an early indication of what was to come, as Traffic.com lobbied and used its considerable political influence to expand the program on a sole-source, non-competitive basis to many more traffic-congested U.S. cities.

In early 2001, control of the House Transportation and Infrastructure Committee passed from Shuster to Rep. Don Young (R, Alaska). Young took up the cause of making Traffic.com the sole source provider almost as vigorously as his predecessor. Interestingly, during Young's tenure, various Traffic.com executives made numerous financial contributions to his reelection campaign and political action committee, particularly at the beginning of his tenure (when the company was lobbying Congress to get funds appropriated for the program) and surrounding the passage of TEA-21's successor, SAFETEA-LU, in 2005. *The Hill*, a prominent Capitol Hill newspaper, found that Traffic.com spent over $900,000 on lobbying efforts over the years.

While TEA-21 had authorized the program, funds needed to be appropriated to make it happen. Traffic.com and its supporters managed to get $50 million appropriated in the FY 2001 transportation appropriations bill. Language in that bill specified that the program would be instituted in 25 additional metropolitan areas, with a $2 million federal grant to each.

USDOT The Transportation Department's position on the propriety and legality of this monopoly has varied. At times officials have been uneasy about it and they once challenged it; other times they have seemed to be reluctant defenders. Yet other times they have been enthusiastic supporters and vigorous defenders of it. In February 2001, the department (specifically the deputy executive director of the Federal Highway Administration) resisted pressure from Shuster to direct funds to Traffic.com without competition, saying in an official letter to Shuster's chief of staff that to do so "would significantly change the scope of the (prior) contract and require recompetition."

To get around the threat of a competitive procurement, the company worked with its legislative backers on a novel legislative maneuver. Although the program has virtually nothing whatever to do with defense, they managed to get language in the FY 2002 defense appropriations bill that authorized the Transportation Department to extend the program contract to "the same competitively selected consortium leader" selected for the earlier contract.

Transportation Secretary Norman Mineta then exercised his authority to expand the program to 25 more cities on a sole-source basis, as explained in a letter to Young on Feb. 5, 2002. In June 2002, the Federal Highway Administration formally signed the task order enabling Traffic.com to be the sole source provider for services under the program's umbrella.

From 2002 to 2004, state and local agencies representing 14 cities signed up to participate in the program, including major metro areas like Boston, Chicago, Detroit, San Francisco, and Washington, D.C. Traffic.com tapped into existing data sources and also installed its own pole-mounted radar traffic sensors to create what it called its "Digital Traffic Pulse sensor network." In one press release, the company said that the new network "generates lane-by-lane data including actual speeds, volumes, and point-to-point travel times, which is then updated every 60 seconds, around the clock."

CONGRESS STEPS IN However, as discussions about the reauthorization of the big transportation bill were heating up in early 2005, a number of Traffic.com's would-be competitors complained to their elected representatives, urging that the language authorizing the continuation of the program be changed in SAFETEA-LU to open the program to competition. Wavetronix of Linden, Utah, was one of the most outspoken of Traffic.com's competitors. The company markets the "SmartSensor" line of digital wave radar traffic sensors, which competes with Traffic.com's own pole-mounted traffic sensors. Wavetronix sought the assistance of its state's senior senator, Orrin Hatch (R). Hatch has long been a strong advocate of open competition and currently serves as the ranking member of the Senate Judiciary Committee's Antitrust, Competition Policy, and Consumer Rights Subcommittee.

Through the spring and summer of 2005, with SAFETEA-LU hanging in the balance, Hatch, joined by several House members led by New York Democrat Anthony Weiner, worked to add language in the new bill that would open up the program to competition. At one point, Hatch teamed with his state's junior senator, Robert Bennett (R), to propose an amendment that would accomplish that goal. In the end, however, Hatch and his staff used the House-Senate conference process to add the new language, which said in part that for the program's new Part II, "the Secretary shall award, on a competitive basis, contracts for the deployment of intelligent transportation infrastructure systems that have been accepted by the Secretary in congested areas." The program was also renamed the Transportation Technology Innovation and Demonstration program.

