

Telecommunications: Pulling the Plug on Government Interference



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Citizens Against Government Waste

Citizens Against Government Waste (CAGW) is a private, nonprofit, nonpartisan organization dedicated to educating the American public about waste, mismanagement, and inefficiency in the federal government.

CAGW was founded in 1984 by J. Peter Grace and nationally-syndicated columnist Jack Anderson to build public support for implementation of the Grace Commission recommendations and other waste-cutting proposals. Since its inception, CAGW has been at the forefront of the fight for efficiency, economy, and accountability in government.

CAGW has more than 1.2 million members and supporters nationwide. Since 1986, CAGW and its members have helped save taxpayers more than \$944 billion. CAGW publishes special reports, its official newspaper *Government WasteWatch*, and the monthly newsletter *Wastewatcher* to scrutinize government waste and educate citizens on what they can do to stop it. CAGW's publications and experts are featured regularly in television, radio, print, and Internet media.

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Introduction

Surfing the Internet or flipping through hundreds of television channels has become routine. Today's college freshmen are routinely equipped with laptops, cell phones, iPods and a bevy of other devices. The telecommunications industry has been quick to innovate while the federal government slowly adapts to the ever-changing marketplace. This lack of understanding, which has been evident for many years, puts taxpayers and consumers at risk.

In his 1984 book that summarized the Grace Commission's findings, *Burning Money, The Waste of Your Tax Dollars*, Peter Grace described the technological ignorance pervading the federal government. At the time of the book's publication, the average age of a government computer was 6.7 years; the average computer used by a U.S. business was three years old. Government computer systems were incompatible and required service technicians specifically trained to maintain the outdated equipment. The extra bodies added \$1 billion to the federal payroll over a three-year period. Meanwhile, in the private sector, IBM's General Systems Division updated its computer technology, saving \$360,000 in the first six months after installation. And the Boeing Military Airplane Company's new word processing system saved \$483,000 over a nine-month period.

In the 23 years since Mr. Grace published his book and subsequently co-founded Citizens Against Government Waste with syndicated columnist Jack Anderson, the federal government's technological ineptitude has persisted. The current telecommunications debates and the federal government's temptation to regulate the industry are symptoms of larger problems. While the private sector speeds ahead with more innovation in response to consumer demand, the federal government lags behind trying to play catch up and fails to see the impact of its policies on taxpayers and consumers.

This paper exposes four areas where government intervention would harm taxpayers and consumers: a la carte, the Internet tax moratorium, network neutrality, and spectrum sales.

Government mandated a la carte programming for cable operators is a classic case of government meddling in the private sector that will ultimately mean less choice and more expense for cable television subscribers. Before the expiration of the Internet tax moratorium on November 1, 2007, Congress can either continue to allow the Internet to flourish and grow or impose unnecessary taxes. Network neutrality could stifle innovation and consumer choice and cost taxpayers millions of dollars in unneeded bureaucracy. Finally, the federal government has billions of dollars in spectrum that it will be putting up for auction in January 2008 and there are questions as to whether or not taxpayers will get the most out of these sales.

A La Carte

Since the 1950s, the cable television industry has been successful in delivering a diverse amount of programming to consumers for pennies per channel. This has been done through a pricing system that places every channel in a certain tier, from lower to higher (or basic to premium). Higher tiers contain some of the more popular channels, and they also give those who purchase them access to all the channels placed in the lower tiers. This bundling system allows consumers choice, yet the federal government is considering regulating how cable companies are allowed to sell their services by eliminating the tiered pricing system and implementing an “a la carte” pricing system.

An a la carte pricing system would force cable companies to stop bundling their programming and sell individual channels separately. This system seems tempting because a consumer would only be charged for the channels that he or she chooses to purchase and watch. However, the current tiered system is the best for both cable companies and consumers, and an a la carte system would be detrimental to both. More importantly, if consumers are not making such demands, the government has no business trying to impose a la carte on cable companies.

However, the government appears to be about to do just that. On September 11, 2007, the Federal Communications Commission (FCC) began considering a ban on programmers from bundling channels together. With “tying” out of the way, the alternative for cable providers would be an a la carte system.

