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Net Neutrality and Spectrum Auctions:

Lessons from History

by

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The upcoming FCC auction of key 700 MHz spectrum has generated intense controversy in the past months, and more than its fair share of political infighting and surprises. The new auction will take place because the FCC will reclaim from the broadcast companies this prime chunk of spectrum when the television companies vacate it in February 2009, when the transition to digital-only broadcasts are complete. The current parameters of the debate concern the nature and intensity of the conditions that should be attached to the auction, including proposals that certain portions of this space be dedicated to bidders who agree to observe certain key "open access/net neutrality" provisions. We know that the attachment of any conditions to any auction item can only reduce its value, so that the burden should be on those who impose the conditions to explain why they are needed.

On this sensitive point, the clear verdict of history is that this burden cannot be overcome. The point here is not to look at the detailed specifications for the auction, but to ask this question: Why is it that all the spectrum is not just sold off with no conditions at all? That proposal in effect is intended to reduce the spectrum to a species of property, which, notwithstanding its intangible nature, operates in the same fashion as land, at least under the common law rules. Those rules sensibly give the owner the power to determine its use so long

as there is no interference with the like use of others, and to decide whether to use the block of spectrum in tact, or to divide it among others.

There is little doubt to my mind that this system of allocation works best for land use decisions, notwithstanding the inveterate use of zoning laws that seek to fine-tune the relationship between parcels, only to tie up key land use decisions for long periods of time while any underlying land use value remains unexploited. In virtually all these cases, there are arguments that the use or disposition of land within the framework of these common law rules will produce adverse externalities on third parties. Yet the supposed external losses are never compared with the huge direct losses that come from the explicit conditions that are put on the use in question.

The same history has played out with earlier spectrum uses. In this modern age, it is hard to remember that, before government regulation, there was some judicial authority to the effect that spectrum allocation was made under common law rules to the first party to occupy a particular frequency. That early effort was shoved aside by the aggressive intervention, first, of the Department of Commerce (under Herbert Hoover) and then the nascent Federal Radio Commission. Both were premised on the dubious assumption that administrative allocation of frequencies beat the bottom up approach. The argument was that scarcity of spectrum required special government-devised rules, to which the proper response was, and is, that scarcity is not just a spectrum problem. Everywhere, property rules are the best way to deal with scarcity because they promise the quickest path to a voluntary market.

Writers like Leo Herzl and Ronald Coase saw this in the 1950s, but the world believed in a different wisdom. The point of government action was not, to paraphrase Felix Frankfurter, merely to set the rules of the road, but to determine the composition of the traffic. The irony on the broadcast side was that the only way to forfeit a radio or TV license for sure was to rent it out to the highest bidder.

It is fair to ask, therefore, just how well the FCC has done with its various licensing procedures to determine the composition of the traffic. The answer on the broadcast side is, not very well at all. No one knows who should get what frequency, so that all the original FCC licensing procedures featured individuals who paraded their local connections or civic service to get a license that they would then sell in a private auction. But the inability to lease, or to subdivide, or to change uses kept the resource value far below what it should have been, for the original licensee or any subsequent buyer.

For present purposes, the vital point to note is that technological ignorance is a virtue, not a weakness. Right now, the best way to sell bandwidth is to sell in outright, with no restrictions on use whatsoever, including bandwidth used for broadband. Let the competitive bids in an unencumbered auction constitute the evidence of value. If the FCC plays the conditions game, it will reduce both market and social value of the spectrum. The bottom line: The FCC

should not impose any open access/net neutrality conditions in the 700 MHz auction.

There is, of course, one exception to this rule, which is misapplied far too often. In those cases in which there is a strong monopoly with respect to a particular service, then the standard rule for regulated industries—the use of reasonable and nondiscriminatory terms—*might* be a sensible way to proceed. But even in the pure case of monopoly, the real danger is that clever use of the regulatory process is more harmful than no regulation at all, by stifling long-term innovation that would quickly render the short-term fixes unwise or unnecessary.

It follows, therefore, that once the monopoly ghost is exorcised, as is the case with telecommunications, the older common law rules of property should dominate the game. They are far cheaper to operate, and they allow for quick responses to changes in both cost and demand. The history of the telephone and telegraph teaches us at least this one lesson: The advance and convergence of technology makes monopolies ever harder to maintain. In reply the defenders of net neutrality might gin up some small distortion from competition. But that game is never worth the candle, if the only alternative is massive distortion from regulation. The often troubled history of FCC regulation should make it clear that a simple common law property rights approach will do best by everyone in the long run. No matter what Google, AT&T, or anyone else may think, this is one case in which the fewer the conditions, the stronger the property right. Hence the following progression holds: The stronger the property right, the greater the return from the spectrum to be auctioned, and the greater the enhancement of long-term consumer welfare.

Primum non nocere—first do no harm—remains the key insight for public policy.

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