But Traffic.com's lobbyists were not idle. On the very same day that Hatch and Weiner were celebrating their legislative triumph, Young, who was also chairman of the House-Senate conference committee, inserted a statement in the *Congressional*

Record clearly intended to starve funding for the new, competed Part II. The statement said it was "the conferees' intent that all of the existing $54 million that has been provided for the current contracting team would be used to carry out the existing contract to deploy the current highway congestion information system under Part I." In other words, the Transportation Department should continue the program under the old no-compete terms and ignore the Part II provisions for competition unless new funds were forthcoming. Ironically, Hatch was a "conferee" and this clearly was not his intent in spearheading the addition of new language for the program.

Young got his way. All 11 agreements signed by state and local governments under SAFETEA-LU since mid-2005 have been under the Part I provisions of the law — including the cities of Atlanta, Las Vegas, San Jose, and Baltimore.

In January 2007, Hatch sent a pointed letter to Transportation Secretary Mary Peters, Mineta's successor, asking why none of the program agreements signed since the passage of SAFETEA-LU utilized "Part II." Her response in March contained a list that essentially confirmed his assertion that the Transportation Department was managing the program to maintain the Traffic.com monopoly, but avoided an explanation as to why.

Hatch wrote Peters again, complaining that her response "does not address my central concern: why the monopoly for Traffic.com has largely continued since the passage of language in SAFETEA-LU specifically was designed to eliminate that monopoly?" Secretary Peters delegated the response to Rosalind Knapp, the Transportation Department's acting general counsel, who claimed the statute "expressly requires the Department to complete the original contract, [so] the majority of the funding that has been provided is committed to Part I of the…program."

Neither Hatch nor Weiner were satisfied with that answer. On September 19, 2007, Hatch wrote to the Transportation Department's inspector general, Calvin Scovel, to "request a review of the funds and administration" of the program. Weiner followed with an October 3, 2007, letter to Scovel requesting that the Office of the Inspector General open an investigation into Transportation's management of the program. Weiner charged the department with "falsehoods" in claiming the law requires no-compete agreements with Traffic.com. He noted that many of the new agreements were with cities not mentioned in the original contract. On January 29, 2008, the Inspector General's Office announced that it was conducting a comprehensive audit of the program. The Inspector General's Office has confirmed to Senator Hatch's staff that the audit will cover both the "pre-SAFETEA-LU" and "post-SAFETEA-LU" time periods, which means that the audit will go back to the TEA-21 era when the underpinning for Traffic.com's monopoly was first put in place.

LOPSIDED AGREEMENT Details of the agreements with state and local agencies signed by the Transportation Department and Traffic.com have never been made publicly available on the department's website. However, as a result of a Freedom of Information Act request, the watchdog group Sunlight Foundation obtained many of the agreements (as well as the Federal Highway Administration's June 2002 task order with Traffic.com). A careful analysis of the agreements shows how lopsided they are in favoring Traffic.com at the expense of both the rest of the commercial traveler information community as well as the local public-sector agency partner in each of the program's cities. Some of the amazing revelations from this analysis include:

- ***Changing the normal "local agency cash match" requirement*.** In all but three of the agreements (verified in one of the letters from Peters to Hatch), the Transportation Department has waived the usual 20 percent local agency cash match that is normally a requirement to access Transportation grants for ITS-earmarked programs. Instead, a new "non-Federal match" was substituted in which Traffic.com's investment in its own profit-making business was considered a satisfactory "match." That change in the normal federal policy meant that, to state/local participants, the normal local agency match was effectively "waived," making it much easier for the company to recruit cities to participate and expand the reach of its monopoly. (Conversely, had the Transportation Department not changed the normal local agency cash match requirement, it is unlikely that many cities would have chosen to contribute the typically $500,000 required to participate and the monopoly would not likely have had the counterproductive impact that it ultimately has.)

- ***Preventing the local public-sector partner from providing valuable traveler information to the public.*** The agreements with Traffic.com usually restrict local agencies to using the most valuable Traffic.com data internally. That prevents the agencies from, for example, providing travel times computed from the data on variable message signs or in their 511 telephone traffic services. In effect, the terms mean that, in most cases, the local public-sector partner cannot use publicly subsidized data to provide information about traffic conditions to the traveling public.

