

The Liberty Bell is centered in the background of the blue banner.

THE FREE STATE FOUNDATION

A Free Market Think Tank for Maryland.....Because Ideas Matter

**The Free State Foundation's
NINTH ANNUAL TELECOM POLICY
CONFERENCE**

**"A NEW DIRECTION FOR COMMUNICATIONS
POLICY: LESS REGULATION, MORE INVESTMENT
AND INNOVATION"**

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“FINAL THOUGHTS”

MODERATOR:

Randolph J. May – President, The Free State Foundation

PARTICIPANTS:

Michelle P. Connolly – Professor of the Practice of Economics,
Duke University, and Member of FSF's Board of Academic Advisors

* This transcript has been edited for purposes of correcting obvious syntax, grammar, and punctuation errors, and eliminating redundancy in order to make it more easily readable. None of the meaning was changed in doing so.

P R O C E E D I N G S

MR. MAY: Our next speaker, Michelle Connolly, is a longtime member of the Free State Foundation's Board of Academic Advisors.

Michelle Connolly is also professor at Duke University. You know, I'm not going to say any more about Duke. I mentioned that earlier. But it's an additional bonus to have someone from Duke.

She is a Professor of the Practice in the Economics Department at Duke University. And again, her full bio is in the brochure and it's on our website.

Maybe the only other thing I will point out is she served, as did Howard Shelanski who led off our program today, as Chief Economist at the FCC. And I think she is the only one that's held that position who did it twice, two different terms. So she must have done an awful lot right the first time around.

So, finally, Michelle is going to offer some final remarks here to conclude the conference.

And the only other thing I will say is that I mentioned when Commissioner Pai was here, our book,

Communications Law and Policy in the Digital Age. The only other plug that needs to be given about this book is that Professor Connolly has a chapter in it, which I hope she remembers. It's on spectrum auctions and how they should be conducted properly to best serve the public and consumers. So that's another reason why you might want to take a look at this book.

With that, I want to call on Professor Connolly for some brief remarks. I think we called this "Final Thoughts" in our brochure.

Professor Connolly.

MS. CONNOLLY: Thank you, Randy.

Randy first reached out to me just as I was about to leave the FCC for the first time and the Free State Foundation was just getting off the ground. I was a little surprised at how ambitious he was. But I have to say, I really underestimated his abilities to create such an important organization and have such an important role in current policy in DC.

I noticed the tagline as I walked in. It says, "Because Ideas Matter." I agree with that tremendously. That's why I wanted to become a professor. That's why I

went through the grueling -- well, I shouldn't say -- six years in grad school. But it took me that long to become a professor. And it's why I have become involved in policy beyond just being in academia. Because I think the ideas matter. I think it matters that people who are somewhat outside, don't have personal interests in certain outcomes, lend other voices to the discussion.

Since this is the "final thoughts" session -- or it reminded me of Saturday Night Live's "Deep Thoughts" -- I thought I'd focus on two deep thoughts. And they will be short, but I will give you a little bit of detail for each one.

So, the first one is that the FCC is in very good hands right now. I believe that absolutely. And one of the things that makes me say that is, as we heard at lunch, Chairman Pai is talking about creating the Office of Economics and Data at the FCC. It's very important -- this is a very important reversal, especially from the last administration, where economists were essentially ignored most of the time and not even spoken to.

The importance of having good analysis so that policy can't be made while ignoring the actual economic

costs altogether, as well as any possible benefits, is important. So I will get back to that.

Secondly, I am very happy that Chairman Pai is working on clearly defining what the regulatory role of the FCC is. So in this sense, the FCC is in good hands.

But my second deep thought is that, unless something is fundamentally changed, unless Congress takes actions to support many of the things that Chairman Pai is doing now, this can be very short lived. So let me go into a couple details related to this.

One, in terms of economics and data, I've been studying with some students the spectrum policy, spectrum auctions since 1997. One thing that we've discovered is that since 1997, of all of the licenses related to cellular services, half of them have been won by small bidders. Half. So this means that we have a policy which is giving bidding credits to 44 percent of people winning the auctions for spectrum, our scarce resource, and another 14 percent are being won in auctions that are set aside only for small bidders. And almost 10 percent have won in set-aside auctions and using bid credits.

But if you look at the combined total, that means

50 percent of our spectrum for cellular services since 1997 has been allocated to small firms. It is not clear that the intent to help small entities and to help competition is really being carried out in our current set of FCC auction rules if this is the outcome.

In an industry with very high infrastructure costs, forcing this scarce resource into the hands of smaller entities simply isn't making a lot of economic sense. And without looking at the data, no one has really noticed this.

In terms of the Title II regulation, there's a similar argument here that it was justified on the grounds of last mile monopoly power. This was justified, despite the fact that the Title II regulations were imposed on both fixed and mobile broadband. It was justified despite the fact that FCC's own data showed that, as of 2014, 97 percent of census blocks had two or more broadband providers providing a minimum of 10 megabits per second download speed and one megabits per second upload speed.