FCC Chairman Kevin Martin has a history of pushing for a la carte. In February 2006, the FCC released a report which advocated a la carte, and declared that cable companies could sell the system in an economically feasible manner. This conclusion reversed FCC findings released in November 2004 by then-chairman Michael Powell. In testimony before the Senate Commerce Committee on November 29, 2005, Chairman Martin said the previous report was based on “problematic assumptions and presented incorrect, and at times, biased analysis.”¹

On August 22, 2007 Martin further articulated his support for a la carte in a letter to several minority groups. He wrote, “While I believe all consumers would benefit from channels being sold in a more a la carte manner, minority consumers, especially those living in Spanish speaking homes, might benefit most of all.”² At issue here is the practice by some cable providers of tying Spanish programming in with blocks of premium channels.

Clearly the FCC chairman is trying to drum up support for a la carte; however, this does not make the system a good idea for consumers or providers. The amount of time and energy required to implement such a system would be burdensome. A la carte would require a cable company to provide customers with a checklist to indicate what channels they choose to purchase. It is unclear how a company would do this, but regardless of whether they do it by phone, Internet, or mailings it will require time to compute. It would also cause delays when the a la carte system is first implemented as the cable companies struggle to get all of their customers to select their channels on their new service plan.

An a la carte pricing system would also require every home with cable to install a set top cable box called an addressable converter box. An addressable converter box would ensure that all channels not chosen by the consumer be scrambled and all channels chosen by the consumer be unscrambled. Again, there would be another time delay as cable companies attempted to distribute the boxes to all of their customers. There would most likely be a number of inconveniences such as customers receiving channels they did not order and not getting channels they ordered. The FCC’s 2002 survey data

estimated that the cost of renting such a box is approximately \$4.39 per box per month.³ The biggest inconvenience would be the immediate need to modify or replace cable ready televisions. All televisions would be required to have an addressable converter box, making it impossible to get cable television access by simply plugging in a coaxial cable from a wall into the back of a television as current cable-ready televisions are able to do.

A la carte pricing would also drastically change television advertising, ultimately making an a la carte system more expensive than a tiered system for consumers. The General Accounting Office (GAO) reported in 2004 that, "Adopting an a la carte approach... could alter the current business model of the cable network industry wherein cable networks obtain roughly half of their overall revenues from advertising. A move to an a la carte approach could result in reduced advertising revenues and might result in higher per-channel rates."⁴ Advertising companies sell their commercial advertisements hoping to reach a diverse audience and would no longer be able to accomplish this under an a la carte pricing system. For example, a company might run an ad on ESPN hoping to reach primarily sports fans, but also reach others who might have a casual interest in the channel or those who might be surfing through channels. Reaching such a broad audience would be nearly impossible through a la carte TV because of channels' reduced take-rates (the percentage of a cable subscribers' subscription to one particular channel).

Higher take-rates ultimately mean less cost for consumers. Channels that are featured on basic cable packages now have a take-rate of 100 percent, but if a la carte pricing is implemented, this will surely be reduced as not every cable subscriber will be willing to subscribe to all of these channels. Advertisers will be unwilling to pay current prices for their advertising to get on the air if it is going to reach a smaller audience. With reduced funding from advertisements, in order to maintain a profitable business, cable companies will have no choice but to obtain a larger portion of their funding from consumers by increasing the price of channel subscriptions. With a 25 percent take-rate, for example, investment banking firm Bear Stearns projects that a monthly subscription to the Disney Channel would increase from \$1.48 to \$5.90. MTV would jump from \$0.43 to \$2.32, and most notably a subscription to ESPN would skyrocket from \$3.78 to \$15.82.⁵

While an a la carte pricing system seems like it would give consumers more choices because they would not be required to buy subscriptions to channels they did not want to view, an a la carte system would ultimately impair consumer choice. It would be difficult for smaller independent and niche channels to stay afloat financially with an a la carte pricing structure. While large, popular channels such as CNN or ESPN could still be viable in this new business climate, channels like the Food Network or Lifetime could go off the air if they did not get enough subscribers to make them profitable.