- ***Traffic.com's huge conflict of interest in marketing transportation data.*** Traffic.com is given the power to exclusively set the terms (including the price) for sale of the data outside the local agencies, even though it is dealing in many cases with its arch-competitors in the commercial traveler information business. While the task order that the Federal Highway Administration signed with Traffic.com says that "it is to the contractor's [Traffic.com's] advantage to prospect new business opportunities," the company clearly has a huge conflict of interest in marketing the data to its competitors, large and small.

- ***Revenue "sharing" that goes right back into Traffic.com's coffers.*** Revenue sharing provisions with Traffic.com generally do not involve unrestricted "sharing" with the state/local partner at all. The shared funds must go back into the "program," which effectively means that they go back into Traffic.com's own profit-making business.

CONCLUSION In coming years, the widespread availability of accurate and comprehensive real-time traffic information will be vitally important to our nation's mobility. This is particularly true as we are increasingly unable to "build our way out of congestion" because of shortfalls in the Highway Trust Fund that has traditionally funded the vast majority of new roadways.

While the Transportation Department clearly sees the building of new, privately financed toll roads and their variants as the primary solution to this conundrum, our nation's ability to better utilize and leverage our existing roadway infrastructure must play a much larger part in the solution than it does today. Clearly, if travelers are aware of which roadways are "parking lots" and which are free-flowing, they can make better decisions about which route to take that will shorten their trip times and, ultimately, conserve fuel. Widespread and accessible information about current traffic conditions is the key.

ITS is an attractive "tool in the toolbox" to help government agencies combat traffic congestion in major cities. But in the end, the monopoly over ITS data that federal legislation gave to a single company effectively prevents most commercial traveler information providers and even the local public-sector partners from accessing the most valuable data from a program that was subsidized with millions of public dollars. The program needs to be replaced with a new initiative that is designed from the start to serve the public interest, rather than the interest of one company with extraordinary political connections. R

The FCC's $19 Billion Baby

By Robert Hahn
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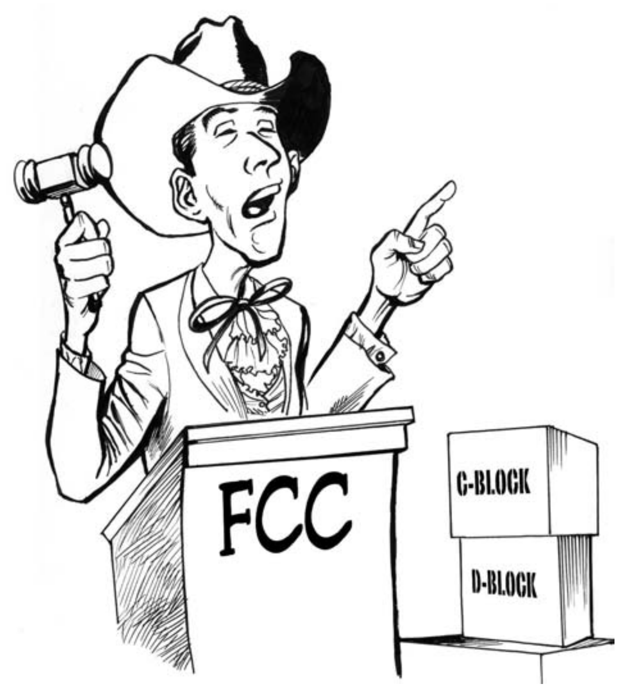
The Federal Communications Commission has completed its auction for a big swath of electromagnetic spectrum in the 700 megahertz frequency range that was recently reclaimed from television broadcasters. Who cares, you say? Some heavy corporate hitters, including Google, AT&T, and Verizon, certainly do. And so should you.

The allocation of this techno-friendly "beachfront property" spectrum is expected to usher in a new era of innovation in wireless communications, making it cheaper and faster to download movies, surf the Internet, send instant messages, or do anything else you can imagine on a mobile device. And then there's the money: bidders paid $19 billion to the U.S. Treasury for the rights — a record for a U.S. airwaves auction and a nice chunk of change even in an era of 10-digit federal budgets.



