PERSPECTIVES

PHOENIX CENTER FOR ADVANCED LEGAL & ECONOMIC PUBLIC POLICY STUDIES

Comcast's Capital Spending After Reclassification: A Check on Claims

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> ***In this PERSPECTIVE, I evaluate Comcast's investment behavior over the years 2004 through 2017 to see if there is any evidence either for or against the 2015 Open Internet Order. In contrast to claims, Comcast's investment data provide, if anything, evidence that reclassification has been detrimental to capital spending .***

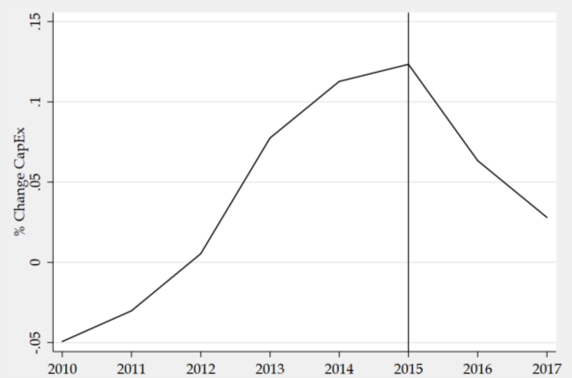
In a recent PERSPECTIVE, I evaluated deployment data for broadband services satisfying the Federal Communications Commission's ("FCC") 25/3 Mbps threshold for "broadband" services.[1] My analysis was prompted by recent testimony given to the U.S. Congress by Matt Wood, Policy Director of the advocacy group Free Press, in which he claimed that the FCC's 2015 reclassification of broadband as a common carrier "telecommunications" service under Title II of the Communications Act of 1934 did not affect the expanding availability of broadband service.[2] Statistical analysis of FCC data, however, reveals quite clearly that the availability of 25/3 Mbps service slowed considerably following the reclassification decision of the *2015 Open Internet Order*. Indeed, the FCC's 2015 reclassification decision may reasonably be blamed for a lack of "broadband" access to about 6.5 million Americans.

My eye was likewise drawn to Mr. Wood's claim that "Comcast's total capital spending for the two years following the 2015 vote increased by 26 percent."[3] That's admittedly a big number, so Mr. Wood's claim deserves some attention. In this PERSPECTIVE, I evaluate Comcast's investment behavior (for its cable segment) over the years 2004 through 2017 to see if there is any evidence either for or against the *2015 Open Internet Order*. In contrast to claims, Comcast's investment data provide, if anything, evidence that reclassification has been detrimental to capital spending.

Comcast's CapEx Growth and the *2015 Open Internet Order*

In this analysis, I focus my attention on Mr. Wood's claim that "Comcast's total capital spending for the two years following the 2015 vote increased by 26 percent."[4] Assuming for the moment that Mr. Wood's calculation is correct, we might ask—so what? What if, for instance, Comcast's investments were growing at a faster rate prior to the *2015 Open Internet Order*? Would this not suggest that reclassification was detrimental to capital spending? Sadly, the lack of any frame of reference—a *counterfactual*—is endemic to most Title II advocates' claims, including Free Press in particular. As I see it, this failure to do a proper analysis of the data cannot be due to ignorance; it is plainly a strategic choice.[5]

Figure 1. Percent Change in CapEx



Mr. Wood's 26% claim is intended to signal two things: (1) capital expenditures have increased post-reclassification; and (2) they increased by a lot. Parsing the growth into annual levels, Comcast's capital expenditures (unadjusted for inflation or firm size) rose by 14.4% in 2015 and 7.9% in 2016. These numbers do not add to 26%, even accounting for cumulative growth across years (that sums to 23.4%).[6] Mr. Wood has summed annual investment levels in 2015-2016 and compared that to the sum of spending for 2013-2014, offering policymakers an exaggerated growth rate spanning two years, hiding in the process the fact that growth in 2016 (the last year he considered) was substantially below trend (which occurs likewise in 2017, with growth of 4.7%).

