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When Is an Incentive Not an Incentive?

by

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Newly appointed Chairman Wheeler is under pressure to set the rules for implementing the upcoming incentive auction, giving broadcasters an incentive to volunteer spectrum that will be auctioned and repurposed to mobile broadband use. I certainly wish him luck in this endeavor because the auction can produce enormous public interest benefits in needed capacity and increased facilities-based broadband competition. But all the good luck in the world might not keep the "incentive" in "incentive auction" unless good choices are made to achieve the desired results. Simply put, if bidder restrictions reduce the spectrum to be repurposed, then the auction is likely to fail.

There are a lot of revenues riding on the incentive auction. Part of the proceeds of the second half of the incentive auction must support the nationwide first responder broadband network, pay for certain relocation costs, remit the broadcaster's share of auction proceeds, with the remainder going to the U.S. Treasury.

Perhaps more importantly, however, more spectrum needs to be allocated for mobile broadband use, a key Administration goal. Additional spectrum will contribute to consumer's increasing demand for faster and more ubiquitous mobile broadband, which will be competitive with other broadband offerings. It is no wonder in these circumstances that both Congress and the FCC concluded that maximization of broadcaster participation is the most important goal to be achieved.

After the Middle Class Tax Relief and Job Creation Act was enacted, some have suggested that restrictions should be placed on bidders in the auction so that the two largest wireless carriers could not purchase all or "too much" of the additional spectrum. T-Mobile for one has proposed excluding certain bidders for specific spectrum in geographic markets where the bidder already possesses an FCC-predetermined amount of spectrum in that market. Sprint attempts to justify bidder restrictions because some other countries have conducted spectrum auctions by limiting participation by large potential bidders. DOJ filed a rather weak speculation that large carriers might warehouse spectrum to foreclose their competitors. The FCC itself has fueled this debate by adopting an NPRM concerning possible revision of the Commission's spectrum aggregation policy at the same time it issued its incentive auction implementation NPRM.

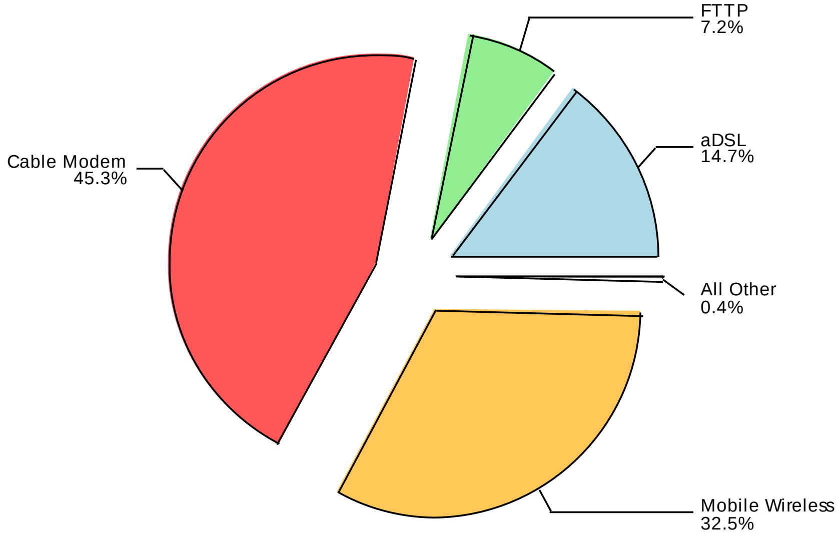
It is incumbent on the government to keep its eyes on the prize: repurposing the maximum amount of spectrum possible to mobile broadband use. There are six reasons why bidder restrictions are a bad idea.

First, actual marketplace facts belie the need to limit bidder participation. The wireless marketplace is robustly competitive, as FSF scholars have observed many times, including here. The following chart reproduces data from the FCC’s 16th Mobile Competition Report, which documents this rigorous competition for voice services.

