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It's Time for U.S. Leadership Regarding Zero-Rating and Similar Programs

by

Randolph J. May * and Gregory J. Vogt **

Introduction and Summary

The Internet is a remarkable, international communications medium. Marketplace developments and government reactions in one country inevitably impact those in another – often very rapidly. Because the U.S. is a global leader in private Internet infrastructure deployment and applications development, actions of the U.S. government regarding communications policy naturally tend to be influential.

Indeed, U.S. actions are likely to be influential abroad with respect to so-called zero-rated services, whereby Internet Service Providers (ISPs) and applications providers allow, in various ways, customers "free" access to some Internet content. Governments in other countries have been mixed in their reactions to Internet regulation, including zero-rating and similar programs, such as Facebook's "Free Basics" program.

Current FCC "fact-finding" investigations concerning the lawfulness of certain zero-rated services are raising the specter of potential U.S. regulation, even though the FCC has refused to adopt a blanket prohibition of such services and the FCC Chairman previously praised T-Mobile's Binge On. Even the pendency of this "fact-finding" mission creates unwelcome speculation domestically and internationally concerning harmful regulatory intervention, particularly since these inquiries tend to remain open for months if not years.

The different ways in which countries have approached zero rating to date shows the potential for U.S. influence. Some countries have adopted prohibitions whereas others have performed more careful economic analyses. An unfortunate case in point is India. Just this year India stymied efforts of Facebook's Free Basics program that was designed to expand Internet usage in the country, which presently has a broadband penetration rate of only 22 percent of the population.

Various zero-rating offerings can benefit consumers, improve broadband adoption, provide application and content providers more customers, and contribute to network infrastructure investment. Because U.S. influence abroad regarding telecom policy matters, the U.S. government must be doubly cautious before intervening with regulatory restraints that adversely impact the Internet subscribership and infrastructure deployment. This caution applies not only to ISP offerings but, as well, to programs offered in conjunction with ISPs like Facebook's Free Basics program in India.

Chrysler ex-chairman Lee Iacocca once provided sage advice that we could apply to zero-rated and similar "free" data services that exempt certain content from charges that might otherwise apply: lead, follow, or get out of the way. It is time for the U.S. government to lead by getting out of the way of a form of Internet innovation that benefits consumers, most certainly including low-income consumers.

American Leadership for the Internet

American ingenuity is still driving world economic growth and progress. Despite misguided U.S. government efforts to "fix" competition (which was never broken in the first place), Internet growth and innovation is largely driven by private U.S. infrastructure investors and related software and content developers. Up until 2015, the U.S. Internet marketplace has had direct and indirect benefits and innovations that exponentially grow the economy, which some estimate in the trillions, with minimal government involvement.

Non-U.S. companies recognize this leadership and constantly improve their ability to become part of this global economic movement. Consumers and businesses worldwide reap the economic and social benefits of these U.S. development efforts. Because of this private sector U.S. leadership, U.S. government actions traditionally have had an oversized influence on non-U.S. government approaches to the Internet. As the country with the most developed Internet market in the world, other countries naturally look to U.S. leadership as a guide with regard to the issues they face.

U.S. Government's Raised Eyebrows (Real or Imagined)

The FCC previously announced that it would not make blanket findings with respect to zero-rating, sponsored data, and similar "free" data services, recognizing their potential to produce both consumer benefits and theoretical harms. FCC Chairman Wheeler has repeatedly said that he favors "permissionless innovation," presumably without the stultifying overhang of *ex ante* regulation or *post hoc* regulatory raised eyebrows. So U.S. Internet and content providers have, at least for the most part and until now, largely been free to innovate without government permission, all to the good of the consumer. Thereafter, dark clouds began forming, which may signal these forward-thinking principles may be slipping away.

U.S. companies have begun to offer Internet zero-rated services, such as T-Mobile's Binge On, AT&T's Sponsored Data program and Verizon's FreeBee Data, and Comcast's Stream TV. Even though Chairman Wheeler initially praised T-Mobile's Binge On, he now has begun an "inquiry" of Binge On and these other services as well. No one knows for sure the outcome of the inquiries, but the very long and increasingly involved discussions indisputably create a negative overhang, whether the FCC intends that result or not.

Although each of these innovative marketing programs has different characteristics, they all have one similarity: they are searching, often through a trial and error process, for ways to encourage U.S. customers to use services and access data they otherwise might not use because of the cost to consumers, such as the incurrence of data usage fees. Usage fees, of course, in the past have been explicitly approved by the FCC as a legitimate means to require (especially disproportionately heavy) network users to pay the cost of adding bandwidth. But given consumer price sensitivity (competition at work!), usage fees can be a disincentive for some end users to access higher bandwidth services or data. To overcome initial market acceptance, ISPs are easing consumer access, which is clearly beneficial to consumers, particularly new or lower income consumers. Businesses benefit because zero-rated and similar services can create a useful toe-hold that can be leveraged into additional consumer purchases in the future. Such beneficial results improve the economy, and add jobs and useful services, vastly increasing consumer welfare. In other words, a win-win-win situation.

Of course, zero-rated and similar services have been around for decades in many market contexts. Advertiser-supported TV is one such service. Toll-free telephone service is another. The Internet itself sports many "free" services, including news, music, games, etc., such as Wikipedia or Google's market-leading search engine or Facebook's leading social media site. Consumers have flocked to these services, expanding subscribership and overall use of the Internet. Would these "free" services ever have gained such a market presence if they had not been so readily and easily available?