A look at Comcast's investment data presents a very different story than that offered by Mr. Wood. Figure 1 illustrates the CapEx growth rates from 2010 through 2017. Investment growth prior to 2015 was trending positive. In 2016 and 2017, the years following the Commission's 2015 reclassification decision, investment growth declined sharply (though still positive). While this figure offers only a naïve view of Comcast's investment behavior, it certainly does not paint a rosy picture for the FCC's 2015 reclassification decision; capital spending growth noticeably slowed following the decision.

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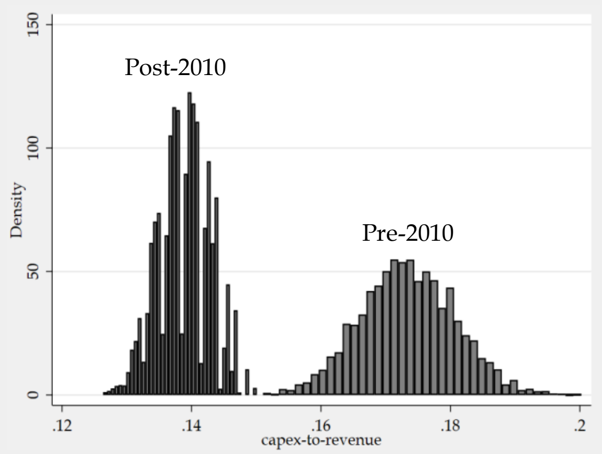
Capital Intensity and a 2010 Treatment Date

In addition to hiding relevant facts, Mr. Wood also fails to consider that Comcast's business grew substantially over the same period. The company's revenues grew 13.4% between 2013-2014 and 2015-2016 (and revenues are about seven-times larger than capital expenditures).[7] Naturally, capital expenditures might be expected to grow with the size of the company's business. As Free Press Research Director Derek Turner observes, "[h]earing that a company spent $100 million on capex certainly sounds impressive, unless you then consider that the company also took in $100 billion in revenue. This is why it is also useful to measure capital investment as a percentage of revenues."[8]

Let's analyze Comcast's capital expenditures per dollar of revenue (more formally, the Capital Intensity Ratio). In my own research, I have demonstrated from stock market evidence and investment trends (using a Difference-in-Differences method) that the potential harmful effects of reclassification began in 2010 when Chairman Julius Genachowski first indicated the

Commission was considering the reclassification of broadband as a Title II service.[9] Cable stock prices plummeted and investment analysts warned of investment effects.

Figure 2. CapEx/Revenue Pre- & Post-2010



Over the period 2004-2009, Comcast invested about $0.173 per dollar of revenue. From 2011 through 2017, after reclassification was put on the regulatory table, Comcast invested only about $0.138 per dollar of revenue. This difference is plainly large. In fact, the range [min, max] of capex-to-revenue values prior to 2010 is [0.149, 0.203] and [0.124, 0.150] after 2010. These ranges abut and essentially do not overlap, so there is an unquestionable reduction in investment by Comcast (as a share of revenue) after 2010. This difference can be seen clearly in Figure 2 that illustrates the empirical distributions (10,000 simulations) of the pre-2010 and post-2010 capex-to-revenue ratios.

Caveats

The analysis of one company's data to assess the effects of industry-wide regulation is not determinative. Comcast's capital spending is driven by its own unique circumstances, including the mix between different components of its network infrastructure, its particular take on general economic conditions, among other considerations (some of which are specific to cable systems).

Also, regulation, even if bad for business, may favor some firms relative to others. If firms exit due to a regulation, for instance, then remaining firms may increase capital spending as they receive the customers from failing firms.[10] Studies of capital spending much carefully parse expectations.

My purpose here is merely to evaluate the claims made by Mr. Wood (and by Free Press more generally) about Comcast's capital spending following the FCC's 2015 reclassification decision, which are shown here to offer an incomplete and misleading narrative regarding the effects of reclassification.

While the need for a counterfactual is well established, advocates peddling their preferred policies often avoid comparisons to a counterfactual, since doing so threatens their grandiose and inaccurate claims. Such behavior is strong evidence that the advocates' desire for a particular policy is unrelated to its effects on society at large.