C BLOCK But the auction was not without controversy. The biggest concerned a new "open-platform" requirement imposed on the C block, a particularly prized 22-megahertz slice of the pie. The requirement would allow third parties with wireless applications — for example, Google Maps — to piggyback on the spectrum owner's wireless network at no charge, which explains why Google supported the open-platform mandate. But the open-platform idea also has fans with financial interests in spectrum policy. The requirement, they argue, would make the wireless network market more competitive by making it more difficult for the big wireless providers to squeeze out potential competitors that need a network platform on which to operate.

It is far from clear, though, whether consumers will reap the benefits because the mandate will leave the owners of the C block less inclined to offer a full menu of services and pricing plans. Consider, for example, wireless networks that offer data-only services at discounts from full-service offerings. With the open-access requirement, consumers would be able to use free voice applications like Skype and thus get full-service access for the price of data-only service. The result: C-block owners would have a powerful incentive to eliminate this shortcut by dropping the option of data-only service.

One measure of the size of the costs imposed by an open-platform requirement is provided by the auction itself. Bidders offered less for the C block than for other, roughly comparable spectrum. Indeed, one other block went for almost triple the

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price per potential customer. Spectrum in the A block sold for about $0.40 per "megahertz-pop" (a measure of spectrum quantity adjusted for the potential population it can serve) more than spectrum in the C block. Similarly, B block spectrum sold for an average of $1.91 more. Multiplying those price differences by the population of the United States (286 million) and the size of the C block (22 megahertz), we can infer that bidders estimated that the openness requirement would reduce the value of the C block by between $2.5 billion and $12 billion.

Customers' gains from new wireless applications from third parties, moreover, are unlikely to exceed the C block owners' losses calculated above. That is because the wireless market is already highly competitive, making it difficult for network owners to use market power to gouge consumers. Between 2000 and 2007, the price of wireless service fell by almost two-thirds, even as objective measures of service quality — coverage, dropped calls, etc. — showed improvements.

Further, some customers may actually be hurt by an openness requirement. If the revenues that a provider receives from applications are reduced, the provider may be forced to increase the price charged for basic cell phone service. That could, in turn, reduce the number of cell phone subscribers and reduce cell phone use among existing subscribers.

D BLOCK Bidders on the D block (10 megahertz of spectrum) faced a different restriction. The FCC required the winner to share its network with police and firefighters in ways to be negotiated directly with public safety officials. That sounds good, but it apparently made the block almost unsalable. Only a single bid was placed (by Qualcomm, the big wireless-software maker), and it was far below the $1.3 billion minimum set by the commission. In light of the tepid bidding — and the fact that Congress was more than happy with the unexpectedly high proceeds from the sales of the other spectrum blocks — some expect the FCC to re-offer the D block for sale with a reserve price that is significantly lower than $1.3 billion.

We think that the reserve price is less important than auctioning off the D block without restrictions. If auctioned without restrictions, the D block could fetch a considerable price — and that price is a measure of the value lost by leaving the spectrum fallow.

Of course, public safety uses of spectrum are a high priority. No one wants private spectrum users to degrade the quality of communications among firefighters and police. But a far more economical way to meet both public and private needs would be to set aside revenues from the auction to modernize existing public safety networks to increase their capacity and reliability.

By most assessments (including ours), the 700-megahertz auction was a success: private networks got room to expand wireless services and Uncle Sam got the gravy. It is a pity, though, that the FCC could not resist the political impulse to attach strings to the sales. Free markets in spectrum are most valuable when they are truly free. R

The Energy Bill's Theft

By Michael J. Lockerby

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No one has ever accused Hugo Chávez of being a running dog of capitalism. But when the government of Venezuela nationalized the assets of oil companies doing business there, the Chávez regime compensated refiners for taking their property. The U.S. government, in contrast, is not paying one red cent for taking intellectual property, real estate, and contract rights of petroleum marketers pursuant to the Energy Independence and Security Act of 2007 (EISA). The law rewrites service station franchise agreements so that branded franchisees are permitted to label renewable fuels as being the branded product of their franchisor, even if the fuel comes from another source. Moreover, the law allows franchisees to use their franchisor's trademark to sell renewable fuels from other suppliers even if the franchise contract prohibits the franchisee from doing so and even if the franchisor owns the gas station tanks, pumps, and other property from which the fuel is sold. Those violations of petroleum marketers' intellectual property, real estate, and contract rights create a troubling precedent for franchisors, trademark owners, and landlords in other industries.

