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Communication Policy Reform, Interest Groups, and Legislative Capture

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Abstract

There are varied models of regulatory agency behavior. Economists have recently emphasized the incentive-incompatibility of agencies "captured" by regulated entities and a legislature concerned with welfare maximization. This conflict is characterized as a principal-agent problem to which the legislature responds in various ways, including the imposition of administrative procedure laws, oversight committees, and other attempts to control the regulatory bureaucracies. I argue that the principal-agent incentive compatibility model of regulatory capture is naïve. Regulatory agencies are, in general, eager to please or at least appease their congressional oversight and budget committees. It is the committees themselves, and especially their chairs, who capture and are captured by regulated entities, with the objective of funding expensive election campaigns in return for access to a seat at the regulatory policy negotiating table. The existence of the regulatory state and the details of regulatory policy reflect this systemic bias in the political system, which Lawrence Lessig has recently tagged "Type 2" (lawful) corruption.

Working Paper: Comments Welcome. Author contact: bmowen@stanford.edu.

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Introduction

One of the problems of our system of democracy, or rather, of representative government, is its characterization by “independent” administrative agencies. The Framers of the federal Constitution, although they would immediately have recognized the problem of interest group “capture,” did not, of course, foresee the rise of the regulatory state. The Framers therefore failed to incorporate effective measures to check systematic special interest biases in administrative decisions and policies. Indeed, it is not clear what remedy they might have fashioned, given that promotion of commerce was then thought to be a principal legitimate role of the new government.

However, the political economy tradition of characterizing regulatory agencies as captured by special interests and therefore at odds with their “welfare-maximizing” overseers in Congress is deeply flawed. Although it permits the application of sophisticated principal-agent models, the tradition is out of touch with reality.

It is rather legislative oversight and budget committees and their chairs that are (willingly) captured by special interests in the first instance. One could equally say that legislators capture the special interests, seeking campaign funding. The behavior of regulatory agencies simply reflect the preferences of their congressional masters. Regulators generally seek to please their committees, not to defy them.

Communications policy likely will continue to be subject to welfare-suppressing regulation because such regulation is consistent with the interests of legislators.

The Political Economy of the Regulatory State

Most of the papers in this volume describe what their authors see as potentially meritorious reforms in federal regulation of the communications industry. A common objective running through many of them is the notion of enhancing consumer economic welfare through more efficient pricing of services and lower barriers to entry, especially entry employing new technology. Generally, the recommendations favor less regulation, or even deregulation, of sectors of the industry, with greater reliance on marketplace competition. In some cases the proposed reforms aim to eliminate substantive regulations that restrict competitive market outcomes; in other cases the recommendations take aim at procedures that are unduly permissive of regulatory intervention.

Unfortunately, in my view, fundamental communications policy issues over the next few years are likely to mirror those of the recent past because little has been done to change the incentives of policymakers or the structure of the decisionmaking process. The chief difference between the medium-term future and the medium-term past is the prevailing mood of economic pessimism and the tightening fiscal constraints facing all levels of government.[1] This may affect regulatory policies capable of generating revenue, such as spectrum auctions, and will tend to encourage off-budget transfers mandated by regulation, such as telephone and broadband cross-subsidies. But there exists no general movement toward meaningful regulatory reform in communications policy or any other area, except perhaps banking and finance.

Elected representatives have more to gain than to lose from the opportunities to mediate disputes that arise because regulatory institutions exist. Congressional

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[1] Lauren Weber, "Politics, Tax Code Said to Stymie U.S.," *Wall Street Journal* January 18, 2012, (describing surveyed views of Harvard Business School alumni.) http://online.wsj.com/article/SB10001424052970203735304577167312137123818.html?mod=WSJ_hp_LEFTTopStories (visited Jan 18, 2012).

services provided to various sides in these disputes give rise to streams of campaign contributions and future job opportunities for legislators and regulators alike. These rewards are more predictable than the vagaries of public opinion that make public office a relatively risky occupation. The usefulness of regulation as a source of campaign and other benefits to legislators and regulators is a core feature of the administrative (or regulatory) state. A government responsive to interest group pressure seems likely to have this characteristic by its nature, due to the incentive structure of collective action.[2]

Specific communications policy issues in the years ahead will include the continuing, growing consumer welfare losses and fiscal consequences of the FCC's stranglehold on allocation of the electromagnetic spectrum; the political consequences of legislation and regulations that force some telephone customers to pay for costs incurred to bring services to high-cost locations; whether to capitalize on the groundwork that has now been laid to permit future Commissions and Congresses to expand media content regulation; and the consequences of widespread acceptance among the public of the notion that every conceivable fear of market failure in the communications industry can and should be treated prophylactically by aggressive federal legislation and regulation. The playing out of each of these issues will reflect the growing tensions between the incentives of elected and appointed officials to supply services to well-organized interest groups and the implacable fiscal constraints imposed by America's declining competitive position in a global economy and its addiction to open-ended entitlement programs.