Conclusion

To be policy relevant, a change in a statistic of interest must be put into perspective. Standing alone, a change in capital expenditures (or any other outcome) following a policy intervention offers no insight into the effect of the policy. Capital expenditures change over time—it's what they do. So, a change must be compared to what the change would have been absent the policy intervention, even if based (naïvely) on changes prior to the intervention. That is, a counterfactual analysis is required to assess the effects of the intervention. As shown here, the claim that Comcast's capital spending rose after the *2015 Open Internet Order* is meaningless in and of itself. A review of Comcast's capital expenditure data show clearly that the company's growth in capital expenditures fell after the 2015 reclassification decision and were below those occurring before the FCC threatened reclassification.

With respect to investment, classifying broadband as a telecommunications service is bad policy. The risks of expansive regulation under Title II are too great, leading broadband firms to curtail both investment and innovation. Attempts of the advocates for reclassification to prove otherwise have failed.

While the need for a counterfactual is well established, advocates peddling their preferred policies often avoid comparisons to a counterfactual, since doing so often threatens their grandiose and inaccurate claims. Such behavior is strong evidence that the advocates' desire for a particular policy is unrelated to its effects on society at large. The motivation is private. What is good policy for a few may be bad policy for the many, a fact that has been recognized and analyzed by economists for ages.[11] Title II regulation of the Internet, it appears, is special interest politics.

With respect to investment, classifying broadband as a telecommunications service is bad policy. The risks of expansive regulation under Title II are too great, leading broadband firms to curtail both investment and innovation.[12] Attempts of the advocates for reclassification to prove otherwise have failed.[13]

Advocates of Title II regulation for broadband might best embrace the views of former Chairman Tom Wheeler, who conceded that reclassification was a trade-off between investment and openness.[14] Doing so, however, requires an explicit analysis of the costs and benefits of the policy. There is no evidence that advocates for reclassification are either willing or able to craft a proper cost-benefit analysis.

NOTES:

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1 G.S. Ford, *Reclassification and the Availability of "Broadband" Service: A Counterfactual Check on Recent Claims*, PHOENIX CENTER POLICY PERSPECTIVE No. 18-02 (April 19, 2018) (available at: http://phoenix-center.org/perspectives/Perspective18-02Final.pdf).

2 Testimony of Matt Wood, before the Congress of the United States House of Representatives Committee on Energy and Commerce Subcommittee on Communications and Technology regarding *From Core to Edge: Perspective on Internet Prioritization* (April 17, 2018) (available at: http://docs.house.gov/meetings/IF/IF16/20180417/108168/HHRG-115-IF16-Wstate-WoodM-20180417-U41.pdf) at p. 10. *See also Protecting and Promoting the Open Internet*, REPORT AND ORDER ON REMAND, DECLARATORY RULING, AND ORDER, FCC 15-24, 30 FCC Rcd 5601, 80 Fed. Reg. 19738 (rel. Mar. 12, 2015) (hereinafter "*2015 Open Internet Order*"), *aff'd United States Telecom Association v. FCC*, 825 F.3d 674 (D.C. Cir. 2016), *pet. for rehearing en banc denied*, 855 F.3d 381 (2017); *In the Matter of Restoring Internet Freedom,* FCC 17-166, DECLARATORY RULING, REPORT AND ORDER, AND ORDER, __ FCC Rcd __ (rel. January 4, 2018) (hereinafter "*2018 Restoring Internet Freedom Order*").

3 Wood Testimony, *id*. at p. 16.

4 *Id*.

5 Free Press has been on notice about the need for a counterfactual analysis since at least 2009. *See* G.S. Ford, *Finding the Bottom: A Review of Free Press's Analysis of Network Neutrality and Investment*, PHOENIX CENTER PERSPECTIVE No. 09-04 (October 29, 2009) (available at: http://phoenix-center.org/perspectives/Perspective09-04Final.pdf).

6 The cumulative growth rate is $(1 + 0.144)\cdot(1 + 0.079) - 1$. The 95% confidence interval for the two-year change is [-0.084, 0.341], so the change in 2015-2016 is not abnormally large.

7 All data is from Comcast's Annual Reports (available at: https://www.cmcsa.com/financials/annual-reports) and a revision (available at: https://www.cmcsa.com/static-files/82e4866e-303b-453d-9595-7afa4f20fd4a).