And as Blair Levin was saying, once we have enough competition then the issues or the concerns related to net neutrality disappear. Which might have also suggested

that they weren't there to begin with.

I also want to focus on block prioritization within the Title II regulations, which I think is the most harmful of those, other than the general conduct standard.

This rule was imposed, despite the fact that content service providers might be creating congestion. This rule was imposed despite the fact that content service providers might prefer -- might find it profitable -- to pay for paid prioritization. There are content delivery networks that are in existence that are hired by content service providers in order to speed up the rate at which their content is coming in.

So this policy, as imposed with the Title II regulations -- I'm going to steal from Michael Katz -- he actually called anti-competition regulation. Basically, you are harming differentiation between different content providers and content services or service providers. So there really is a difference between something being intellectually free and being economically free. Or another way of thinking of it is one might be interested in open Internet; that doesn't mean a free Internet.

The consequences that we've already seen, we know

there is going to be reduced investment. It is obvious both from a theoretical perspective as well as an empirical one. There have been several studies, [Hal J.] Singer and FSF's Horney also did a study showing a fall, not just in the rate of growth of investment but in absolute decline in the level of investment, which is very suggestive of regulatory uncertainty.

The consequence of this is reduced deployment. Reduced deployment is going to lead to reduced competition. We can have reduced quality of services. And what I think is particularly interesting when we talk about the issues related to the digital divide is the markets that are going to be hit most by this reduction in investment are going to be the economically marginal markets. So if we care about access and adoption, these are rules that are going to make that much more difficult to have and much more difficult for the digital divide to be reduced in the economy.

One thing that was not mentioned today is something called the waterbed effect, and that is also where the Title II regulation with the no paid priority regulation is essentially an implicit subsidy that is

being forced onto the Internet service providers and given to the content service providers. But in the waterbed effect, this subsidy can be passed on to the consumers. And that's passed on in the form of either higher prices and/or decreased quality.

So again, while the policy was intended for many different things, one of the impacts is directly on the consumer. And within the issues of the digital divide this, by pushing up average prices for average consumers, is if anything going to marginalize more people who have less income.

So the big picture -- now, my deep, deep thoughts here. Uncertainty that is created by vague and continuously changing regulation is a huge disincentive to investment. Unless Congress explicitly states that an agency does not have authority over a particular market, at some point, someone heading such an agency will make a regulatory grab.

So I will geek out on you. In grad school, when we were talking about fixed exchange rate policies, they would say the following: Within finite time, there is a hundred percent probability of a fixed exchange rate

failing.

What I am saying here is, within finite time, there is a hundred percent probability of someone making a regulatory grab, if they are not prevented from doing so. And this grab, when it occurs, will occur without proof of harm from a hypothetical risk and without any credible analysis of the economic costs of such a regulation.

So I absolutely support Chairman Pai's market-based approach and desire to move to light-touch regulation. But I do feel that without some kind of Congressional action, this approach may only last as long as Chairman Pai's chairmanship.

I guess the good news is that technological progress can make certain regulations become irrelevant. The bad news is that if you have built in these catch-all rules like the general conduct standard, then regulators can easily make new or random rules and actually help further slow future innovations.

But I guess the best news is that people like Randy May and the Free State Foundation help open up these discussions, bring very relevant speakers from the different areas, and keep us on task for that.

So I want to say thank you again to the Free State Foundation. Today's event was quite spectacular and what you guys do every day is quite spectacular. And the food was really good.

(Laughter.)

MR. MAY: I know my wife especially appreciates, and Kathee Baker, that last remark. Because, of course, they had the most to do with that.

But what I want to say really is that having you here and listening to you is just another illustration, along with Daniel Lyons, both professors, as to why I'm so proud of our Board of academic Advisors. And so both of you make me very proud to have you part of the Free State Foundation.

And, you know I'm about to end, and I want you to stay seated just a moment. But we really should properly give Michelle Connolly a round of applause.

(Applause.)

MR. MAY: Because those really were deep thoughts and important thoughts, and not just final thoughts.

So all I want to say to end up is, for those of you that were with us at the beginning when I welcomed you

this morning, those of you in our C-SPAN audience, I said, every year I say that our annual telecom policy conference just keeps getting bigger, better, and more impactful. And I said that I was going to keep on saying that as long as it's true.

So, in my mind, and I hope in yours as well, I think this was our biggest and best. I like to think they're all really impactful. That's what we strive for. And hopefully this was, as well.

And I want to thank you for being here. We all always welcome your ideas and input of whatever kind. There are a lot of battles that become ideological and that's the way they should be, because there are different philosophies, and I appreciate that.

But I consider people who are working on these issues as friends, and I appreciate your being here. I look forward to seeing you at the next Free State Foundation conference. Thank you very much.

(Applause.)