The irony is that some groups, such as the Parents Television Council, who have endorsed a la carte, also advocate the type of channels that would be compromised if such a system were to be instituted. The ratings of family oriented stations such as the Christian Broadcasting Network, the Eternal World Television Network, and the Nogin Network could diminish as they may not be popular enough to thrive under an a la carte system that forces people to purchase specific networks.

Consumers would also have less of a choice because they would not have as many channels. The GAO reported that, "Subscribers place value in having the opportunity to occasionally watch networks they typically do not watch."⁶ No longer would a consumer be able to channel surf through all of the channels a tiered pricing system provides. The death of channel surfing also means a consumer has no way of discovering a new program or a new channel that he or she might enjoy. There is little incentive

on the part of the networks to come up with new and innovative programming because they know the only people that will have access to that program have already subscribed to their network, and the opportunity to win new subscribers is extremely limited.

It may appear that a la carte programming would be a winner for consumers, but upon closer inspection that is not the case. Consumers will most likely have more hassle to get their programming, the programming they do get will be more limited than it is in the current tiered pricing system, and for many it will cost more. Coupled with a disincentive for networks to create quality programming, a la carte pricing is much less desirable for all parties, especially consumers.

The cable television industry has thrived and consumers have benefited from the tiered system. Now is not the time for the FCC to mandate a la carte and take a step backward.

Internet Tax Moratorium

Since private groups first offered the opportunity to surf the World Wide Web to the general public in 1992, the Internet has been mostly free from government regulation and taxation. This lack of intervention in the development of the Internet has contributed to its remarkable growth. Whether buying products, researching information, or e-mailing friends or business associates, the Internet has changed everything. But that progress could come to a grinding halt when the Internet tax moratorium expires on November 1, 2007.

In the fall of 1998, the Internet Tax Freedom Act put a moratorium on discriminatory and multiple taxes on electronic commerce and Internet access at the federal, state, and local levels. With large bipartisan support, the ban was extended in 2001 and 2004. There are bills in Congress that would extend the moratorium and others that would make the ban permanent. Before the moratorium expires, there is time to remind politicians, the media, and taxpayers why the prohibition should be made permanent.

As of June 2007, the Internet reached 1.2 billion users; this is almost one billion more users than when the Internet Tax Freedom Act was first enacted.⁷ Electronic commerce has become a larger part of the economy, accounting for \$31.5 billion in the first quarter of 2007, or 3.2 percent of total sales, and increasing at a rate of around 20 percent per quarter.⁸

Even though the Internet tax moratorium has worked for consumers and taxpayers, states are becoming increasingly concerned about the lack of revenue as companies expand their Internet sales. Instead of recognizing the positive impact such as increased levels of production and entrepreneurship, many state and local governments claim that these sales evade their regional and local taxes and ultimately hurt citizens. In 1999, then-Governor William Janklow (R-S.D.) joked about using state troopers to pull over Federal Express and United Parcel Service trucks in order to find out which packages did not include state taxes. This showed the states' desperation of trying to collect as much revenue as possible.

The argument that state and local governments are greatly affected by their lack of revenue from goods purchased on the Internet simply does not hold water. Small Business and Entrepreneurship Council Chief Economist Raymond Keating found that revenue at both levels of government over a 10-year period has gone from \$1.4 trillion in 1995 to \$2.5 trillion in 2005, a 78 percent increase compared to an inflation level of 22 percent.⁹

Some members of Congress claim to be in favor of extending the tax ban for existing Internet merchants while taxing any new commerce on the Internet and grandfathering in older companies. Unfortunately, once government involvement begins, there is little chance that the scope will be limited.

Opponents of retaining the moratorium claim that it is a simple case of federalism, which requires giving taxing authority back to the states. Being "grandfathered" in, the nine states that are allowed to tax Internet access are Connecticut, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Wisconsin, and Washington.¹⁰ This grandfather clause needs to be eliminated. Doing so would not excessively disrupt the budgets of the nine states, as it would only eliminate 0.1 percent of their revenue.¹¹ Internet taxes affect the economy at a national (if not global) level, and they should be taxed or not taxed at that level.