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'INFRASTRUCTURE' When EISA became law late last year, it generated a great deal of publicity and controversy — but for reasons wholly unrelated to its effect on franchisors' property rights. EISA's claim to fame was its ban on the sale of incandescent light bulbs, which will be phased out beginning in January 2012. Meanwhile, another provision of EISA — which took effect immediately — received relatively little attention or scrutiny. That provision is the "Prohibition on Franchise Agreement Restrictions Related to Renewable Fuel Infrastructure."

EISA defines "renewable fuel" as any fuel containing at least 85 percent ethanol or at least 20 percent biodiesel or renewable diesel. EISA does not, however, specifically define the "infrastructure" to which it refers. The reason is that this particular "infrastructure" is not comprised of roads, bridges, or some other public work financed with taxpayer dollars. Nor is the "infrastructure" owned by the government. Rather, the "infrastructure" is — or at least *was* before the enactment of EISA — private property.

This "infrastructure" has three major components. First, it includes trademarks adopted by major oil companies to identify gasoline, motor oil, and other petroleum products. Second,

it encompasses the vast real estate holdings of petroleum marketers nationwide. This real estate includes retail gas stations in which the owner or lessee has invested several million dollars in signage, pumps, underground storage tanks, and buildings — with the reasonable expectation of recouping that multi-million dollar investment by having the premises used to market petroleum products under a particular refiner's trademarks. Last but not least, this "infrastructure" consists of the branded distribution systems, including franchise agreements, whereby motor fuel is marketed nationwide under refiners' trademarks.

No shots were fired and no troops were called up to nationalize this "infrastructure" in the name of "energy independence" and "security." Instead, Congress and the president simply amended a pre-existing federal statute, the Petroleum Marketing Practices Act (PMPA). As originally enacted 30 years ago, the PMPA merely established uniform federal standards and procedures for termination and non-renewal of petroleum "franchises." The PMPA defines "franchise" in terms of a license to use a refiner's trademark — such as the familiar "Exxon" and "BP" signs that motorists see at gas stations. The franchisors to which the PMPA applies, however, are not limited to the major oil companies. For example, many relatively small distributors of gasoline and motor oil — known in the industry as "jobbers" — are authorized to sublicense refiners' trademarks to independent dealers to which the distributors supply petroleum products. Distributors' franchise agreements and real estate holdings, along with service stations owned by the oil companies but leased to independent dealers for operation under the refiners' trademarks, are thus part of what EISA has declared to be "renewable fuel infrastructure."

Of course, nothing prohibits sellers of ethanol and biodiesel from creating their own "infrastructure" to sell renewable fuel. But why buy the cow when you can get the milk for free? By virtue of EISA, a PMPA franchisor must now permit its franchisees to purchase, advertise, and sell renewable fuel — even if the renewable fuel is not a product supplied by the refiner whose trademark identifies the service station, and even if the renewable fuel is not a product that the refiner has authorized to be sold under its trademark. EISA thus allows franchisees to use refiners' trademarks as part of a scheme of "bait and switch." The "bait," of course, consists of the familiar oil company trademark that entices a motorist to stop and patronize a particular service station in the first place. The "switch" can now occur because, thanks to EISA, the PMPA franchisee is no longer restricted to selling petroleum products identified with the trademark that the gas station displays. Instead, the franchisee can use the refiner's trademark to sell "renewable fuel" of unknown origin, even if it is branded with someone else's trademark.

PROPERTY RIGHTS Refiners' trademarks are not the only property that EISA expropriates for the benefit of competing suppliers of renewable fuel. Often the franchisor owns the service station property, having leased it to an independent dealer on the condition that it be operated as a particular oil company's franchise. EISA, however, permits the franchisee to use the franchisor's pumps, tanks, credit card system, and other service station "infrastructure" to sell renewable fuel supplied by a competitor that has no investment in either the service station or the trademark with which it is branded.

