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Title II Would Not Just Harm Consumers, It Would Harm Workers Too

by

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During an October Federal Communications Commission Open Internet Roundtable discussion, Professor Tim Wu and other scholars, including FSF Board of Academic Advisors member Gus Hurwitz, discussed the ramifications of reclassifying broadband under Title II. In referring to the regulatory costs Internet Service Providers (ISPs) would incur under Title II, Professor Wu said: "Ultimately, consumers always pay for everything, no matter what we say otherwise." (See the 79-minute mark of the first video.)

FCC Commissioner Mike O'Rielly reiterated Professor Wu's statement during his speech at the Free State Foundation's November 14 policy seminar "Thinking the Unthinkable: Imposing the 'Utility Model' on Internet Providers." (See this video around the 51-minute mark.)

It is very important that FCC regulators understand the impact Title II regulations would have on future prices as well as the quality and quantity of broadband service that consumers experience. FSF scholars often look at consumer welfare implications when analyzing public policy. These implications should be understood before adopting any policy, but especially one that would regulate such an innovative and dynamic tool like the Internet. In fact, regarding consumer impact, economists Robert Litan and Hal Singer estimated in a December 2014 Progressive Policy Institute policy brief that Title II reclassification could add $15 billion in new user fees, considering the amount of the fees the average consumer will have to pay to the federal, state, and local governments.

However, consumers would not be the only segment of the economy affected by Title II regulations. Although consumers ultimately would pay for *most* of the regulatory burdens that Title II would levy on ISPs, workers and job seekers would also experience a significant burden that should not be ignored. Of course, these regulatory costs have a substantial overlap among consumers and workers.

Regulating an Unbroken Market Will Adversely Affect Employment

Keith Hall, a Senior Research Fellow at the Mercatus Center, released a March 2013 paper entitled "The Employment Costs of Regulation." Hall's analysis is quite simple: If a regulation is not correcting for a market failure, it will have negative impacts on employment, whether in the form of reduced wages or lower levels of employment. Even advocates of Title II regulations generally admit that there is no market failure that needs to be corrected. Senator Al Franken (D-MN), a supporter of Title II reclassification, admitted "nothing" is broken about the Internet. (See the first minute of this video.) This is why Title II advocates most often say that regulations are needed to "preserve" or "maintain" an Open Internet.

Using Hall's analysis, if the advocates of Title II generally concede that there is not a current market failure, it is fair to conclude that Title II reclassification would have negative effects on employment. In a world where "Jobs!" is often the slogan of public officials and regulators, the actual market impact of regulation on employment is frequently overlooked, underanalyzed, or even ignored.

Executive Order 12866 requires that all notices of proposed rulemaking (NPRM) for economically significant regulations (regulations which have an annual impact on the economy of $100 million or more) must have a Regulatory Impact Analysis (RIA). Hall makes the point that RIAs often do not accurately take into account the regulation's impact on employment. However, since the FCC is an independent agency, Executive Order 12866 does not apply to it. Therefore, there was no such analysis in the FCC's May NPRM on "Protecting and Promoting the Open Internet," and there likely will not be any such analysis performed by the FCC if Title II is adopted. But this certainly does not mean that the impact Title II regulations would have on broadband employment should be ignored.

Title II Reclassification Would Negatively Affect Workers

When regulations are levied on firms, the firms' costs increase because additional requirements must be met. For example, one firm may need to completely change its production methods to comply with the regulations. Another firm may have already adhered to the rules but now must hire a compliance expert in an attempt to ensure all regulatory requirements are met. Either way, both firms experience cost increases as a result of the regulations.

Policy scholars understand that consumers end up paying for these regulatory costs in two basic ways. The first is that ISPs will increase prices for consumers in order to offset the increased costs that Title II regulations would impose on them. The other way consumers pay for regulations is through decreased competition. If Title II is adopted, some ISPs likely will not be able to afford the costs of the regulations and will fall out of the market. Consumers pay for the

decrease in competition through increased prices and/or lower quality of service. A less competitive market disincentivizes ISPs from providing quality service because consumers cannot switch as easily to a new ISP.[1]

Of course, if ISPs raise prices as a result of additional regulatory costs, consumers will have less money to spend on other goods and services, which in turn will result in fewer jobs in other markets. This could be referred to as the indirect effect of regulations on employment. But regulations can have very direct effects on workers in the *regulated* market.

