The Broadband Credibility Gap

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\[ \bar{Q} = f(K, L) \]
Why Focus on Investment?

Chairman Genachowski:
“the basic goals have been constant: to encourage private investment and the building of a communications infrastructure that reaches all Americans”

National Broadband Plan:
“plan [describing] actions government should take to encourage more private innovation and investment”
Comcast Case:

DC Circuit rejected the FCC’s attempt to regulate outside of its statutory authority.

So, now what?
Title I
“serious risk of failure in court”

Title II
“clarify legal foundation”

“fail[s] to reflect the long-standing bipartisan consensus that the Internet should remain unregulated”

“subject broadband ... to extensive regulations ill-suited to broadband” that will “chill investment and innovation” by reducing “investors’ confidence”

Quotes from Genachowski Statement (May 6, 2010).
The Chairman’s Causal Chain

Title II
“extensive” and “heavy handed prescriptive regulation”

Cause

“can chill investment and innovation”

Effect
Title II “Lite” – Break the Chain

Title II

“Legal Certainty”

“heavy handed prescriptive regulation”

Apply only a handful of provisions of Title II, creating a ‘Title II Lite’ or ‘third way’ to break causal chain

“can chill investment and innovation”

Unfortunately, this proposal has no credibility.
A BSP makes investment decision

Then, FCC chooses regulation.
Credibility

- Can the FCC be *trusted* to impose and maintain “light touch” regulation under Title II authority?
- What does the evidence show?
  - Pre-Commitment
  - Present behavior
“Put in place up-front forbearance and meaningful boundaries to guard against regulatory overreach”

“The Commission would take steps to give providers and their investors confidence and certainty that this renunciation of regulatory overreach will not unravel”

“The difficulty of overcoming section 10’s deregulatory mandate and a prior agency finding in favor of forbearance.”

“has broad authority to preempt inconsistent state requirements when they frustrate valid federal policies.”

but ...
this Commission’s decision “would, could, or should absolutely prevent the Commission from adjusting its future policies in light of changed circumstances”

This is an explicit statement of the lack of pre-commitment.
“Frankly, I would have preferred plain and simple Title II reclassification through a declaratory ruling ... ”

Commissioner Copps Statement (May 6, 2010)
(Former FCC Chairman)
What about present behavior?
No Price Regulation

- **Open Internet NPRM**
  - Explicit price regulation of broadband service

- **National Broadband Plan**
  - Give spectrum for promise of “free or very low-cost service”
  - “affordability barrier to adoption”
  - Monitor prices to see if policy is needed (what policy?)

- **Special Access Proceedings**
  - Multiple proceedings dealing directly with the pricing of broadband transport

- **SkyTerra Decision**
  - Sneakily imposed Spectrum Cap based on “dominance” argument
No Unbundling

- **National Broadband Plan**
  - Plan states “FCC should comprehensively review its whole competition regulation”
  - inquiry into “competitive access to local fiber facilities”
- **FCC-sponsored Berkman Study**
Qwest Omaha vs. Qwest Phoenix
- Legal decision consist of two parts: (1) Solve a current problem; (2) establish precedent
- Qwest Phoenix is an outright reversal on precedent
- Forbearance now has a very high hurdle

Title II reclassification is plainly a reversal on an earlier decision
Wireless as Archetype

- Open Internet NPRM
  - Wireless Carterfone Rules
- ETF inquiries
- CMRS Competition Report
- SkyTerra Decision
  - Sneakily imposed Spectrum Cap based on “dominance” argument
Title II classification “chills investment,” by the Chairman’s own causal connection, unless the FCC can pre-commit to “light touch” regulation.

Yet, the FCC explicitly rejects its ability to pre-commit, and its own current actions belie its commitment to a light touch.

As such, the “chilling” effect remains intact.
Evidence on Investment Effects

- Cable stocks were down 10% on the announcement of Title II reclassification (event study in paper)
  - \[ \text{INV} = f(Q) \text{ where } Q = \frac{\text{MKT VALUE}}{\text{REPLACEMENT COST}} \]

- Analysts:
  - “Reclassification could act as a Trojan Horse for greater regulation”
  - “cable operators and Verizon ... could be forced to share .. network with competitors”
  - “the potential for lower investment are likely and the ramifications will be felt not just in telecom and cable, but potentially in the vendor sector as well”
  - “profoundly negative impact on capital investment”
The Comcast Decision

- The court’s decision was not a commentary on Title I jurisdiction, but a rejection of a poorly drafted Order.
- Was the Comcast decision “heavy handed”?
  - Does the FCC have the authority to manage the way in which traffic get delivered?
- The FCC continues to use Title I authority for much of its regulation, both historically and in the present.
- Regulations on transparency, blocking of traffic, interconnection, could be implemented under Title I.
Legal Certainty

- Legal Certainty is not the question when it comes to investment; Financial Certainty is.
- We can be legally certain all profits will be extracted, or legally certain that firms will be left alone
  - Obviously not the same influence on behavior
- “Chilled Investment” reflects a decline in expected returns on investment
  - Greater legal certainty to extract profits with heavy-handed regulation reduces expected return, thereby reducing investment
Not Scope of Regulation, But Probability of Success

Legal Certainty (Prob. of Success in Court)

Title II

Title I

Light-Touch Regulation

Heavy-Handed Regulation