Problems of the regulatory state

James Madison, writing one of the best-known of the Federalist Papers (No. 10), focused on one of the major "problems of democracy"—the power of special interests or "factions." Factions, for Madison, included not only special interests in the modern sense—well-organized minorities seeking advantage at the

[2] Mansur Olson, 1965. *The Logic of Collective Action*, Cambridge, MA, Harvard University Press.

expense of the ill-organized majority—but also and especially passionate *majorities* seeking to disadvantage others, such as property interests or geographic or sectarian minorities. Thus, as Madison put it: "By a faction, I understand a number of citizens, whether amounting to a majority or a minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adversed to the rights of other citizens, or to the permanent and aggregate interests of the community."[3]

Madison argued that a large and diverse republic would tend to include specialized and conflicting interests within the majority, which would discourage the dangerous exercise of the majority's potential power. Specifically, Madison saw as the great danger of popular government that the less-well-off majority would seek to expropriate the property of the well-off minority, precipitating class warfare, violence, and the destruction of the state.[4]

The Framers' argument may be read as focused on the usefulness of unfettered private enterprise and opportunities for self-betterment in diverting members of the majority away from a focus on redistribution and toward productive rivalry amongst themselves.[5] The major purpose of Federalist No. 10 was to support a national representative republic, properly structured, as having a better shot at achieving successful and stable popular government than smaller (i.e., state or local) government, even with direct democracy.

One element of the Madison's argument was the equation of individual material success, or at least its hope, with happiness, and the pursuit of happiness thus understood as the principal legitimate aim of government. The Founders did not deny that there are other, higher, aims than material well-being, but they saw those aims as belonging only to individuals or like-minded individuals convening

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[3] James Madison [Publius], *The Utility of the Union as a Safeguard Against Domestic Faction and Insurrection (continued),* 1787 (Federalist No. 10), New York: Heritage Press edition, 1945, 54-62.

[4] Martin Diamond, "Democracy and the Federalist: A Reconsideration of the Framer's Intent," 53 *The American Political Science Review* 52, at 63, March 1959, characterizing Federalist 10.

[5] Id. at 61-64.

in non-government organizations. Governments with nobler aims were seen as greater threats to liberty and individual freedom. This explains, for example, the necessity to forbid establishment of religion.

The Founders' vision of a limited government chiefly concerned with the promotion of material happiness hardly would be approved by many today. The Founders' argument and assumptions in favor of this vision are not generally understood, and the theory's empirical validity is open to question. Most everyone now has at least one passionate deontological belief that "ought" to be read into the Constitution, if not already discernible therein. Government, far from being limited, according to the Supreme Court, "now wields vast power and touches almost every aspect of daily life."[6] Still, history is not inconsistent with the success of the Founders' design, at least prior to the events that ushered in the regulatory state—such as the loss of legitimacy that free markets suffered in the Great Depression and the continuing revolution in information collection and processing technology that supports greater government control of economic and social activity.

The Framers did not foresee the regulatory state. If they had, they might have predicted that two of the phenomena they feared would arise in a different way and on a different level than in the context of 1787. First, both the legislative and the administrative processes associated with regulation by independent agencies are battlegrounds in which special interests vie to redistribute the gains from both private productive activity and efficiency-enhancing interventions. Second, as the Founders sensed and Mansur Olson formalized,[7] the regulatory state is systematically biased against consumer and other interests that face collective action barriers to effective participation in the process. This view of power in American society is characterized by Andrew McFarland as plural elitism:

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[6] *Free Enterprise Fund v. Public Company Accounting Oversight Bd*., ___ U.S. ___ (2011), slip op. at 18.

[7] Mansur Olson, *The Logic of Collective Action*, Cambridge, MA, Harvard University Press 1965

"[P]ower in America is largely a matter of co-option of specific public-policy areas by elites, serving their own private interests."[8]

A more fundamental problem with the interest-group influence on regulatory outcomes is that there is no strong mechanism to limit outcomes to those that are welfare-enhancing. Although the game in which all (or a subset of) interest groups interact often is potentially positive-sum, there are numerous bargaining, legal, and other constraints on the process. Interest groups can gain by focusing on their own shares even of a somewhat diminished pie. Indeed, in the context of complex technical, legal, and economic regulations, there may be circumstances in which a group can gain *only if* the pie is incidentally diminished. So, in the regulatory state, not only are certain interests un- or under-represented, but the cause of welfare maximization is often orphaned. This happens when the beneficiaries of a significant slice of the pie (i.e., consumers) are unable effectively to defend themselves from expropriation. If every slice of the pie had effective defenses against expropriation, there would be more support for the pie's expansion.