Workers can directly pay for the regulatory costs in several different ways. First, if an ISP increases the price of its service to offset the increase in costs from the regulations, consumers will demand less service at the higher price. This decrease in the quantity demanded from consumers likely will negatively impact employees, either through lower wages or unemployment, if the ISP becomes less profitable than it was before the regulations were in effect. Second, in order to avoid the initial burden on consumers, an ISP may simply lower the wages of its employees in order to cover the cost of the regulatory burdens. Third, an ISP simply could lay off workers in order to allocate funds towards paying for the regulatory costs. Fourth, if an ISP simply cannot compete due to the additional costs, the ISP will shut down and all of the firm's workers will become unemployed.

While consumers are severely burdened by the additional regulatory costs, the employees of the firms that are forced to shut down are also paying for the regulatory costs with *forgone income*. Additionally, because the market for low-skilled workers is much more competitive than high-skilled workers, low-skilled workers are often the employees whose wages are reduced or whose jobs are lost as a result of the additional costs of regulations.

Although these are general effects on employment as a result of regulation, Title II regulations would have very specific adverse impacts. The three parts and 47 sections under Title II amount to hundreds of specific requirements. Even if all the requirements under Title II are not imposed, ISPs likely would have to hire regulatory compliance employees to attempt to ensure that their operations are compliant with the regulations that the FCC mandates. The ISPs likely would offset the increased employment costs with another variable, whether it is increased prices, lower quality of service, lower wages, or laying off employees in another area. As Hall describes in his paper, "the effect of regulation compliance works much like a tax on the firm."

More specifically, Title II reclassification would require traditional public utility rate regulation.[2] Under rate regulation (or the absence of market prices), shifting the burdens imposed by regulatory costs onto consumers is much more difficult. Therefore, ISPs are more likely to shift the burden onto their employees. This does not mean that rate regulation is better for consumers than market prices. Market prices are always better for consumers because rate regulations, or

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[1] A firm can increase its prices, lower the quality of its services/goods (if regulations allow it to), or some combination of the two in order to cover the costs of regulations. Either way, consumers are worse off.

[2] Even if direct traditional public utility rate regulation is not adopted under Title II, banning paid prioritization (which the FCC does not have authority to do under Title II but has been included in several proposals) is rate regulation because it would effectively regulate the price of priority at $0. Therefore, doing this under Title II would have similar effects to those of rate regulation.

price controls, suppress the amount of service an ISP would be willing to offer. If ISPs do not have control over the prices they charge consumers, they will have a disincentive to invest, innovate, and upgrade old networks.

Economists Kevin Hassett and Robert Shapiro estimated in their November 2014 Sonecon report that Title II regulations would reduce investment from ISPs by 12.8 to 20.8 percent over the next five years, which is massive considering American ISPs have invested $344 billion in broadband infrastructure over the last five years, according to USTelecom. This decrease in investment will adversely affect the almost 1 million American jobs that help build this country's broadband networks. Hassett and Shapiro also estimated that ISPs will invest over $218 billion over the next five years if no regulations are adopted, meaning Title II regulations could reduce investment by $28.1 billion to $45.4 billion over the same span. This means a lot of network building jobs will be lost as a result of Title II regulations.

Conclusion: Markets Allocate Jobs More Efficiently Than Regulations

When entrepreneurial activity occurs in a market, some workers lose out to more efficient actors in the market who can charge lower prices to consumers. This process, which Joseph Schumpeter called "creative destruction," can occur through increased worker productivity or through the advent of innovative and disruptive technologies. But when creative destruction occurs, consumers and the economy, in general, are better off because it occurs through a voluntary market process.

If a regulation (that does not correct for a market failure) affects employment and wage levels in the market (whether up or down), the impact should be seen as a negative effect on the economy. If these shifts in the labor market were a positive *market outcome*, they *would have occurred* absent the regulation.

"Jobs!" should not be a mere political slogan. Public officials, including regulators, should focus on the impact of regulations on employment. Any public official who says he or she wants a healthy labor market should be against Title II reclassification because such regulations likely would have serious negative impacts on many workers.

Professor Wu deserves credit for understanding and admitting that consumers often end up paying for the costs of regulations. But consumers alone do not "always pay for everything." Workers can often experience the burden of regulations through lost jobs or lower wages.

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