There is widespread speculation as to how taxes would be levied if the moratorium is not continued or made permanent. While the obvious choice is a tax on Internet access allowed in the grandfathered

states, some have suggested that taxes could be applied to downloaded files, and even on emails.¹² However, this could be just the tip of the iceberg. The Internet has never been open to pervasive taxation by government; it is impossible to predict the extent to which politicians may attempt to fill government coffers.

One of many problems with taxing the Internet is when something becomes more costly, people will engage in less of it. If the government decides to get involved, Internet businesses will lose customers. It is better for government to keep the status quo than try to manipulate the free market.

As Congress faces the expiration of the moratorium, the ban should be made permanent. If not, the extension of the moratorium should be for at least six years. Internet business and commerce have become an important part of the economy, and the tax ban has been a contributing factor. As the economy will undoubtedly become more digitally-focused, America has a lot to gain from keeping this sector unshackled from the burdens that come from regulation and taxation.

Net Neutrality

Network neutrality, a.k.a. net neutrality, is generally defined as a system that allows information on the Internet to move freely without regard to content, destination or source. In other words, every Internet service provider (ISP) would provide everything it makes available on the Internet without making any determination that one type of content is either more important or more expensive than any other content.

While the term sounds innocuous or even positive, there is heated debate over net neutrality, pitting content providers against creators of the material viewed on the Internet. These arguments are being played out in the media, on Capitol Hill, and at the Federal Communications Commission (FCC). The question is whether politicians and bureaucrats or market forces will determine the type of products and services that will be developed on the Internet.

Currently, there is no priority for one form of content over any other, so net neutrality opponents suggest there is no reason for regulation. Those seeking intervention from the government believe that even the potential for prioritization should be pre-empted.

Cable providers, telecommunications companies, and other content providers oppose net neutrality. They point out that there is no logical reason why a cable or telecom company would block or censor any information. If a company blocked information, customers would switch to a provider that did not block such content.

When talking about consumer choice, Verizon Communications Chief Technology Office Mark Wegleitner said, “We see no reason to prohibit a customer from accessing any lawful Web site. And in fact, that is one of the FCC's principles, and we have no problem with those principles. We think the richest, broadest choice in applications provides a better broadband experience and makes for a happier consumer.”¹³

According to the FCC's website, “Regulatory policies must promote technological neutrality, competition, investment, and innovation to ensure that broadband service providers have sufficient incentive to develop and offer such products and services.”¹⁴ The FCC further states that its broadband “goals are to:

- Broaden the deployment of broadband technologies
- Define broadband to include any platform capable of transmitting high-bandwidth intensive services
- Ensure harmonized regulatory treatment of competing broadband services
- Encourage and facilitate an environment that stimulates investment and innovation in broadband technologies and services.”¹⁵

With the exception of the Madison River case in 2004, an example of ISP tampering does not exist. In 2004, Madison River Communications, located in Mebane, North Carolina, blocked customer's ability to access Vonage VoIP (Voice over Internet Protocol). When the issue was discovered, Vonage filed a complaint with the FCC, which then quickly fined Madison River \$15,000, thus resolving the issue. FCC Chairman Michael Powell said, “We saw a problem, and we acted swiftly to ensure the Internet voice service remains a viable option for consumers.”¹⁶

One reason service providers oppose net neutrality is that they think they should at least have the right to charge more for premium or tiered service. If consumers pay more for such services, then they will be able to connect to video or music at a faster speed. The companies argue that this sort of pricing plan allows them to collect on their broadband investments as well as promote the growth of technology on the Internet. If everything were kept neutral, then spam e-mails would be given the same priority as medical information.

Net neutrality opponents also argue that regulation will increase bureaucracy, taxes, and government control, which would inhibit further growth of the Internet. Without such regulation, companies have thrived and created a lucrative market. Usually, those that seek government intervention regret such a decision.