Captured regulators?

The economic and political science literature devotes substantial attention to the behavior of regulatory agencies and their interaction with industries they regulate. The early models assumed that regulatory agencies took seriously the "public interest" objectives of their statutory foundations.[9] Those models saw regulation as chiefly a battle about excess monopoly profits, in which agencies with less than adequate resources, information, and expertise struggled against utilities adept at hiding the ball and evading constraints. Subsequently, the literature turned to focus on interest groups (including but not limited to regulated firms) that succeed in "capturing" the regulatory agency by fostering close personal

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[8] Andrew S. McFarland, "Interest Groups and Theories of Power in America," *British Journal of Political Science*, 17, 130 (April1987).

[9] See, e.g., Dwight Waldo. *The Administrative State*, Transaction Publishers 1948

relationships between agency officials and lobbyists, by controlling information, and by hiring ex-regulators in order to induce current regulators to form expectations of future rewards for present favors.[10] In this account, collective action limitations prevent consumers from forming effective representative groups, permitting the agency to be captured by some combination of the better-represented interests.

Solutions to the capture problem take several forms. One is greater oversight by the courts.[11] Another is legislative oversight, in which the relationship between Congress and the agency is cast as a principal-agent problem with asymmetric information.[12] The principal's problem is to design methods for better aligning incentives or for constraining agency behavior.

A third approach to the capture problem, akin to Madison's solution to the problem of controlling majority power, is an aggregation of agency jurisdictions, seeking to eliminate highly specialized agencies (such as the FCC) in favor of regulators with broad jurisdiction (such as the antitrust agencies).

A fourth approach relies on what is called "high politics"—periodic interventions by the president or other political leaders to reform regulation. The fourth method is said to produce cycles of political reform that only briefly interrupt "business as usual" at the captured agency. The last major reform effort involving communications took place in the late 1970s and early 1980s, beginning under Chairman Charles Ferris. The Telecommunications Act of 1996, intended by its terms to promote competition and deregulation, has in effect been negated by

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[10] Ernesto Dal Bó,. "Regulatory Capture: A Review," Oxford Review of Economic Policy, vol. 22, no. 2, 203-225; 2006; Jean-Jacques Laffont and Jean Tirole.. "The Politics of Government Decision-Making: A Theory of Regulatory Capture," Quarterly Journal of Economics November, Vol. 106, No. 4, 1089-1127, 1991.

[11] For a negative assessment of proposals to subject regulatory decisionmaking to stricter judicial review, see, e.g., Einer R. Elhauge. "Does Interest Group Theory Justify More Intrusive Judicial Review?" 101 *Yale Law Journal* 31 (1991)

[12] Barry Weingast,. "The Congressional-Bureaucratic System: A Principal-Agent Perspective," Public Choice, XLIV, 147-92, 1984; Nolan McCarty, "Complexity, Capacity and Capture," Working Paper, Woodrow Wilson School, Princeton University, 2011.

the FCC. And the courts have generally deferred to the FCC's supposed expertise. [13]

None of these solutions seems very promising. Modeling the relationship between Congress and agencies in a principal-agent framework assumes, naively, that Congress (or, more realistically, relevant committees and committee chairs) seeks to advance the public good. Except in times of “high politics,” typically involving the president, legislators have very little incentive to advance the public good at the expense of potential campaign contributions and other interest group favors. Indeed, legislators are even more likely to be captured than the heads of regulatory agencies, simply because they, unlike regulators, can lawfully accept cash contributions. The fact is that congressional committees and the regulatory bodies they oversee often do not have seriously incompatible incentives. In communications policy, key legislators often successfully pressure regulators to adopt policies favoring important contributors or politically powerful groups such as the National Association of Broadcasters. If pressure does not work, legislation can solve the problem. In general, independent regulatory agencies such as the FCC are in fear of and eager to please the oversight and budget committees to which they are responsible.