8 S.D. Turner, *Finding The Bottom Line: The Truth About Network Neutrality & Investment*, FREE PRESS (October 2009) at p. 2 (available at: https://www.freepress.net/sites/default/files/legacy-policy/Finding_the_Bottom_Line_The_Truth_About_NN_and_Investment.pdf) ("capital investments as a percentage of revenue are useful metrics for analyzing investment trends").

9 G.S. Ford, *Reclassification and Investment: A Statistical Look at the 2016 Data*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-08 (July 13, 2017) (available at: https://ssrn.com/abstract=3138865); G.S. Ford, *"Regulatory Revival" and Employment in Telecommunications*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-05 (June 12, 2017) (available at https://ssrn.com/abstract=2989333); G.S. Ford, *Net Neutrality, Reclassification and Investment: A Further Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-04 (May 16, 2017) (available at https://ssrn.com/abstract=2982413); G.S. Ford, *Net Neutrality, Reclassification and Investment: A Counterfactual Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-02 (April 25, 2017) (available at https://ssrn.com/abstract=2982436).

10 T.R. Beard, G.S. Ford, T.M. Koutsky, and L.J. Spiwak, *Network Neutrality and Industry Structure*, 29 HASTINGS COMMUNICATIONS & ENTERTAINMENT LAW JOURNAL 149 (2007) (available at: http://phoenix-center.org/papers/CommEntNetworkNeutrality.pdf).

11 R.B. Ekelund Jr. and R.F. Hebert, SECRET ORIGINS OF MODERN MICROECONOMICS: DUPUIT AND THE ENGINEERS (1999); G.J. Stigler and C. Friedland, *What Can Regulators Regulate? The Case of Electricity*, 5 JOURNAL OF LAW & ECONOMICS 1-16 (1962); S. Peltzman, *Toward a More General Theory of Regulation*, 19 JOURNAL OF LAW & ECONOMICS 211-240 (1976); G.S. Becker, *A Theory of Competition Among Interest Groups*, 98 QUARTERLY JOURNAL OF ECONOMICS 371-400 (1983); F.S. McChesney, *Rent Extraction and Interest-Group Organization in a Coasean Model of Regulation*, 20 JOURNAL OF LEGAL STUDIES 73-90 (1991).

12 *See, e.g.*, Transcript from Comcast's Q4 2016 Results - Earning Call (January 26, 2017) (available at: http://seekingalpha.com/article/4040405-comcast-cmcsa-q4-2016-results-earnings-call-transcript) ("So we're encouraged by the prospect of rules that we believe will encourage that investment, stimulate investment, whether that's tax decreases

NOTES CONTINUED:

or revisiting the authority of the government to go to places that they said they weren't going to, but legally they could go to in the Open Internet Order with Title II (Brian L. Roberts).")

13 G.S. Ford, *In Response to Criticisms of Phoenix Center Research on Net Neutrality…*, @LAWANDECONOMICS BLOG (September 14, 2017) (available at: http://www.phoenix-center.org/blog/archives/2250); G.S. Ford, *A Review of the Internet Association's Empirical Study on Network Neutrality and Investment*, PHOENIX CENTER POLICY PERSPECTIVE No. 17–09 (July 24, 2017) (available at: https://ssrn.com/abstract=3138864); G.S. Ford, *A Further Review of the Internet Association's Empirical Study on Network Neutrality and Investment*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-10 (August 14, 2017) (available at https://ssrn.com/abstract=3138862); G.S. Ford, *Below the Belt: A Review of Free Press and the Internet Association's Investment Claims*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-06 (June 20, 2017) (available at https://ssrn.com/abstract=2989968); G.S. Ford, *Reclassification and Investment: An Analysis of Free Press' "It's Working" Report*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-04 (May 22, 2017) (available at https://ssrn.com/abstract=2982440).

14 Remarks of FCC Chairman Tom Wheeler, Silicon Flatirons Center, Boulder Colorado (February 9, 2015) (available at: https://apps.fcc.gov/edocs_public/attachmatch/DOC-331943A1.pdf) ("to balance the goals of openness with the needs of network operators to receive a return on their investment.'').