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The "Free Lunch" Free Press

by

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The brouhaha kicked up by Free Press regarding Time Warner Cable's ("TWC") plan to launch a four-city experiment later this year to test a consumption-based pricing model for broadband Internet usage is sad and discouraging – especially discouraging for those who understand that building, maintaining, and constantly upgrading high-speed broadband networks requires a huge private sector investment of billions of dollars.

The simple fact of the matter is that Internet usage is growing exponentially, which is generally a good thing. But the fast-growing demand obviously places strains on the capacity of broadband providers' existing networks. Capacity constraints impact the ability of providers to carry the increasing traffic loads without diminishing speed and quality of service.

Of course, broadband providers continually invest in expanding and upgrading their networks in order to handle the increased demands. But whether such investments must be made more or less quickly, and to what extent, may depend on the pricing model employed by the providers. There may be a "Free Press" organization ready to issue a call to arms to prevent absolutely any change in Internet pricing. But with its *ad hominem* attack on the TWC trials, the organization might as well change its name to "Free Lunch."

As with most things in life, there really is no "free lunch" for broadband users. I suspect most consumers understand that, ultimately, the costs of investments in network facilities – absent government ownership or subsidies -- must be recovered from the providers' subscriber base. This is being so, it is not necessarily best for consumers -- for overall consumer welfare in an economic sense -- for all subscribers to be charged the same flat rate for service, regardless of the amount of their own usage.

This is why, from a consumer perspective, TWC's plans to conduct trials in four cities to test some form of usage-based pricing model should be welcomed, not condemned. Before I explain further the economic rationale, consider these facts. According to TWC, the top 25% of users consume *100 times* more bandwidth than the bottom 25%. In fact, 30% of the subscribers use less than 1 GB of capacity each month. As a response to this disproportionate usage pattern, TWC has devised trials with various pricing tiers tied to usage. For example, at the low usage end, there will be a tier priced at $15 per month for 1 GB, with overage charges of $2 per GB per month. The tiers will range up to a new 100 GB Road Runner Turbo package for $75 per month, with an overage charge of $1 per GB per month. Overage charges will be capped at $75 per month. Significantly, there will be no caps on usage. A subscriber can use as much capacity as he or she wants. With the overage cap of $75, for $150 per month a customer can enjoy unlimited usage at the fastest speed.

In its press release calling for "nationwide opposition" to TWC's planned trials, Free Press does not dispute any of the above facts. Instead, it uses misleading, inflammatory rhetoric to try to obfuscate the merits of TWC's proposal. Thus, it declares, for example, that TWC is moving forward "with plans to limit consumers' Internet use." Not true. TWC's subscribers can continue to use as much capacity as they wish. The claim that TWC is "penalizing consumers for using the Internet" may, in Free Press' "free lunch" mindset, make good copy. But it is not true – unless Free Press believes that grocery stores that charge more for four bananas than two bananas are "penalizing consumers for eating bananas" or clothing stores that charge more for two pair of socks than one are "penalizing consumers for wearing socks." Similar rhetorical flourishes concerning "excessive penalties" for exceeding usage limits do no more than expose the extent to which Free Press' mindset is divorced from economic reality.

And there is real-world economic reality. Virtually all economists recognize that consumption-based pricing – price "discrimination" if you will, in the sense in which economists understand discrimination to be a positive good – may serve a useful purpose in a network environment heavily dependent upon substantial infrastructure investment. When network capacity is not unlimited, so that the cost of using an additional increment of bandwidth is something more than zero, consumption-based pricing may be the fairest and most economically efficient way to recover the network's costs while, at the same time, managing the network in a way that prevents traffic flow from grinding to a halt.

It may be the fairest way because consumption-based pricing may prevent lower usage customers from subsidizing higher usage subscribers. In other words, it is a way to require higher usage subscribers to pay for more of the costs they impose on the network as a result of their high usage. And it may be the most economically efficient way because price signals indicate to consumers that there are real economic costs associated with higher Internet usage. If this leads to a reduction in the rate of usage growth, it may delay the need to add more network capacity, the capital costs of which must be recovered from the entire subscriber base. A consumption-based pricing regime may be a way to avoid other network management actions, such as "prioritizing" of packets or outright usage caps, which otherwise might have to be considered as a means of addressing capacity constraints in the face of exponential usage growth. (This is not to say that, as the Internet continues to evolve, these other means might not make sense as well. It is rather to say that one of the benefits of TWC's proposal is that useful information will be obtained from the trials about economically efficient ways to manage the growing demand for capacity consistent with consumer preferences.)

After ignoring the facts relating to TWC's announced trials, Free Press blithely asserts that "many see this as an attempt to stifle the emerging online video market – a competitive threat to Time Warner Cable's television service." Many? Really? I think few would see TWC's trial in this light if they understood the facts. And the reality is it would be silly to do so. The real competitive threat is the one TWC and other cable companies face from telephone companies like Verizon and AT&T and other broadband providers, including wireless and satellite operators. All these competitors provide video services, to one degree or another, in competition with TWC. It would be foolish for TWC to adopt offerings, whether consumption-based pricing or otherwise, which do not meet consumers' marketplace expectations. It is questionable whether the type of "competitive threats" imagined by Free Press can inflict harm on consumers, even in environments in which a platform provider possesses monopoly power. It is clear that providers cannot harm consumers by metered pricing in a competitive environment such as the one that exists for broadband.

So back to consumers and consumer welfare – which, after all, should be the foremost consideration. Even in monopolistic markets, such as electricity or water distribution, consumption-based billing is the norm because it prevents low usage subscribers from subsidizing high volume users, and it increases overall economic efficiency as a result of consumers' response to price signals. Certainly, in a competitive market we should welcome trials to determine whether such consumption-based billing might be a useful way to achieve the same fairness and efficiency ends.

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