The day-to-day, issue-to-issue work of independent regulatory agencies is very largely controlled by the cognizant congressional committees and especially their chairs and minority leaders. Susan Snyder and Barry Weingast make the point quite directly:

> Although economists and political scientists approach the politics of regulatory agency policymaking in different ways, nearly all agree that, to a great extent, elected officials control regulatory agency policymaking for political ends. Elected officials negotiate the balance between citizen and interest group demand, translating this balance into pressure on the

[13] The Supreme Court’s ruling in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc*. 467 U.S. 837 (1984) grants considerable “deference” to administrative agencies’ rulemaking efforts. See Peter L. Strauss, “Deference” Is Too Confusing – Let’s Call Them “Chevron1 Space” and “Skidmore2 Weight,” Columbia Law School Public Law and Legal Theory Working Paper 11-284, October 10, 2011 copy available at: http://ssrn.com/abstract=1932446 (forthcoming, *Columbia Law Review*).

> agency. Scholars presume that agencies respond to political pressure, implementing the goals of elected officials. An impressive body of scholarship supports these conclusions.[14]

Congressional committees are not aloof from the agencies in their jurisdictions. Members of Congress communicate frequently with the heads of agencies as well as senior agency officials both formally (in hearings and correspondence) and informally (in phone calls, meetings, and encounters at political or social events). Congressional committee staffs as well as Members' personal staffs are in frequent communication with agency employees at all levels and rub shoulders at industry-sponsored and other events. Lobbyists and reporters carry messages back and forth, including in the form of rumor and gossip. The trade press covers as much of the action as it can, much of it deliberately leaked. Although the law of administrative procedure restricts the timing and scope of such communications and may require disclosure, there are effective "work-arounds." If the agency is engaged in policymaking on an issue affecting an influential Member's significant supporters and campaign contributors, the Member's views will be well-known to the agency decisionmakers, and are likely to be respected. Therefore, well-funded interests with a stake in the issue will certainly be contributors and supporters of key Members and build personal and social relationships with agency heads, agency staff, and corresponding denizens of Capitol Hill.

Captured regulatory agencies, in short, reflect, to a significant extent, captured congressional committee chairs and other legislative leaders. The legislators are not unwilling captives; they rely on regulated entities and their representatives for election campaign funding. There is seldom a serious principal-agent conflict between committees and independent agencies like the FCC because agencies seldom buck their Congressional overlords. The political system as a whole is set up to favor policies that win elections, but most regulatory issues are insufficiently salient to have any direct effect on elections. Therefore, the system is biased in

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[14] Susan Snyder and Barry Weingast, "The American System of Shared Powers: The President, Congress, and the NLRB," *Journal of Economics, Organization, and Economics* vol. 16, n. 2, 269, 2000.

favor of policies that favor campaign donors and those who control grassroots election machinery, such as unions and major employers. Leaving aside far-reaching and unlikely constitutional changes affecting campaign contributions or the scope of government, the only remedies would seem to be empowering underrepresented interests or insulating regulatory policy from the political process.[15] Neither approach is appealing.

Empowering citizen or consumer interests is unappealing because those who purport to speak for such groups have a poor track record in identifying important sources of welfare loss and because they reflexively favor more or more intrusive regulation and less reliance on market solutions while ignoring the imperfections of regulation. Insulating regulation from the political process throws the baby out with the bath water. The point of "independent" administrative agencies is to insulate quasi-legislative and quasi-judicial regulatory bodies from the exercise of executive power while retaining accountability to the body whose power has been delegated—the legislature. Agencies untethered from both Congress *and* the Executive, and to which the judicial branch pays deference, open the door to bureaucratic tyranny. Or as Madison put it in Federalist No. 47: "The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, self-appointed or elective, may justly be pronounced the very definition of tyranny."[16]

Issues and Interests in Communication Policy

With this background in mind, consider the likely evolution of communications policy at the FCC over the next 5 to 10 years. Any significant changes in policy require corresponding changes in the constellation of groups whose interests the Commission and the congressional committees serve, or changes in technology

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[15] Stephen Breyer proposed creating a kind of Confucian bureaucracy of regulatory experts sitting in the White House and speaking with the voice of the president. *See* Breyer, *Breaking the Vicious Circle: Toward Effective Risk Regulation*, Cambridge MA: Harvard Univ. Press., 1995. Experience has shown that White House economists are not talented ventriloquists.

[16] James Madison [Publius],. "*The Particular Structure of the New Government and the Distribution of Power Among Its Different Parts,"* 1787, (Federalist No. 47), New York: Heritage Press edition, 1945, 322

that must be embraced within the pre-existing balance of power reflected in policy.

The FCC, Congress, and administrations of both parties continue to design new interventions in the communication industries. The likely effect of such interventions will be to render industry structure less responsive to competitive forces and to attenuate technical innovation. The simplest explanation for these interventions is the desire of legislators and their “agents” at the FCC to maintain their roles as the gatekeepers of interest group access to the rents that arise from the provision of communication services—rents that are greater in the absence of effective competition.

