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REGULATION was first published in July 1977 "because the extension of regulation is piecemeal, the sources and targets diverse, the language complex and often opaque, and the volume overwhelming." REGULATION is devoted to analyzing the implications of government regulatory policy and its effects on our public and private endeavors.

The Latest on the 'Smart Road' Scam

Since *Regulation's* publication of my article with Peter Samuel ("The 'Smart Road' Scam," Fall 2008), we've discovered yet another important element of this scam. It turns out that, over the life of the earmarked Transportation Technology Innovation and Demonstration (TTID) program, Traffic.com will likely not distribute millions of dollars to the transportation agencies it partners with, despite being obligated to do so by law.

As we explained in our article, the bulk of the federal funding (\$50 million covering 25 cities) for the TTID program was appropriated to Traffic.com on a sole-source provider basis by language inserted into the FY2002 Defense Appropriations Act. (Of course, the TTID program is not in any way a defense initiative.) Here's the relevant language from the bill (emphasis added):

[T]he Department of Transportation has the authority to extend the original contract that was competitively awarded for the deployment of the system in the follow-on deployment areas under the contract, **using the same asset ownership, maintenance, fixed price contract, and revenue sharing model, and the same competitively selected consortium leader**, as were used for the deployment in that initial deployment area under the program.

In other words, the contract extension for the national rollout of the program to 25 new cities was — by law — required to follow the same "revenue sharing model" used for the original contract for the "initial deployment area" (i.e., Pittsburgh and Philadelphia).

That original contract, comprised of a federal task order and agreement with the Pennsylvania Department of Transportation, specifically called for revenue-sharing payments to the partnering transportation agency based on Traf-

fic.com's annual revenues using the following sliding scale:

- 0 percent for gross revenue up to \$250,000,
- 5 percent for gross revenue between \$250,000 and \$1 million, and
- 10 percent for gross revenue above \$1 million.

A Traffic.com press release dated June 7, 2001 shows that the company initially provided a revenue-sharing payment to PennDOT. Quoting from that release: "The company also presented a check in the amount of \$33,610.64 to the U.S. Department of Transportation (USDOT) and the Pennsylvania Department of Transportation (PennDOT), partners with Mobility Technologies [an earlier name for Traffic.com] in a unique public-private cooperative." A quick calculation shows that such a payment corresponds to gross revenues of more than \$900,000.

Similar revenue-sharing arrangements by law should have been made with the local agency partner (typically a state transportation department) in each of the 25 follow-on city contracts. But no such payments are called for in the contracts for 18 of those cities (Atlanta, Boston, Chicago, Cincinnati, Columbus, Detroit, Las Vegas, Los Angeles, Oklahoma City, Phoenix, Raleigh, Sacramento, Salt Lake City, San Francisco, San Jose, Seattle, St. Louis, and Washington, D.C.). Instead, the contracts for those 18 cities typically let Traffic.com retain the "shared revenues" for use on a wide variety of eligible business expenses, including the operation and maintenance of the firm's own existing equipment. This type of "revenue sharing" is a mirage — essentially a bookkeeping trick — and violates not only the intent but the clear language of the FY2002 Defense Appropriations Act that funded the bulk of the TTID program.

Assuming that the Pittsburgh revenue-sharing payment is typical of the annual payments for an "average" city participating in the TTID program, and

that the program runs for an average of 10 years from inception, a rough estimate of lost revenue-sharing funds would total almost \$6 million.

Keep in mind that this estimate is extremely conservative because:

- Pittsburgh's \$33,000 represents only the initial year of operation, and commercial revenues have undoubtedly grown substantially in subsequent years.
- The gross revenue amount for Pittsburgh was just under \$1 million. However, the percentage of revenue going to the transportation agency doubles for revenues over \$1 million. The revenue share from larger cities (e.g., Los Angeles, Detroit) and/or cities in which Traffic.com is more commercially successful would be substantially larger than Pittsburgh's initial amount.

Taking those factors into account, it's very likely that the actual amount of "missing" revenue-sharing funds could easily exceed \$10 million or even \$15 million over the life of the program. Assuming that Traffic.com's revenues continue to grow, the most lucrative years for this revenue-sharing arrangement are yet to come. Hopefully, the TTID program audit report expected out sometime this summer from the USDOT inspector general will shed additional light on the magnitude of this revenue-sharing shortfall.

The bottom line: Many millions of dollars of shared revenue from this "public-private partnership" will never in fact be shared with the program's public-sector partners, in violation of federal law. This absolutely needs to be remedied. Better yet, a new public-private partnership that's designed from the start to serve the public interest (rather than the interest of one extraordinarily well-politically-connected firm) should take the TTID program's place.

JERRY WERNER

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Too Big to Fail, Read, Count, or Stop

BY ADAM SMITH, *George Mason University*

AND BRUCE YANDLE, *Clemson University*

Since the fall of 2007, we have heard repeatedly about a host of organizations that are considered "too big to fail" (TBTF) and thus, in their moment of need, are the beneficiaries of government lifelines. Included in this ever-growing list of firms are Fannie Mae and Freddie Mac, Bear Stearns, AIG, Bank of America, Citibank, Merrill Lynch, major insurance companies, a legion of auto parts suppliers, and Chrysler and General Motors. Fannie, Freddie, Citibank, and Chrysler — who are each being saved from failure for a second time in recent decades — remind us that both good and bad incentives matter.

Expectations of bailout predictably increase the willingness to take risks. Once a firm is designated TBTF, it can then increase its risk-taking. This is the problem economists call moral hazard. In the words of an old country song, we are reminded that "Uncle Jack insured his shack and now he plays with matches." In this case, the American taxpayers provide the no-fault insurance.

TBTF is nothing new in America. Benton E. Gup's 2004 book, happily titled *Too Big to Fail*, tells us that President Ronald Reagan's comptroller of the currency, C. T. Conover, apparently coined the phrase in 1984 when he appealed to Congress to save Continental Illinois and 10 other banks. Ultimately, Continental Illinois was snatched from failure's fire by the Federal Deposit Insurance Corporation. Such rescues had

been occurring for many years previous to Conover's request. In 1971, Lockheed Aircraft and its 60,000 employees were rescued by the 1971 Emergency Loan Guarantee Act. New York City taxpayers and bondholders were salvaged in 1975 by the New York City Seasonal Loan Act. Then in 2001, the Air Transportation System and Stabilization Act provided up to \$5 billion in loan guarantees to domestic airlines following the 9/11 attacks. In short, bailouts seem to be the American way for both Democrat and Republican administrations.

Uncle Jack would be proud.

TOO BIG TO READ? While attempting to understand and digest the rationale and legislation designed to salvage members of the TBTF family, we taxpayers have yet another big project to comprehend: legislation that is too big to read. Apparently, the more than 500-page American Recovery and Reinvestment Act wasn't read completely by those or their proxies who matter most in our political system — the president who signed it and the congressional leaders who guided the law through the legislative process. Consider as evidence the now-infamous AIG bonuses. President Obama, with his army of readers, expressed shock and surprise to learn that the legislation allowed as much as \$165 million in bonus payments to AIG executives. And Senate Banking Committee chair Christopher Dodd's staff initially indicated that the senator knew nothing of the matter. Later, with recovered memory, Dodd found himself in the unhappy situation of admitting that he removed earlier language in the bill that would have denied the AIG bonuses, and did so at the request of U.S. Treasury officials.

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