



THE FREE STATE FOUNDATION

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Perspectives from FSF Scholars
June 28, 2016
Vol. 11, No. 22

Is the Open Internet Order an “Economics-Free Zone”?

by

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Hi. I’m the “economics-free zone” guy.

For those of you not deep in the weeds of net neutrality policy in the United States, I’m the former chief economist of the Federal Communications Commission who used that line as part of a self-deprecating joke I told to defuse tensions at a small but contentious conference on the FCC’s *Open Internet Order*. In the Order, the FCC controversially redefined broadband provision as a service subject to “Title II” common carrier regulation. It claimed it was doing so to prevent broadband providers – cable, fiber, wireless – from charging content suppliers for delivery at all or for higher quality service, a practice known in the trade as “paid prioritization.”

The phrase “economics-free zone” ended up in a Wall Street Journal op-ed and went somewhat viral, to my regret and chagrin. A panel of the D.C. Circuit Court of Appeals recently upheld the *Open Internet Order* by a 2-1 vote, but the dissenting judge, unfortunately from my perspective, made reference to what was part of an off-hand joke.

I do not deny saying the *Open Internet Order* was an “economics-free zone,” although I did not say it intending to slap the FCC. As will be apparent, I do disagree with the Order. But I do so in the belief that the FCC was pursuing its genuine view of the public interest. But now with allusions to this phrase in a judicial opinion, I want to set the record straight.

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Not Economics-Free, But ...

Economics was in the *Open Internet Order*, but a fair amount of the economics was wrong, unsupported, or irrelevant. Some examples:

Wrong. Even if broadband providers have market power because subscribers are slow to switch broadband services, as the FCC claims, the FCC incorrectly found such providers lack an incentive to provide high-quality service. Broadband providers, in the FCC's scenario, will raise their prices up to where subscribers will consider switching. The better the broadband service, including content "neutrality" if that's what consumers want, the higher that switching price will be – establishing the incentive that the FCC denies.

Unsupported. The FCC claims that a "virtuous circle" preventing broadband providers from charging content suppliers for delivery will lead to more content suppliers, driving up demand for broadband. But the circle can work in reverse – charging content suppliers for delivery creates incentives to attract subscribers by cutting retail rates. The FCC didn't use its best supporting evidence – that broadband providers had already largely adopted net neutrality – as that would have undermined the necessity of regulation.

Irrelevant. In arguing against "paid prioritization," the FCC cited articles on what economists call "price discrimination" to suggest possible harms when a broadband provider charges different prices to content providers that compete with each other. But paid prioritization isn't price discrimination; it's charging higher prices for better service. These price discrimination articles are relevant only if there is no cost to providing better service, such as guaranteed speeds or minimal transmission gaps. The only way this can be done at no cost is that the existing capacity can provide the best service anyone would ever want at any time – that is, that capacity can never be congested. While counterintuitive, especially for wireless, some nonetheless believe this premise.

Potentially Better Alternatives

Nevertheless, there could be economic reasons warranting some rules regarding the relationship between broadband providers and content suppliers. First, if broadband providers advertise content-neutral practices, they should be held accountable as a matter of consumer protection. It remains to be seen whether we are better served by the FCC taking over this responsibility from the Federal Trade Commission, which lost its authority over broadband following its reclassification by the FCC as a common carrier.

Second, if the value of broadband depends on confidence that others can open links I post (unless they lie behind a paywall, like *The Wall Street Journal's*), minimum-quality regulation may be warranted. While the FCC nominally rejected a minimum-quality rule, its "no throttling" rule implies minimum quality – the lower limit of what would presumably be acceptable quality, "unthrottled," to use the FCC's terminology. A minimum-quality rule would also address concerns that a broadband provider would diminish the quality of non-priority service. The

theoretical appeal of a minimum quality does not make such a rule operational, enforceable, and worth any costs in additional congestion management.

A third possibility is regulating the price broadband suppliers charge for content delivery. The FCC effectively has done this. Its “no blocking” rule implies a regulated price of zero for content delivery, because broadband service cannot be denied to content suppliers who do not pay. But the novelty – and highly problematic nature – of this approach is not appreciated by some. The federal government has been reluctant to regulate sectors without a clear monopoly provider, because competition between only two firms is likely to lead to a better outcome than regulation. And regulation is even harder to justify when, as in this case, technological progress rapidly changes the definition of the product one is trying to regulate.

The D.C. Circuit Court of Appeals that sustained the FCC’s *Open Internet Order* apparently believed that the agency properly took those difficulties into account in its decision to take this unusual step. I do wonder how the FCC’s effective imposition of zero price regulation on content delivery was legally sustainable, when it denied that content delivery was a service that could be regulated. That denial could be taken to be a device to evade having to show that a zero delivery price is just and reasonable. I guess the Administrative Procedures Act prohibits arbitrary and capricious regulations, but perhaps not bizarre ones.

And on the Other Side

Opponents of the FCC’s order had flawed arguments too. One often heard that these issues should be left for antitrust. Yet consumer protection, minimum quality standards, and price regulation all lie outside the scope of antitrust. Moreover, in a series of rulings since 2004, the Supreme Court has limited the role of antitrust in industries subject to federal regulation.

Opponents also claimed that but for President Obama’s support of Title II, the FCC would have adopted less stringent rules. I was not privy to discussions and phone calls, and I was not on the FCC’s staff when the Order was adopted. But in my year as the FCC’s Chief Economist, my sense was that more stringent intervention was always a serious and widely preferred option on the table.

What Might Be Going On?

If broadband providers had largely followed net neutrality principles, why did both sides fight so hard over this regulation? The broadband industry may have feared even stronger regulation. The FCC in 2005 had classified broadband as an unregulated “information service” so providers would not have to provide regulated wholesale service to competitors with no facilities of their own. Now that the FCC’s Order has reversed this position, regulated wholesale service may be on the way.

Moreover, when the New York Times reports the D.C. Circuit’s decision as “Court Backs Treating Internet as Utility,” one has to ask when customer rates, untouched by the Order, will eventually be regulated as well.

From the government's side, a speculative possibility may be that if the U.S. government allows broadband providers to charge content suppliers for delivery, it will invite broadband providers in other countries to extract delivery fees from the dominant U.S. content suppliers, such as Google, Facebook, Amazon, and Netflix.

Finally, the FCC's motive may not involve economics and competition. It rather may be "public interest" civic and cultural populist values that the Internet "belongs to everybody." The *Open Internet Order* was not really an economics-free zone. But were those civic and cultural norms the real concern, perhaps it should have been.

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