Spectrum policy

The FCC has allocated spectrum based on input from existing and would-be interest groups. And it has sought in most cases to protect the economic interests of politically powerful local broadcasters. The explanation for these policies is simple: continuing local radio and television news coverage is of crucial significance to incumbent elected officials, such as members of Congress. Together with the other advantages of incumbency, abundant local media coverage promotes re-election.

But another consequence of the early spectrum nationalization was that the revolution in electronics associated with the transistor and the microprocessor proceeded much more slowly in broadcasting and telephone service than in other, unregulated, industries. Historically, the FCC’s role as arbiter of technical standards served the interest of broadcasters and the old Bell System by barring new competitors from using innovative technologies.

Mobile communication devices arrived later than would have been the case in the absence of FCC spectrum allocation. Right now “4G” broadband technology for mobile video is available, but spectrum constraints likely will prevent full realization of the new technology, keeping prices higher than they would be if spectrum markets were allowed to work.[17] Meanwhile, huge quantities of spectrum suitable for mobile communications are wasted because they are assigned to broadcasters whose signals now reach most viewers by cable or satellite, not over the air. But broadcasters are forbidden to sell spectrum to mobile telephone companies. There are no good reasons for these restrictions—they simply prevent markets from working in the way they should, moving resources to their most productive uses and users.[18]

Broadcasting and mobile communications are but two of many areas where spectrum allocation is economically inefficient, because supply is based on economically arbitrary criteria. While it is often said that spectrum markets are impossible because spectrum lacks well-defined property rights, this is not true. Most of the spectrum is now licensed by the FCC or a government committee called "IRAC" (Interdepartment Radio Advisory Committee) that manages government-used spectrum. These licenses define explicitly or implicitly the levels of interference that users can impose on each other. If all the licenses were simply re-categorized as negotiable "deeds," adjacent users would be free to bargain toward consensual adjustments in these interference levels. Uses of the spectrum that contribute less than others to national productivity could then by repurposed to more valuable uses or sold to users aiming to serve other markets. Current FCC licensees, as a practical matter, enjoy perpetual rights to use their patches of spectrum by virtue of judicially-sanctioned renewal expectancies. Changing their licenses into tradable deeds would make spectrum use, and the economy as a whole, more productive.

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[17] *See* FCC, "Mobile Broadband: The Benefits of Additional Spectrum," FCC Staff Technical Paper (October); Michael Kleeman, "Point of View: Wireless Point of Disconnect," University of San Diego, Global Information Industry Center, 2011

[18] The FCC did act to transfer a patch of spectrum formerly allocated to UHF broadcasting to mobile telephone service providers after the adoption of digital technology to broadcasting. The process took something like 40 years and was insufficient to satisfy mobile service needs.

Ironically, perhaps, it may be the fact that there are major economic gains from such a policy that causes the political roadblock. The interest groups (including the U.S. Treasury on behalf of the taxpayers who fund the government) can't agree on how to divide the gains among themselves. When their demands are added together, the sum likely exceeds the size of the available pie. Meanwhile, the potential flow of consumer benefits from additional services at competitive prices is lost forever.

Spectrum reform has been agonizingly slow, limited mainly to the use of spectrum auctions to raise revenues for the Treasury when new areas of the spectrum become available for use. In these new spectrum regions it has been possible for limited private markets to operate, post-auction. But the licenses that are traded still restrict the uses to which the spectrum can be put. Those favoring these continuing restrictions are likely motivated by fear that the economic value of their spectrum holdings will be reduced if users of other portions of the spectrum decide to enter.

Among the more modest spectrum reform proposals now being considered in Congress is authorization of an incentive auction that would permit broadcasters to return their spectrum licenses to the FCC to be re-auctioned for flexible use.[19] In exchange, broadcasters would receive a portion of auction proceeds. Meanwhile, Congress is deadlocked over legislation to re-auction 700MHZ "D block" spectrum or designate it for public safety use.[20] And the National Telecommunications & Information Administration (NTIA) is engaged, somewhat lackadaisically, in the President's initiative to identify 500MHz of spectrum for public commercial use. The timetable for the initiative is 10 years.[21]

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[19] Reuters, "FCC sees support for incentive auctions of wireless spectrum" http://www.reuters.com/article/2012/01/12/us-ces-fcc-idUSTRE80B02L20120112

[20] "Will D Block Allocation have to wait until 2012?" *Police.com News* December 13, 2011, online http://www.policeone.com/pc_print.asp?vid=4813008 retrieved January 18, 2012.