ESTIMATED MOBILE VOICE COVERAGE, OCTOBER 2012		
Number of providers	Population Covered (%)	Road Miles Covered (%)
1	99.9	95.3
2	99.3	87.7
3	97.2	72.8
4	92.8	56.0
5	80.4	25.5

The same networks used to provide voice are also used for and being upgraded to accommodate broadband. These wireless providers not only compete against each other, but they also face stiff competition from wireline broadband competitors, who have a clear head start in the broadband marketplace. And as NTIA has reported, these wireline providers have been adding capacity at a significant rate in the last three years, which far outpaces expansion of mobile broadband capacity. The FCC’s 2012 Internet Access Service Report reports:

Chart 9
Residential Connections at Least 3 Mbps Downstream and 768 kbps Upstream by Technology as of June 30, 2012



Allowing mobile broadband providers to increase bandwidth and coverage as competitors to established wireline broadband providers should be just as important a goal, if not more so, than promoting competition among mobile broadband providers themselves.

Second, bidder restrictions may deter broadcasters from volunteering spectrum if they believe that they cannot command sufficient revenues for the spectrum they volunteer. Some persuasively argue that total auction revenues decline when bidder restrictions are introduced. Some broadcasters have submitted an economic study which outlines this suspected deterrent effect from reduced broadcaster participation. Low yields, both in terms of spectrum volunteered and earned bidding revenues, will make the incentive auction a failure. It should be remembered that the so-called 700 MHz D Block auction, which contained significant conditions and limitations on the winning bidder, was a failed auction. If anything, this history counsels against imposing bidder restrictions in the incentive auction.

Third, bidder restrictions could distort competition. The T-Mobile proposal is designed to limit competition for spectrum, thus likely reducing the cost of spectrum for the "favored" bidders, in this case the third and fourth largest wireless carriers in the country. Although T-Mobile claims this result will not occur, its theory depends almost entirely on the FCC's ability to set the "correct" "revenue target" (a market bid below the FCC's threshold amount would permit the restricted bidder to enter the bidding for that market). Setting the correct amount is virtually impossible to do because no one knows the value of this spectrum in advance of a competitive auction. If the third and fourth carriers were to obtain spectrum at lower costs than their main rivals, their capital costs are reduced relative to the largest carriers'. Artificially impacting specific carrier costs is anti-competitive and should not be condoned.

Fourth, the notion that either AT&T or Verizon would be motivated to or capable of spectrum warehousing makes little logical sense for several reasons. Investors, who are routinely hostile to large construction budgets, would likely punish warehousing behavior in the capital markets. Because bidding in the incentive auction is blind, neither large wireless company would know whether it was competing against T-Mobile, Sprint, or each other, making a warehousing motivation self-defeating, or at least possibly so, and therefore unlikely. And buildout rules would protect the public interest as a backstop to these strong anti-warehousing deterrents.

Fifth, the few bidder-restricted auctions that have been conducted in other countries for the ostensible purpose of increasing competition for smaller competitors have not achieved their purposes well. Some commenters show that competitive market share did not change much with such restrictions. And we do know for a fact that the international auctions with bidder restrictions are not the same kind of complex two-sided auctions contemplated here, and therefore are unlikely to accurately predict U.S. outcomes.

Sixth, utilizing T-Mobile's procedure would unnecessarily complicate the auction. Although the FCC has a reasonable track record with one-sided auctions, the FCC has no experience conducting a two-sided auction. Complicating auction procedures increases the risk of making unpredicted errors.

So when is an incentive not an incentive? When insufficient promised revenues deter broadcasters from volunteering spectrum. At base, attempts to steer the incentive auction toward certain multi-billion dollar competitors smacks of competitive favoritism. It is flatly inconsistent with free market principles that ought to guide the FCC's implementation of successful auctions.

As Chairman Wheeler has said: Competition works because it tends to produce optimal outcomes. Bidder restrictions should be rejected in favor of free market principles because they will produce a more optimal outcome.

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