What is clear at present is that even the pendency of the FCC's current "fact-finding" mission, much less any agency decision jeopardizing the continuing existence of zero-rated services, is likely to have an unfortunate impact on non-U.S. government reaction. This situation is exacerbated because the U.S. government has a tendency not to shut down promptly such a fact-finding mission, leaving the "proceeding" to fester for months or years.

India's Action Unwisely Undermines Internet Adoption

One example of potential adverse consequences from a lack of decisive U.S. leadership occurred recently in India. In February 2016, the Telecom Regulatory Authority of India (TRAI) prohibited Indian telecom services companies (TSPs) from engaging in allegedly discriminatory pricing based on the Internet content they transmit. In particular, the TRAI prohibited TSPs from giving consumers access to a package of Internet content, without charging for usage.

The service at issue was "Free Basics," offered through a partnership between Indian wireless provider Reliance Communications and Facebook. Free Basics would have permitted Reliance's subscribers the opportunity to access some 100 Internet programs, including Facebook, over their wireless phones without incurring usage fees. Facebook actively solicits additional content providers to become members of the program so that Free Basics is a diversified offering that is attractive to customers. As of April 2016, the Free Basics program reportedly is offered in some 37 countries, including in those countries where wireless usage charges are high. These fees may be an absolute bar to subscribership by some customers. And Free Basics should be attractive to various content providers as a means of gaining additional subscribers.

The TRAI believed that providing such zero-rated services would allow a TSP "to shape" the Internet experience of the user, possibly with the effect of interfering with customer ability to "migrate to the open internet." The TRAI also thought zero rating would be anti-competitive, allowing large content providers to "create significant entry barriers" to smaller content providers. The regulator posited that there was "information asymmetry" between TSPs and users, making users unable to make informed choices as to the content they wished to view outside of Free Basics. In the end, the TRAI concluded that pricing discrimination would risk imposing "negative externalities on the rest of the network," i.e., reduce contributions to network investment.

The opinion itself relies on international government approaches to network neutrality rules, including evaluating the approach of the U.S. Although the TRAI rejected the U.S. case-by-case approach on zero rating, there is little doubt that it paid attention to U.S. developments in this area, repeating some of the same arguments that so-called public interest groups make in the U.S.

First, the TRAI's argument that Free Basics might "shape" a customer's Internet experience, or create a "walled garden," is seriously flawed. The "information asymmetry" viewpoint is nothing more than government asserting it can make "better" decisions for consumers than consumers themselves. This is wrong.

This same "walled garden" criticism was the major feature of the original AOL.com web access service in the Untied States. The mid-1980s version of AOL.com clearly attracted millions of new users to the Internet who could experience the value of the Internet for themselves once access was made easy for them. But the market (yes, driven by consumer preferences) then rendered AOL.com's business model mostly obsolete because consumers wanted something different. In the end, usage of the Internet exploded. This happened without one government entity doing anything. Why can't we learn from the market?

Second, the TRAI decision concerning the potential exclusion of smaller content providers is not based on sound economic analysis. Rather, Free Basics' "walled garden," if that's what you want to call it, is designed to promote eventual, more general access to the Internet. Access to smaller content providers is never restricted. And small content providers will end up being free riders once these new users are attracted to the Internet using their wireless devices and decide they want more.

In any event, Facebook's Free Basics actively solicits additional content providers to join the program. In addition, the availability of other mobile ISP services gives consumers the ability to avoid the zero-rating carrier altogether. Therefore, the allegedly exclusionary impact, far from being a competitive threat, appears a straw-man argument.

Third, far from creating "negative market externalities," Dr. Jeffrey Eisenach demonstrated in March 2015 that zero rating can improve overall network usage, to the benefit of both consumers and ISPs. Indeed, Eisenach recognizes, as do other economists, that promotional "price discrimination" can attract marginal customers who are price sensitive to the network, defraying infrastructure costs and growing the network. The externalities are positive.

Finally, only a fifth of the Indian population is online, as reported this month by Pew Research. TRAI itself admits that "the majority" of the population of India is not connected to the Internet, a dismal showing compared to the U.S. and some Pacific-rim and European Union countries. Giving consumers the opportunity to access services without incurring data charges, such as various zero-rating programs and programs like Facebook's Free Basics, is clearly designed to improve adoption, one of the oft-stated goals of the U.S. government.

Given these flaws in the TRAI's decision, the end result will not improve access to local providers at all. So India's action will really harm those consumers it proclaims to be protecting.

Other countries unfortunately have employed India's same uneconomic framework, such as the Netherlands, which fined two operators in early 2015 for zero-rating deals, and the adoption of a outright ban on zero rating in Chile in 2014, with no better rationale than that offered by India. Fortunately, the European Union in October 2015 refused to outlaw zero rating altogether as long as the program does not violate the policy of non-discriminatory traffic management. And even Chile apparently is making exceptions to its absolute bar of zero rating with respect to specific services, such as Wikipedia.

Conclusion

The U.S. government should realize that maintaining U.S. leadership regarding Internet policies depends on encouraging the marketplace to drive innovation and consumer choice, not imposing government restrictions. Proper market-driven U.S. policies can benefit all consumers globally by demonstrating marketplace "facts on the ground" that encourage foreign governments to follow suit.

Even the pendency of zero-rating "fact-finding" – the regulatory "raised eyebrows" approach – by the FCC likely will have an unfortunate impact on the international scene, impeding efforts such as Facebook's Free Basics program to facilitate increased access in places with low penetration rates.

The FCC should lead by getting out of the way of market-driven policies that lead to increased consumer choice, innovation, and investment.

* Randolph J. May is President of the Free State Foundation, an independent, nonpartisan free market-oriented think tank located in Rockville, Maryland.

** Gregory J. Vogt is a Visiting Fellow at the Foundation.