Before the enactment of EISA, one federal court after another had rejected attempts by service station dealers to use their franchisors' trademarks and other property to sell competing products. As one federal judge in New York put it: "For [the defendant dealer] to use the [refiner's] trademark as defendant pleases while depriving [the refiner] of any revenue from its trademark is to attack the core purpose of trademark and franchise as it exists in this country." Of course, attacking "the core purpose of trademark and franchise" (not to mention real estate law) is like shooting fish in a barrel when the targets are the major oil companies at a time when retail gasoline prices and oil company profits have reached record highs. It is therefore understandable why franchisors, trademark owners, and landlords in other industries may be tempted to feel safe from a similar legislative assault.

But if EISA goes unchallenged, it is not hard to envision the federal government expropriating franchisors' investments in other industries in the name of goals no less worthy than "energy independence" and "security." Proper nutrition, for example, is as American as motherhood and apple pie. And federal expenditures on health care might go down if that apple pie were replaced with slices of organically grown apples. So why not dictate that the vast "infrastructure" of the nation's fast food restaurants — including their trademarks, real estate holdings, and franchise systems — be conscripted for the sale of whatever menu items the state dictates?

In a country like Venezuela, perhaps such expropriations of franchisors' "infrastructure" are constrained only by the imaginations and grand designs of the nation's leaders. Here in the United States, however, such "infrastructure" is in fact private property that is supposed to be protected by the Bill of Rights. R

More Forbearance Please

By Andrew Perraut
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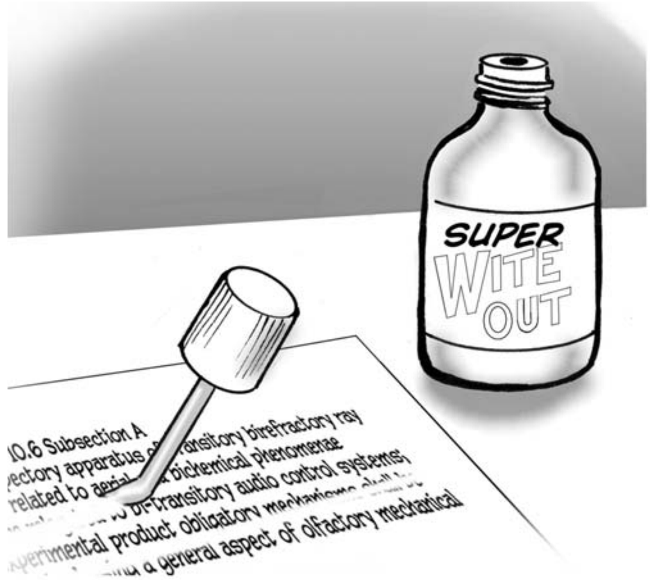

Imagine a world in which Congress's ham-fisted attempts at regulation were never implemented and agencies actively reviewed their rules to remove those that no longer make sense. If that sounds like a regulatory paradise, think again: it's the Federal Communications Commission. Or, more precisely, it is what the FCC is supposed to be.

Anyone who has had dealings with the FCC knows that misguided regulations are both plentiful and very much enforced, so skepticism is to be forgiven. Still, the 1996 Telecommunications Act makes it effectively illegal to enforce "bad" regulations by giving the FCC a unique and powerful deregulatory tool: forbearance.

As the communications bill neared completion, a number of congressmen became concerned that it did little or nothing to prune the regulatory thicket that had grown around the telecom industry. But so much regulation in this area is arcane, how to decide what needed to go? Congress struck on an elegant solution to this complicated problem: rather than introducing specific reforms, the act orders the FCC to forbear from enforcing any regulations that it finds are no longer in the public interest.

> The 1996 Telecommunications Act makes it effectively illegal for the FCC to enforce "bad" regulation.

Two facets of the law make forbearance particularly powerful. First, the policy not only applies to FCC rules, but to statutory rules imposed by Congress. This essentially gives a veto pen to the FCC when misguided legislation is passed. Second, corporate stakeholders may petition the commission to forbear — and their petitions are automatically granted if the FCC fails to act within a year (or 15 months, if the FCC grants itself an extension).

PASSIVITY With both the power to overrule Congress and a deadline for responding to stakeholders, forbearance has the potential to be a dramatically powerful and beneficial tool for sweeping away the regulatory deadwood. But if forbearance is so promising, why is the FCC still the commission that everyone loves to hate? The problem does not seem to be with the law itself, but with how it has been put into practice.

