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New FCC Regulations Reduce Investment and Hinder Job Creation

by

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On September 6, FSF submitted public comments in the FCC's Section 706 Inquiry. Those comments emphasized that the text and context of Section 706 demonstrate the provision's deregulatory approach to encouraging broadband deployment. Strangely enough, the FCC has argued that Section 706's directive that the agency exercise regulatory forbearance and other means to accelerate deployment "by *reducing* barriers to infrastructure investment" justified its imposing network neutrality regulations and other regulatory mandates. As one of us put it in a blog post reviewing the FCC's most recent Section 706 report, "[t]he Commission refuses to acknowledge, or fails to understand, that the costs imposed on broadband providers by increased regulations, such as the recently adopted net neutrality mandates, likely will have the effect of discouraging private investment." And, needless to say, reduced private investment hinders the job creation that the country so desperately needs.

FSF's comments in the FCC's Inquiry for its next Section 706 report elaborate on the problematical aspects of the FCC's pro-regulatory approach to Section 706, including the anti-investing incentives resulting from new regulations. Along the way, we cite Gerald R. Faulhaber and David J. Farber's 2010 paper "The Open Internet: A Customer-Centric Framework." In that paper, the authors compared winning bid prices for A and B block spectrum in the FCC's 2008 auction of 700 MHz spectrum with the prices for C block spectrum that was encumbered by "open access" or network neutrality-like regulatory conditions. As Professors Faulhaber and Farber recounted, the mean winning bid price of A and B block spectrum was $1.89/MHz-Pop whereas Verizon paid only $0.76/MHz-Pop for C block spectrum. Here is direct empirical evidence of the investment-stifling effect of FCC regulatory action. In the authors' words, "[n]etwork neutrality regulation thus decreased the value of the spectrum asset by 60%...reduc[ing] the affected telecommunication asset and thus reduc[ing] the incentive to invest in such assets."

More recently, Professor Faulhaber has published a helpful article in *Communications & Convergence Review* titled "Economics of Net Neutrality: A Review" (2011). As the title suggests, the paper is a review of recent economics literature on the FCC's network neutrality regulation. But it also provides some pointed criticisms of the premises of the net neutrality regulations that the FCC imposed by order in December 2010.

The FCC's order imposing net neutrality regulations – which mistakenly claims Section 706 as the main basis for the agency's authority – insists that broadband ISPs have numerous incentives and opportunities to engage in abusive activity to benefit themselves at the expense of content providers and their own subscribers. On the contrary, writes Professor Faulhaber:

> [N]owhere in the [FCC's order] can we find anything approaching an economic analysis of these hypotheses (or allegations). In fact, one has to read the [FCC's order] very closely to find any empirical support whatsoever that any of the suspect behaviors the FCC seeks to prevent have actually occurred…
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> So in over a decade, there were only four examples of purported misconduct (one which was denied by the courts and another which didn't even rise to the level of a complaint for the entire broadband ISP industry. By any standard, four complaints about an entire industry in over a decade would seem to be a cause for a commendation, not for restrictive regulations.

The lack of any existing, real-world problem for regulation to address is something we addressed in FSF's comments to the FCC in its Open Internet proceeding and on very many occasions elsewhere.

In addition, Professor Faulhaber criticizes the FCC's order imposing net neutrality regulations for reaching beyond the protection of markets from anticompetitive behavior. According to Professor Faulhaber, the FCC's abandonment of its traditional reliance on competition to ensure good performance is evidenced by the disregard of competition from wireless broadband displayed in the agency's order:

> The FCC exempts the wireless broadband market from much of the network neutrality regulation it imposes on wireline broadband ISPs, but

> it's rationale for doing so is that this market is still new and evolving. Surprisingly, no mention is made in the [FCC's order] of the competitiveness of this market. Most economists would conclude that a competitive market (such as wireless) will yield outcomes that customers want, and therefore customers would get just the net neutrality that they demanded. A competitive market would solve whatever problems that might occur without need of regulation. And yet the FCC chose not to make this argument, even though the evidence that the wireless market is competitive is quite compelling.

On several prior occasions we have similarly observed the FCC's unwillingness to consider cross-platform competition, particularly where recognition of such competition should prompt deregulatory action. For instance, in its Qwest Phoenix MSA order, the FCC denied a petition from forbearance relief from legacy wireline regulations by refusing to consider competition from wireless service providers. And as our comments in the 706 Inquiry point out, the FCC's refusal to consider 3G wireless in its latest 706 report results in a broadband deployment assessment that fails to sensibly convey the reasonable and rapid state of ongoing broadband deployment efforts. For the Commission to fail to take the impact of wireless broadband into account in its upcoming report would be an even more egregious error.

Professor Faulhaber also argues that the FCC's net neutrality regulations create rent-seeking opportunities for interest groups "to create rents for themselves by suborning government power via the regulators on their own behalf." According to Professor Faulhaber:

> Almost all of the economic analysis has focused on the actual net neutrality regulations themselves and their potential impact. It is likely, however, that the real costs of regulation will arise from the *presence of a regulator positioned to intervene in the broadband ISP market,* whatever the actual regulations are.

He then points to Level 3's loopy advocacy for FCC intervention on its behalf in a dispute over Internet network traffic dealings with Comcast as one significant example of "attempts to press the FCC to order changes in commercial arrangements." Before the FCC began considering the imposition of net neutrality mandates, no one seriously contended that the FCC ought to intervene with respect to the exchange of Internet traffic under peering arrangements. Such peering arrangements previously have been conducted on a commercial negotiating basis, without regulatory intervention.

Rent-seeking concerns relating to the FCC's net neutrality regulations were a subject of an *FSF Perspectives* paper, "Opening the Internet to Regulation," which explains how the privileged treatment given to "edge users" and the murky distinction between "end users" and "edge providers" "raises the possibility that future attempts by the FCC to demarcate 'edge users' from mere 'end users' will become fertile ground for special interest pleading and lobbying." And Larry Downes has pointed out in a *Tech Liberation*

Front blog how the FCC's procedural rules for filing complaints leaves the door wide open for marketplace competitors and interest groups to attempt to bog down rivals through the complaint process that will soon be going into effect.

While Professor Faulhaber's article – including his responses to other articles in the economics literature – is worth reading in full, here's how it wraps up:

> The conclusion of this review is clear: *the economic evidence does not support prophylactic net neutrality regulation.* In the absence of significant evidence of 'bad behavior' by broadband ISPs over the past decade, the extensive literature is unable to support such regulation. Even articles specifically arguing for net neutrality regulation cannot make an unambiguous case for regulation…

This same conclusion applies not only to its net neutrality mandates, but also to many other FCC regulations as well across all technology platforms. With the nation confronting severe economic difficulties, and with all eyes focused on job creation, the FCC ought to recognize that the way for it to do its part to contribute to economic recovery is to alter its pro-regulatory disposition and actions.

The FCC recently jettisoned the Fairness Doctrine regulation, which had *not* been enforced for a quarter century. Now, it needs to get serious about revoking, or not adopting as the case may be, unnecessary regulations that it *does* intend to enforce.

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