[21] "NTIA [the National Telecommunications and Information Administration, part of the U.S. Department of Commerce, which chairs IRAC] is also collaborating with the Federal Communications Commission to make available a total of 500 megahertz of Federal and nonfederal spectrum over the next 10 years for mobile and fixed wireless broadband use. This initiative, to nearly double the amount of commercial

The best hope for fundamental reform in spectrum allocation over the next five years is the prospect that Washington will see full privatization of spectrum as one opportunity to raise the new revenues necessary to reduce the budget gap. However, revenues received from auctioning this spectrum would be a one-time windfall for the Treasury, not a continuing flow of revenue.

Using telephone pricing to redistribute income

The federal government supports a telephone pricing subsidy policy for the same reasons that explain farm subsidies and other programs aimed at lowering the cost of living in inconvenient locations—Article I of the U.S. Constitution, which gives each state two senators and at least one representative, regardless of population. Citizens of rural states simply receive more political power per capita than citizens of urbanized states. The consequence is redistribution of income from urban citizens to rural citizens. Much of the redistribution is accomplished by federal transfers (taxes and subsidies), but off-budget "taxation by regulation" is also a popular transfer mechanism.

The universal service and intercarrier compensation systems continue to produce off-budget transfers by mandating that all telephone service competitors charge higher prices to all customers. This obviously is just a disguised communications excise tax. The revenues from the higher prices go into a pool that the government then divides among suppliers of services (now to include broadband rather than just plain old telephone service) to favored customers. This is supposed to produce lower prices and therefore wider service use in rural areas, as well as lower prices for hospitals, libraries and other recipients deemed worthy by the government—even outside rural areas. The cross-subsidy system is complex and inefficient, and its rules are slow to change. The details of the rules inadvertently give suppliers and consumers distorted incentives. For example,

spectrum, will spur investment, economic growth, and job creation while supporting the growing demand by consumers and businesses for wireless broadband services."
http://www.ntia.doc.gov/category/spectrum-management retrieved Jan 18 2012.

many call centers are now located in places that make little sense but for the pricing distortions.

Economists generally agree that the most efficient way to transfer income to a needy or deserving group of people is to send them a check. Lowering the prices (or increasing the availability) of specific goods or services produces less improvement in economic well-being than the same expenditure on direct subsidies targeted to needy persons. In addition to the efficiency loss, there is likely to be a misdirection of the subsidy to non-needy persons. Most call center stockholders do not live in rural areas. Many people who do live in rural areas are far from poor. Many well-off urban dwellers own rural vacation homes, whose telephone and now Internet service is cheaper than it would be without the cross-subsidies. And so on.

In 2011 the FCC adopted a series of comprehensive reforms to the universal service and intercarrier compensation subsidy systems.[22] But while the universal service reforms include some form of soft caps on the size of subsidies going to carriers serving high cost areas, those reforms also include the creation of new universal service funding mechanisms for wireless and broadband. Since the FCC's reforms put primacy on universal broadband adoption rather than the eventual termination of government subsidies to carriers, it remains uncertain as to whether the size of the subsidy system will actually decrease. And no end appears in sight when it comes to subsidizing carriers rather than low-income consumers.

A minimum reform would be to change the program to target poor people in rural areas. Even better would be a voucher system targeting the rural poor and letting them decide what to buy with the voucher. The FCC is now embarking on a series of reforms to its Lifeline program, which targets low-income households.[23] And the Lifeline program would provide a vehicle for such reform. This would

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[22] http://transition.fcc.gov/Daily_Releases/Daily_Business/2011/db1122/FCC-11-161A1.pdf
[23] http://transition.fcc.gov/Daily_Releases/Daily_Business/2012/db0110/DOC-311940A1.pdf

continue our constitutional bias in favor of rural states but improve the efficiency and fairness of the transfers.

Regulating mass media content

Libertarians who support press freedom as a bulwark of broader political freedom are quite likely a minority of Americans. Both extremes on the standard political spectrum favor various forms of media content regulation. The right favors government intervention designed to promote or protect “family values.” The left favors government intervention designed to shift media content away from populist-quality and toward elitist-quality content. Neither side misses an opportunity to curry favor with their constituencies by condemning media excess in any direction. (Regrettably, it is media excess that, as they say, sells newspapers.) Given the political consensus in favor of government regulation of media content, the courts are a far more likely force to protect freedom of the press than either the legislative or the administrative branches of government.

The leading appellate cases on freedom of the press date from a period when printed newspapers were the dominant mass medium. Freedom of the press today is near absolute for newspapers and other print media. The situation is quite different for broadcast media.