An August 2007 report from the Pacific Research Institute (PRI) concluded that net neutrality legislation does more to restrict the Internet than it does keep it neutral for all users. The report said, "Preventing the operation of market forces is a negative concept, one that seeks to turn back the clock." The heart of the debate is price controls and how advocates of net neutrality support regulation as opposed to free market models endorsed by Citizens Against Government Waste (CAGW) and others. The PRI report concluded, "Regulation has consequences at odds with consumer welfare in the short term and long term. But that does not deter advocates of net neutrality from seeking legislation to impose the regime they want."¹⁷

Content providers such as Amazon, eBay, Google, and Yahoo! support net neutrality legislation. It has also received grassroots support from organizations such as AARP, Consumers Union, and MoveOn.org.

Proponents argue that regulating the Internet would increase content. During an August 21, 2007 speech to the Progress and Freedom Foundation's Aspen Summit, Google CEO Erick Schmidt said, "We also care a lot about Net Neutrality. Whether you agree with me or not, you would agree with the following principle: No entity that controls the last mile, whether it's a telco or a cable company or, by the way, a local government since they're doing this stuff, too, should be able to control the content that flows over it."¹⁸

On January 19, 2007, David Farber, a computer public policy expert at Carnegie Mellon, and Michael Katz, a University of California economics professor published an op-ed in *The Washington Post* stressing the importance of exercising caution when legislating net neutrality. They stressed that a solution is only needed when a problem is afoot, stating "No one would propose that the U.S. Postal Service be prohibited from offering Express Mail because a fast lane mail service is undemocratic."¹⁹ Farber and Katz said that net neutrality would "prohibit practices that could increase the value of the Internet for customers" and concluded that "public policy should intervene where anti-competitive action can be identified and the cure will not be worse than the disease."²⁰

The government's jurisdiction over the Internet includes the FCC, Federal Trade Commission (FTC), and Department of Justice (DOJ). On September 6, 2007, the DOJ filed comments to the FCC on net neutrality. DOJ's press release regarding the filing said, "Whether or not the same type of differentiated products and services will develop on the Internet should be determined by market forces, not regulatory intervention."²¹ Furthermore, DOJ made it clear that it would continue to oversee and enforce any anticompetitive conduct to ensure a competitive marketplace. The press release quoted Assistant Attorney General for Antitrust Thomas O. Barnett as follows: "Regulators should be careful not to impose regulations that could limit consumer choice and investment in broadband facilities."²²

The rejection of Internet regulation by the DOJ follows the release of a report by the FTC in June 2007. The 155-page report made the argument that the Internet should be left alone for the time being. The FTC warned, “broad regulatory schemes almost certainly will have unintended consequences.”²³ There also is the matter of lawmakers being able to undo the regulations if they prove too ineffective once in place.

Additionally, the FTC was unaware of any market failures or abuses conducted by broadband providers. The agency argued that abusive actions by broadband companies would only hurt them in the long run. Such companies are vertically integrated, giving them the incentive to invest in their own networks to provide better service to existing customers and to attract new ones as well. The FTC cited the example of vertical integration in the early days of cable in which the investment made by cable companies into their content made the entire cable package more attractive to future subscribers.²⁴

An April 26, 2006 letter to the House Committee on the Judiciary from Hands Off the Internet, a net neutrality opponent, said, “it is the absence of regulation over the past decade that has allowed engineers, entrepreneurs and innovators to build the Internet into the amazing tool” that it is today.²⁵ The group argued that there are no problems plaguing the Internet that need to be resolved by government regulation. The letter said net neutrality supporters are “anti-consumer because the rules and regulations they espouse will discourage innovators and investors, and ultimately limit consumer choice,” and that “Government intervention now would be bad bureaucratic medicine.”²⁶

Another example of public opposition is a letter to the editor of *The New York Times* written by a representative from the Ayn Rand Institute. He suggested that “As owners of their own networks, they have the right to run their businesses as they see fit.”²⁷ The inability of companies being able to offer separate “tiers” of service is an attack on their ability to run a free and fair business. The writer also cited the Farber and Katz example of companies being free to charge their customers for speedier delivery.