The FCC has largely squandered the promise of this sort of regulatory relief by using its power only passively. As feared, the commission has not examined its own rules for regulations that should be retired, but has generally waited for a corporate stakeholder to petition for action. Those petitions certainly have a place, but the 1996 law puts the burden of forbearance on the FCC itself.

The commission has no doubt resisted this role at least in part because of time and funding constraints. Expending resources to evaluate existing policy leaves less to go around on other projects. A reluctance to do means-testing on each regulation every year might be understandable, but the FCC has no active policy of review with an eye to forbearance. This is unacceptable in the face of regulations that are costly both monetarily and in terms of constrained future innovation. Waiting for petitions from businesses does not meet the basic obligations imposed by the Telecommunications Act of 1996 and eviscerates the power of forbearance as a positive deregulatory tool. The FCC needs to get out of the business of faith-based regulation and embrace a process of gradual review.

At the same time, the commission's passive policy has added to the suspicions of some critics who charge that it has simply turned the veto pen over to the most powerful corporations. Allowing the process to be entirely corporate-driven can needlessly create a perception of taint. While the law rightly provides for input from the business community that the regulations will affect directly, allowing this to become the only path to regulatory relief has been a mistake.

The problem is made worse by poor implementation. There are no formal rules that allow the public to comment on petitions submitted by firms, further adding to fears that the foxes are guarding the henhouse. In practice, the FCC has generally adopted the same notice-and-comment rules that the Administrative Procedures Act has made familiar in most

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administrative rulemakings. This has, however, been completely voluntary, leaving open the possibility that some petitions might not be opened to the public at all. That lack of transparency rightly worries some and is easily remedied. The commission can quite simply formalize what it is already doing in practice by applying APA-style rules to all future forbearance proceedings.

Without those reforms and a more active policy of review from the FCC, the effectiveness of forbearance is seriously compromised and a real opportunity is wasted. The commission should immediately revisit its forbearance policies and bring them in line with Congress's intent. If it fails to do so, Congress may need to remind the FCC of its responsibility to the public interest.

BROADER APPLICATION Looking forward, if the correct changes are made and forbearance lives up to its promise, there is no reason to limit it to the FCC. Why not extend the practice to the other regulatory agencies? Economists often remind us that our institutions are shaped by the incentives they face, and those incentives have all favored excessive regulation for far too long. Forbearance can be a small but significant step toward realigning those incentives.

For our economy to remain a dynamic powerhouse in the 21st century, we must begin reforming our method of regulation. Forbearance rules, properly implemented, can begin that process by doing something that should be wholly uncontroversial: eliminating rules that no longer serve the purpose for which they were written but instead inflict actual harm on public welfare.

OIRA at Midnight

By Jerry Brito and Patrick McLaughlin

Mercatus Center

"Midnight regulations" are a regular target of criticism. However, unless you believe that regulation of any kind is always problematic, the fact that regulatory activity increases at the end of a presidential term should not by itself be a cause for concern. Thus, thoughtful objections to midnight regulations do not center simply on the increase in regulations, but on the process of their formulation.

The most common criticism relates to accountability. During the "midnight" period — after the November election, but before a new president is sworn in — a lame-duck administration might be impervious to normal checks and balances. It need not worry ever again about securing Congress's cooperation nor the electorate's votes, and therefore has a freer hand to pursue regulatory prescriptions that might otherwise have invited retaliation.

Related to the concern over accountability is the criticism that midnight regulations can be undemocratic. After the election, the people have spoken, and if they have chosen a new president with policies different from those of the sitting president, then actions by the sitting president aimed at exerting power beyond his term may directly contradict the stated preferences of the electorate.

The concerns over the lack of accountability and democracy during the midnight period are very serious. Midnight regulations, however, present another problem that receives little attention. It is the prospect that an increase in the number of regulations promulgated in a given time-period could overwhelm the institutional review process that serves to ensure that new regulations have been carefully considered, are based on sound evidence, and can justify their cost.

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OVERWHELMED The regulatory review process that is currently embodied in the Clinton-era Executive Order 12,866 requires the Office of Information and Regulatory Affairs (OIRA) to check significant proposed regulations against a series of criteria, including the existence of a clear market failure and whether societal benefits and costs were considered. To that end, OIRA employs "desk officers" who specialize in specific areas of regulation. They vet proposed regulations in their designated issue areas and work with agencies to make sure final regulations comply with the principles laid out in the executive order. The midnight regulations phenomenon, however, undercuts OIRA's ability to engage in a productive review process.