Justice Felix Frankfurter’s majority opinion in *U.S. v. NBC* (1943) stripped away most of broadcasters’ first amendment protections, relying on the fact that the radio spectrum was too “scarce” to permit everyone to speak who wished to do so.[24] Of course, this distinction makes no sense; newspapers also are too “scarce” to permit everyone who wishes to be published, and the same scarcity that applies to spectrum also applies to the resources used by publishers to produce newspapers. There is nothing unique or unusual about the broadcast medium to distinguish it from the print medium for first amendment purposes. It simply uses a different technology. The Supreme Court will have an opportunity

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[24] *National Broadcasting Co. v. United States*, 319 U.S. 190 (1943)

this term to repeal the scarcity doctrine and extend first amendment rights to broadcasters. [25]

But broadcasters are no longer the most important class of publishers to be denied freedom of the press. Newer distribution technologies—wired and wireless broadband media—are already more important than over-the-air broadcasting and print as distributors of news and opinion, as well as entertainment. Internet dominance of media distribution will grow. Fortunately, there is so far no evidence that broadband distribution is a natural monopoly, and therefore no reason to impose either economic or content regulations.

But, unfortunately, the FCC has now issued its first regulations concerning Internet content originating from broadband distributors, ironically justified "in order to *preserve* the free and open nature of the Internet."[26] The Supreme Court earlier, in the *Turner* cases, applied only minimal standards of first amendment protection to cable television operators on the theory that cable regulation was necessary in order to further the FCC's policy of safeguarding broadcasters' profits. [27] The Court took a cable bottleneck analogue to the scarcity doctrine as a given in the *Turner* decisions. A case now before the Court (which involves FCC fines imposed for allegedly indecent broadcast programming), gives the Court a chance to correct Justice Frankfurter's erroneous understanding of spectrum scarcity, and thereby protect the Internet itself from the growing risk of federal censorship. The Court may also have an opportunity to review the FCC's claim of jurisdiction to regulate Internet content.

There is considerable danger in the loss of press freedom for electronic media and the Internet in the United States. We will not know the full implications until

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[25] *Fox Television Stations, Inc., et al. v. FCC,* Docket Nos. 06-1760-ag, 06-2750-ag, 06-5358-ag, 2d Circuit, ___F. 2d. ___ (2010), *cert. granted* ____ U.S. ____ (2011).

[26] FCC, In the Matter of Preserving the Open Internet [and] Broadband Industry Practices, *Report and Order,* GN Docket No. 09-191 and WC Docket No. 07-52, released December 23, 2010, FCC 10-201, at pg. 1.

[27] *Turner Broadcasting v. Federal Communications Commission,* 512 U.S. 622 (1994), *Turner Broadcasting v. Federal Communications Commission (II),* 520 U.S. 180 (1997).

some future political or other crisis, akin to President Nixon's Watergate and *Pentagon Papers* incidents, or the more recent WikiLeaks episodes,[28] where the government has a strong interest in suppressing information about itself and its behavior. But our taste for expansion of the administrative state at the expense of electronic press freedom threatens most of our other freedoms as well. A government that can lawfully suppress news of its own malfeasance can go a long way toward suppressing all opposition. Neither legislators nor executive branch officials have an interest in protecting freedom of the press. Neither do most powerful interest groups benefit from such freedom.

Device design regulation

Environmental and safety regulations are often faulted for setting design standards (specifying which technology to use) rather than performance standards, (which give industry a specific goal to meet without dictating the means to be used). Design standards often favor one supplier or group of suppliers over another and especially existing suppliers over new entrants with innovative approaches. Design standards permit agencies to be more responsive to economic interests associated with current producers and technologies; performance standards less so.

Design standards regulation is also a too frequent factor in the area of communications services and equipment. In the case of telephone service, for decades the FCC protected the old AT&T monopoly from competitive challenges,

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[28] In the WikiLeaks episodes, a series of secret and embarrassing government documents were released illegally to an Internet publisher, most spectacularly in November 2010. See Scott Shane and Andrew W. Lehren. 2010. "Cables Obtained by WikiLeaks Shine Light Into Secret Diplomatic Channels," .*The New York Times*. Retrieved 28 November 2010 (http://www.nytimes.com/2010/11/29/world/29cables.html?_r=1&hp) For both technical and jurisdictional reasons, successful injunctive relief was deemed unlikely and the government did not attempt to prevent publication. If the FCC had by that time successfully asserted its right to regulate Internet content, it might have ordered U.S. ISPs to block WikiLeaks content. The right was asserted by the FCC less than a month after the November 2010 WikiLeaks disclosures. See FCC, In the Matter of Preserving the Open Internet [and] Broadband Industry Practices, *Report and Order,* GN Docket No. 09-191 and WC Docket No. 07-52, released December 23, 2010, FCC 10-201. Whether the assertion will survive challenge in the courts remains unclear.

ensuring high telephone rates and very slow adoption of new technology in comparison to unregulated electronics industries.