The flurry of activity over net neutrality in 2006 was partly due to the introduction of legislation in the House and Senate. The Communications Opportunities Promotion and Enhancement (COPE) Act, intended to update the Telecommunications Act of 1996, was being considered by the House Energy and Commerce Committee. Rep. Edward Markey (D-Mass.) proposed an amendment to COPE that would grant the FCC the authority to enforce net neutrality. Markey’s amendment stated that each broadband provider has the duty “not to block, impair, degrade, discriminate against, or interfere with the ability of any person to use a broadband connection.”²⁸

Sen. Ted Stevens (R-Alaska) added the Internet Bill of Rights to S. 2686, the Communications, Consumer's Choice, and Broadband Deployment Act of 2006. It would allow the FCC to levy heavy fines against companies that do not comply with neutrality. Farber and Katz wrote that if such regulation existed, it would impose “far-reaching prohibitions affecting all broadband providers” that would “restrict a wide range of innovative services without providing any compensating customer benefits.”²⁹ The authors made it clear that Congress should not regulate the Internet unless anti-competitive practices are directly harming the marketplace.

After winning the majority in Congress, Democrats announced their intention to continue pursuit of net neutrality legislation. House Judiciary Committee Chairman John Conyers, Jr. (D-Mich.), Rep. Rick Boucher (D-Va.), and Senate Interstate Commerce, Trade and Tourism Subcommittee Chairman Byron Dorgan (D-N.D.) are leading this effort. On the other side of the aisle, Sen. Stevens and Sen. Olympia Snowe (R-Maine) are pressing forward.

Opponents argue that enactment of such legislation would harm the open market. Without intervention, businesses could choose the pricing model that works best for their customers. Advocates argue that without such legislation, telecom companies will have too much content control.

In a January 2006 *Tech News World* article, Sonia Arrison illustrated the divisiveness of the issue by citing two separate polls. The first poll was conducted by the Consumer Federation of America (CFA), which supports net neutrality. It found that 70 percent of Americans were fearful of Internet providers blocking their Internet access. The other poll, released by the American Consumer Institute, a net neutrality opponent, said 84 percent of American households were willing to pay more for safer and more reliable Internet service.³⁰

Arrison pointed out that without investment, Internet networks will not improve and begin to deteriorate. If a company is able to charge more for a higher tier of service, then it will get a suitable return on its original investment. Arrison also noted that charging more for better service is no different than Google, a net neutrality proponent, seeking higher fees from companies when they want better positioning on the search engine. Advertisers could claim that Google itself is not neutral with its advertising model.³¹

The argument against something that sounds so positive was brought up in a speech by Comcast Vice President David Cohen at the World Affairs Council of Philadelphia on April 12, 2007. Cohen explained that there isn't anything neutral about network neutrality. Providing better service for a higher price is the way business is done by all companies.

For example, Cohen noted that Google has paid Dell to sell computers equipped with Google software and also has an exclusive deal with Sony Ericsson Mobile to have Google search options appear faster than its rivals. On top of all this, if one searches for net neutrality on Google, the company admits that it configured its search engine to return results that coincide with Google's position.³²

Cohen explained that neutral growth on the Internet only exists if the government applies the "hands off the internet" approach. Regulation of the Internet would bring about price controls, which would harm consumers while benefiting certain technology companies. Cohen ended his speech by quoting an advertisement that opposes net neutrality. The ad says, "Net neutrality...is all about regulating something that hasn't been built...to solve a problem that doesn't exist."³³

The more an industry relies on the marketplace, the better the results are for innovation and improvement. Alfred E. Kahn, who played a large role in the deregulation of the airline industry, said that the competition among cable and cellular companies highlights the benefits of open markets. Kahn wrote that the phone companies are investing tens of billions of dollars in converting copper to fiber and continue to invest billions into their own networks, questioning whether anyone could "seriously believe that competition would be forthcoming if those incumbents were still subject to public utility-type regulation?"³⁴

Unless the market gives a company reason to compete, then they will not do so. Kahn wrote, "competition is a far better protector of the interests of both consumers and content providers than government ownership or regulation."³⁵ He added that there is nothing liberal about regulation and that the healthiest decision would be for Congress to put their trust in competition backed up by antitrust laws, leaving regulation as a last resort. If one turns to the cellular industry, without open-market competition, there would still be roaming charges and poor service. In 2006, Intel and Sprint announced they were investing \$3 billion in creating a large wi-fi network.³⁶ All of this competition is a direct result of a lack of intervention in the marketplace.

