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Overregulating the Internet
"Net Neutrality" Would Discourage Investment and Innovation

by

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While health-care reform may be the foremost example of President Obama's overreaching domestic-policy agenda, communications policy deserves attention as well. In October, the Obama administration's Federal Communications Commission unleashed a proposal to regulate a large swath of the Internet under a "net neutrality" regime. If adopted, this policy would likely discourage investment and innovation in broadband Internet networks, a particularly unwelcome development with the nation just emerging from a severe economic slump.

Since taking over as chairman of the five-member commission last June with a newly installed Democratic majority, Julius Genachowski has focused the FCC on developing new broadband policies. In and of itself, this focus is not unwarranted, and in any event Genachowski had little choice: The stimulus law passed last February requires the FCC to develop a "national broadband plan" by Feb. 17, 2010, with a goal of ensuring "that all people of the United States have access to broadband capability."

On the basis of what is now known, we can say that Genachowski's plan will contain some sensible recommendations, including some that could make more spectrum available for wireless operators. But Genachowski is separately pursuing net-neutrality legislation.

Net-neutrality rules would prohibit all broadband Internet service providers (ISPs), such as Verizon and Time Warner Cable, from blocking or degrading access to any website or Internet-capable device that a subscriber might want to use. Most significantly, such rules would prohibit ISPs from "discriminating" against unaffiliated applications and content providers. In essence, net neutrality would convert broadband providers into traditional common carriers, regulated like AT&T in the 20th century or the railroads in the 19th century.

In 2002, the Bush administration's FCC, finding that broadband Internet services already were developing over multiple technology platforms, determined that they should exist "in a minimal regulatory environment that promotes investment and innovation in a competitive market." This position was consistent with that of the Clinton administration, which in 1997 released a white paper declaring that "the Internet should develop as a market-driven arena not a regulated industry." William Kennard, President Clinton's FCC chairman, was beseeched by a coalition of ISPs to order then-emerging cable broadband services to be offered on an "open access" basis, a precursor of net neutrality. In September 1999, he refused, declaring that at the same time the FCC was trying to eliminate outdated "telephone world" regulations, it made no sense to "pick up this whole morass of regulation and dump it wholesale on the cable pipe." To do so, he said, "would not be good for America."

He was right.

Under current regulations, the United States has experienced remarkable progress in increasing broadband access. In 2000, there were approximately 7 million broadband lines. Now there are more than 132 million. More than 95 percent of U.S. households have broadband access, and approximately 63 percent of households currently subscribe. As the FCC stated last April under interim Democratic chairman Michael Copps,"market mechanisms have been successful in ensuring access to broadband in many areas of the country."

So why enact net neutrality now? Genachowski says such regulation is needed to "preserve" an "open Internet." But the FCC cites only two isolated and quickly remedied instances of alleged discriminatory conduct by ISPs. Indeed, the commission does not even argue that any market failure threatens the Internet's current openness. It would be difficult to do so in the light of the competition that generally exists among wireline, cable, wireless, and satellite operators. After extensive hearings in 2007, another regulatory agency, the Federal Trade Commission, issued a 160-page report finding that the broadband marketplace is "moving in the direction of more — not less — competition," and that "we are unaware of any significant market failure or demonstrated consumer harm from conduct by broadband providers." Since then, the market has only become more competitive.

Huge amounts of private-sector capital have fueled broadband's growth and increasing competitiveness. ISPs have invested at least $200 billion over the last five years in deploying and upgrading their broadband networks. There is a substantial risk that the new rules, and the seemingly endless and unpredictable litigation that FCC regulations inevitably engender, would discourage continued private-sector investment and innovation in advanced network technologies.

In rejecting the 2007 calls for net-neutrality regulation, the FTC observed that "the broadband industry is a relatively young and evolving one," with open questions likely to be answered "by either the operation of the current marketplace or the evolution of complicated technologies." Even though Genachowski proposes to allow ISPs some leeway to engage in "reasonable network management" — whatever that means — strict anti-discrimination prohibitions would prevent ISPs from experimenting with new business models that might be responsive to changing consumer demands. Therein lays the real harm.

For example, an ISP would be forbidden to charge content providers more for bandwidth-intensive applications such as video games or prioritized traffic delivery. With alternatives generally available to consumers, perhaps such policies would not succeed in the marketplace anyway. But regulations that prohibit such experimentation with new business models and differentiation of services risk curtailing new investment in the technologically dynamic, still-evolving Internet ecosystem. After all, to the extent the ISPs' services are commoditized by treating them like public utilities, the prospect of earning market-based returns diminishes, along with incentives to put capital at risk.

The Obama administration's proposals for addressing health care are much too interventionist for my taste. But at least there is widespread agreement that in health care, there are market failures that ought to be addressed in one way or another. Not so with respect to the Internet marketplace. Rather than jeopardizing continued progress, the FCC should jettison its proposal to impose new Internet regulation. It should concentrate instead on producing a plan that will help bring broadband to the remaining 5 percent of American households that are unserved.

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