Even today, however, the FCC and Congress continue consider new design standards. The National Association of Broadcasters urges Congress to adopt an FM chipset mandate, requiring wireless device manufacturers to design mobile handsets that include FM radio receiving capabilities. And in its National Broadband Plan, the FCC endorses a slate of technical regulations regarding the construction and operation of video navigation devices. The FCC is presenting considering adopting such video navigation device design mandates in a rulemaking proceeding.

Prophylactic regulation

Most of the traditional areas of federal regulation—energy, transportation, telephone communications, banking, health and safety, the environment—were established after there was long-standing and substantial evidence of market failures. It is true that in many of these cases there was undue optimism that government intervention would succeed in improving consumer welfare. With experience, we have found that regulatory institutions can be at least as bad for consumers as imperfect markets. Nevertheless, there was at the outset, most often, a reasonable concern that market outcomes were impaired and that intervention could, at least in principle, make people better off.

In more recent times, particularly at the health and safety agencies, but also at the FCC and in the Congress, there has been a trend toward prophylactic regulatory intervention. These policies seem to be due to *fear* that markets *may* go wrong, but without significant evidence that anything *has* gone wrong. They ignore the poor track record of regulators who, because of collective action, information and incentive problems, end up giving greater weight to industry interests than to consumer welfare. For example, the Occupational Health and Safety Administration and its counterparts at the state level have been criticized for formulating standards-based regulations in advance of evidence that workers are being harmed, much less harmed often enough or badly enough to justify the costs of compliance with tighter standards.

By virtue of its newly-adopted net neutrality regulations, the FCC has now extended prophylactic economic and content regulation to video and non-video broadband Internet access services, based solely on the fear that distributors may do something to threaten the “free and open” nature of the Internet. Because the FCC has found that the Internet today is indeed “free and open,” there is by definition (at least from the FCC’s perspective) no substantial evidence of existing market failure. There are no Internet equivalents, even roughly so, of such market failures as thalidomide babies, black lung disease, gross carnage on the highways, global warming, or widespread bank failures.

Even if there was evidence of anticompetitive behavior on the part of vertically integrated Internet service providers (ISPs), rational intervention would require two additional conditions: a reasonable expectation that the planned intervention would increase consumer welfare, and a careful review of potential adverse side-effects. Nothing of the sort has been put forward by the FCC. The agency simply decided to agree with those who reflexively distrust big business, without asking whether big business had either the power or the incentive to do whatever it is that is feared. In due course, Internet service providers will doubtless become favored interests of Congress and the FCC, and will seek protection from the next wave of competitive innovation.

Conclusion

Members of congressional budget and oversight committees that deal with independent regulatory agencies have little incentive to promote true public interest (welfare-maximizing) solutions to market failures within the jurisdictions of the agencies. The issues are seldom salient in congressional elections. Instead, their incentives are to induce well-organized special interests to make contributions, in cash or in kind, to Members’ re-election campaigns, or to the parties. In return, Members support the interest groups’ positions on agency policies and regulations. There is typically no misalignment of incentives between the agencies and the committees. The agencies have no greater incentive to pursue welfare-optimization than the committees. The same interests (and often the same lobbyist personnel) seek to influence the agency directly, with the backing of the committees. Despite procedural safeguards, the agency, the committees, and the potent interest groups communicate frequently and informally to reach agreement on the details of regulatory policy. The special interests generally seek increased economic rents, some of which are created at the expense of consumers by policy actions that retard competition and innovation.

This is a built-in or systemic bias of the regulatory state, one that Lawrence Lessig has recently characterized as “Type 2 corruption,” to distinguish it from simple bribery.[29] Its significance grows as the jurisdiction of the regulatory state grows. Jurisdiction grows because regulatory legislation (including that which is merely prophylactic) grows, and administrative regulation satisfies a public demand for action in response to well-publicized, but often purely hypothetical dangers. And it grows because the resulting regulatory institutions serve the private interest of Members in tapping into interest groups’ rents.

The aggregate impact of the policy bias on the economy most likely is analogous to the steady growth of a parasitic organism on a biologic model. The model is less able to compete effectively for resources. This cannot continue indefinitely, and therefore it will not. While the nature of the solution is far from obvious, perhaps continuing education as to the real nature of the problem will, at least in the longer-term, lead to some beneficial reforms.

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[29] Lawrence Lessig, *Republic, Lost,* New York: Twelve Publishing, 2011, 226-247.