Another example of how net neutrality could adversely impact Internet users and technology development is the future of “e-health” plans. In an effort to streamline and improve the American healthcare system, many companies are looking into producing electronic health records, prescriptions and X-rays. Such efforts could allow healthcare providers to send and receive a patient’s records with ease, helping to improve treatment and save lives.

According to the U.S. Internet Industry Association (USIIA), reaching these goals requires a rejection of net neutrality. The USIIA argues that Americans should not support a system where critical medical documents should be put on the same footing as music downloads or non-critical communications.³⁷ Under net neutrality, broadband companies would be unable to set aside bandwidth for medical companies or private security firms that may need to transmit large data files with proper security and protection. No one wants their private medical records to be given the same protection and priority as spam e-mail.

The worry among ISPs is that the more advanced the content on the Internet becomes, the more bandwidth it will need to transmit efficiently. A May 2006 Associated Press article questions whether high-definition content could “choke” the Internet. The fear among ISPs is that when it comes to small videos and low-quality content, fiber sends them along just fine; however, if a website wanted to broadcast TV quality content, it is more problematic.³⁸ This is why ISPs would like to retain the option to create a tiered Internet. The customers who would like to have increased bandwidth could pay the cost, which in turn, would help provide the financing the ISPs need to upgrade their infrastructure.

USIIA President and CEO David McClure said “Ultimately, consumers will decide whether the system makes sense.”³⁹ If the marketplace rejects the tiered internet service provided, then it will move on to a different business model that works for both the consumer and the ISP.

Rep. Diana DeGette (D-Colo.) wrote in an October 21, 2003 CNET.com article that the irony facing net neutrality is that the organizations now clamoring for regulation succeeded because of the lack of regulation in the early 1990s. These are the same companies that fought Internet taxes, opposed broadband regulation and fought vehemently against antitrust lawsuits. DeGette wrote, “If one is concerned about keeping the Internet open – allowing users to click through unimpeded to any site they wish or to attach any equipment or applications they choose to their hardware or operating systems – then restricting the ability of broadband operators to compete is not the place to start.”⁴⁰

Both sides have a business interest in fighting for their own visions of the Internet; however, whatever the government does in response should benefit consumers and taxpayers. Google, Yahoo! and others desire more regulation, believing it will help their bottom line. ISPs such as AT&T, Comcast, and Verizon are trying keep up the quality of their networks and develop new technology. Congress and the executive branch should just stay out of it. The Internet was founded as a marketplace of ideas free of excessive taxation and regulation and it should stay that way.

While the debate continues, columnist Declan McCullagh believes there are 10 things that will lay net neutrality to rest. They include cooperation between Google and telecom companies with wireless networking, neutrality rules set through the AT&T and Bell South merger in 2006, and signals from the Bush Administration that no new legislation is necessary. Add partisan gridlock and the June FTC report, and McCullagh believes net neutrality is as good as dead.⁴¹ However, no one can underestimate the desire by Congress to do something, even when there is no basis for action.

Spectrum

Although invisible, spectrum is vital and valuable. Every time someone picks up a wireless phone, turns on a radio, or watches television, spectrum is being used.

Spectrum in the megahertz (MHz) range goes from low at 40 MHz and below, used for such devices as garage door openers, to high at 2300 MHz and above, used on deep space radio communications among other complex equipment. Different bands of spectrum have different properties. For example, wireless routers operate on a very high frequency, in the gigahertz (GHz) range. This allows lots of data to be packed into transmissions, but limits the ability of those transmissions to travel far. Most wireless phones operate on the 800 MHz band because the properties of this part of the spectrum allow transmissions from phones to go long distances and through buildings. The 700 MHz band is extremely valuable to telecommunications companies because it has the same properties as the 800 MHz band, but to a greater degree.