The calculus is simple. As we know, at the end of each administration — and especially between administrations of opposite parties — there is a dramatic spike in regulatory activity. However, there is no corresponding increase in the resources available to OIRA during those times of increased activity. If the number of regulations OIRA must review goes up significantly, but the man-hours and resources available to it remain constant, we can expect the quality of review to suffer.

If the number of regulations increases but OIRA's resources stay constant, review quality will suffer.

Since OIRA was invested with regulatory review authority in 1981, its budget has grown only modestly from $4.3 million in 1981 to $7 million in 2007. The high mark was $8 million in 2004 and 2006. However, in real terms OIRA's budget has decreased since its inception. Staffing at OIRA has also decreased consistently and dramatically, from 90 full-time-equivalent employees in 1981 to just 50 today. At the same time that we see a decline in OIRA's resources, however, we also consistently see spikes in the number of economically significant regulations OIRA must review during the last quarters of presidential terms.

During midnight periods, the same number of staff, with the same resources, must review an increased number of regulations. Looking specifically at the midnight periods of the George H. W. Bush and Bill Clinton presidencies, when the transition was to a president of the opposite party, we see the number of economically significant regulations that OIRA was asked to review more than double from the same period in the immediately preceding years. As there was no concurrent increase in the resources available to OIRA, it seems likely that the quality of its regulatory reviews decreased.

REVIEW TIME One possible proxy for quality of regulatory review is the number of days a regulation submitted to OIRA is actually reviewed. OIRA publishes notices both when it receives a regulation for review and when it completes its review. In a recent working paper, this article's co-author, Patrick McLaughlin, examines whether increases in regulatory activity, such as those that occur during midnight periods, cause average review time to decrease. He calculates the monthly average review time (i.e., how many days pass between when each rule is received and when the review is finished) and tests whether the number of regulations submitted to OIRA each month for review affects review time.

While controlling for differences in administrations, McLaughlin finds that during the midnight period at the end of the Clinton administration, review time decreased significantly. Relative to the mean review time between 1994 and 2007, the Clinton midnight period witnessed a decrease in mean review time of about 27 days — a drop of over 50 percent. If OIRA review serves to improve the quality of regulations, then midnight regulations likely are of lower quality than other regulations.

Because there is only one midnight period in the timeframe examined, McLaughlin also investigates a possible underlying cause of the decreased review time: an increased workload for OIRA. While OIRA is charged with reviewing all proposed significant regulations, the most important are those considered "economically significant" — those regulations that are expected to have an annual effect on the economy of $100 million or more. McLaughlin finds that the proportion of economically significant rules to all rules reviewed by OIRA spikes dramatically during midnight periods in general. He further finds that an increase in this proportion negatively affects the review time for all regulations, in and out of the midnight period. Holding constant the number of regulations reviewed that are not economically significant, one additional economically significant rule submitted to OIRA in a given month decreases the average review time for all regulations by half a day.

SOLUTIONS The most commonly proposed solutions to the midnight regulations problem suggest steps that an incoming president can take to undo his predecessor's last-minute actions. Another approach, however, would be to try to prevent the midnight regulation phenomenon in the first place, or at least mitigate its negative effects. To address the specific concern of diminished regulatory review, we suggest capping the number of regulations OIRA is expected to review at any time.

Because OIRA has up to 90 days to review significant regulations, a rolling 90-day window might be an appropriate time period. That is, an agency would be allowed to submit no more than a specific number of significant regulations for review in any 90-day period. That number would be based on the resources — budget and staff — available to OIRA. The number should be well above the "normal" levels of regulatory activity we see during non-midnight periods; the cap should only be approached during dramatic spikes in activity, such as those seen at the end of presidential terms.

Such a cap would also be flexible because the ceiling on the number of regulations that can be processed by OIRA in a given time period can be raised by increasing the resources available to it. In this way, Congress and the president can always choose to allow for regulatory spikes while preserving quality review. This in turn might make such a reform more politically palatable than a hard cap or a regulatory budget. R