This work is distributed as a Discussion Paper by the

STANFORD INSTITUTE FOR ECONOMIC POLICY RESEARCH

SIEPR Discussion Paper No. 10-013

CeLPU & CTIC Fourth International Conference on Equal Access Issues in Communications Law
Honolulu, November 26, 2010

Shooting In The Dark

Comments by
Bruce M. Owen

Stanford Institute for Economic Policy Research
Stanford University
Stanford, CA 94305
(650) 725-1874

The Stanford Institute for Economic Policy Research at Stanford University supports research bearing on economic and public policy issues. The SIEPR Discussion Paper Series reports on research and policy analysis conducted by researchers affiliated with the Institute. Working papers in this series reflect the views of the authors and not necessarily those of the Stanford Institute for Economic Policy Research or Stanford University.

CeLPU & CTIC Fourth International Conference on
Equal Access Issues in Communications Law
Honolulu, November 26, 2010

SHOOTING IN THE DARK

Comments by Bruce M. Owen

I have been asked to comment on the paper by Prof. Hee-Jung Lee of Korea University. Professor Lee's paper is focused primarily on the details of a particular implementation of the open access or net neutrality concept that involves a degree of carrier "self-regulation." My own perspective is to question whether there is a strong economic policy case for any form of open access or net neutrality. Only when we understand why open access is necessary can we design an implementation that is responsive to the particular form of market failure that gives rise to the need for regulatory intervention. Otherwise, we are "shooting in the dark."

There are at least two equal access issues: First, should competitors have equal access to each other's *facilities*, and second, should competitors have equal access to each other's entertainment and other *content*. The answers depend on whether such departures from normal competition policy would enhance consumer welfare. Normal competition policy is to rely on market forces to allocate resources in a way that enhances consumer welfare. Competition generally produces supplier incentives that are compatible with welfare maximization. Centralized allocation and regulation in principle can mirror these incentives, but requires information not usually available to those in charge of the intervention. Regulators are also subject, by design, to political influence.

Departures from normal competition policy typically are motivated by some species of market failure. If the market failure is sufficiently probable and serious, then regulatory intervention, even though handicapped by its own inefficiencies, may produce a better outcome than reliance on markets. For example, the FCC chairman advocates "net neutrality" in order to "Preserve the Free and Open

Internet."[1] The chairman must mean that some market failure threatens to end the freedom and openness of the Internet. His objective is to "preserve" the current "free and open" status of the Internet, presumably from the exercise of market or even monopoly power. The proposed remedy is net neutrality, implying some sort of equal access or non-discrimination regulation. To be effective that would require regulation of pricing, both for transmission and for content, as Professor Yoo's paper at this conference makes clear.[2]

The FCC has identified two specific sources of market power in broadband services. The first is providers of "must have" video programming, such as regional sports networks. The second source is operators of retail distribution facilities, such as cable, satellite, and telephone systems, who may possess or acquire market power. It is remarkable, and perhaps ironic, that the market power of these sellers apparently has not yet prevented the Internet from being "free and open."

Market power is an economic issue; its assessment and the assessment of any remedy is a matter of economic, not legal, policy. However, freedom of expression is sometimes seen to be threatened by market power in media industries. This problem suggests a potential conflict between economic policy and important political rights. In practice, however, no such conflict exists. Competition problems are assessed in "antitrust markets" consisting of products that are reasonably substitutable. For example, broadband Internet access can be obtained either from cable systems or DSL providers, among others. From an economic policy perspective we care about how many such competing services are available to given consumers and how effectively they compete. But from a freedom of expression perspective, citizens have a far wider choice of media than just broadband Internet. All available independent means of conveying and

[1] Genachowski, "Remarks on Preserving Internet Freedom and Openness," FCC, Washington D.C. December 1, 2010.

[2] Yoo, "Promoting the Buildout of New Networks vs. Compelling Access to the Monopoly Loop: A Clash of Regulatory Paradigms," [this conference, Nov. 2010]

receiving political and other messages should be assessed, and concentration of control involves counting the number of "gatekeepers" in the "marketplace of ideas." It makes no sense to cite economic concentration in *one* medium as *sufficient* reason to restrict the political rights of that medium's suppliers.[3]

Whether sports networks or other "must have" video content suppliers have market power is an empirical issue. Of course, content creators such as teams or leagues each produce differentiated products with some degree of market power. But that does not imply that distributors such as sports networks have market power. The FCC maintains its contrary position on the basis of an out-of-date small-sample staff study.[4] My expectation is that the FCC's claim will be seen, ultimately, as absurd, but we await timely and competent studies of the question.

As to market power in facilities used in retail distribution of broadband services, Internet and video distribution facilities today are not monopolies. Consumers typically have a choice of suppliers. In fact, the number of suppliers is growing because of wireless distribution. The FCC could easily expand the number of competing suppliers by permitting TV broadcasters to sell spectrum to wireless carriers.

Thus, the degree of structural competition in broadband distribution is not a given, but rather a policy variable under the control of the FCC. The situation is reminiscent of the early years of over-the-air broadcasting. The FCC controlled the amount of spectrum devoted to broadcasting as well as its geographic allocation. The Commission chose to authorize fewer stations than would have been supplied has spectrum markets not been regulated. The FCC and the courts then used the "scarcity" of spectrum as the legal rationale for regulation of broadcast content, notwithstanding the constitutional rights of broadcasters.[5]

---

[3] Owen, "Regulatory Reform: The Telecommunications Act of 1996 and the FCC Media Ownership Rules" 2003 *Michigan State-DCL Law Review* 671, 2003.

[4] *In the Matter of Adelphia Communications Corporation, Time Warner Cable Inc., and Comcast Corporation*, 21 FCC Rcd 8203 (2004).

[5] Owen and Wildman, *Video Economics,* Harvard University Press, 1992**;** Hazlett, *The Rationality of Broadcast Regulation*, 33 J.L. & ECON. 133 (1990).

Vertical integration among the various businesses related to broadband services and content is viewed with deep suspicion by those advocating various forms of open access. The primary reason for suspicion is the potential for a “conflict of interest.” Owners of content have an incentive to exclude competing content, which they may indulge by controlling distribution facilities.[6] But this suspicion is not sufficient to justify ex ante regulatory intervention. Exclusion of competing content is not costless to the distributor, and the lost profits from exclusion may well greatly exceed the increased profits from protecting owned content. In addition, there may be increased efficiency (lower costs and improved products) from vertical integration.[7]

In the end net neutrality and open access proposals for broadband services reflect political preferences, not economic realities. Those who expect to benefit from restricting the freedoms of broadband suppliers and content creators favor intervention. Those who expect to be harmed economically by such regulation oppose it. The “debate” is primarily a political struggle. One can only hope that one of the major factors taken into account by those responsible for making political decisions will be the effects of intervention on the welfare of consumers.

[6] Genachowski, *supra*, n. 1.

[7] Owen, “Antitrust and Vertical Integration in ‘New Economy’ Industries: Application to Broadband Access” (October 26, 2010). Stanford Law and Economics Olin Working Paper No. 400. Available at SSRN: http://ssrn.com/abstract=1689278