While spectrum is always of interest to those in the communications business, it is especially important to taxpayers through early 2009. In February 2006, the President signed into law the Deficit Reduction Act of 2005, which included the Digital Television Transition and Public Safety Act (DTV). The legislation established a deadline, February 17, 2009, when television broadcasters have to transition from analog to digital technology. As a result, 84 MHz of spectrum will be available in the 700 band. Of that total, 60 MHz will be put up for auction, with the remaining 24 MHz reserved exclusively for use by emergency responders. One billion dollars of the auction proceeds will be used to help improve interoperability, which allows different communications systems to interact with each other.

In the 1980s, the FCC gave portions of the spectrum away in a lottery system. Participants would fill out a complicated application and hand over a \$155 fee for the chance to win the right to broadcast on spectrum. Those who won the spectrum would often resell their winnings for millions of dollars. This money could have gone into federal coffers and been used to pay down the debt, lower taxes, or provide additional public services. Instead it went to people with enough time and legal expertise to complete the complex lottery application.

It wasn't until 1993 that the FCC began to auction off parts of the spectrum instead of simply giving it away. In the auctions of the 800 MHz band in the mid to late 1990s, different companies placed bids. A resounding success, the auctions brought the government \$15 billion in revenue. The result was a wellspring of innovative products and services such as text messaging and Caller ID.⁴²

Spectrum also played a part in the 9/11 attacks. As the initial shock from 9/11 began to recede, the country began to wrestle with more than the questions about what happened and why. On a tactical level, the National Commission on Terrorist Attacks Upon the United States, also known as the 9/11 Commission, showed that the incredible bravery of the first responders to the World Trade Center attack in Manhattan contrasted with inadequate radio communications that made it difficult for personnel from different agencies to communicate and even hampered communications within departments. Of the approximately 2,700 people who died that day, 403 were first responders: 343 firefighters and 60 police officers. The 9/11 Commission also found that interoperability was a problem during Hurricane Katrina as well as 9/11.

In an attempt to coordinate the multiple federal initiatives addressing the nation's problems with interoperability, the Office of Management and Budget in October 2001 created the SAFECOM

program. The goal of SAFECOM is to “provide research, development, testing and evaluation, guidance, tools, and templates on communications-related issues to local, tribal, state, and Federal emergency response agencies working to improve emergency response through more effective and efficient interoperable wireless communications.”⁴³

In April 2004, the General Accounting Office (GAO) released a report detailing the progress of SAFECOM, and it got right to the point with its analysis. The report began as follows: “While its overall objective of achieving communications interoperability among emergency response entities at all levels of government is a challenging task that will take many years to fully accomplish, Project SAFECOM, in its 2-year history, has made very limited progress in addressing this objective.”⁴⁴ In case of a terrorist attack or a natural disaster, first responders from all levels and various jurisdictions need to be able to communicate with one another. However, according to the GAO report, “the wireless communications used today by many police officers, firefighters, emergency medical personnel and other public safety agencies do not provide such capability, which hinders their ability to respond.”⁴⁵

One reason interoperability remains an issue is Nextel. The company, now Sprint Nextel, was serving millions of cell phone customers with a jumble of radio frequencies in the 800 MHz band. Those frequencies butted up against those used by police, fire and emergency medical response units. This created a chronic problem of signals from Nextel’s cell towers interfering with emergency communications traffic. The FCC’s 2004 Consensus Plan attempted to solve that interference through realignment of the 800 MHz spectrum band to separate public safety systems from commercial wireless systems.

As part of the Consensus Plan, Nextel agreed to give up some of its localized 800 MHz spectrum worth about \$1.6 billion. In return, it got a nationwide slice of prime 1.9 GHz spectrum with an estimated value of as much as \$5 billion had it been sold at public auction.⁴⁶

Nextel also agreed to contribute \$850 million to the technical changes involved in implementing the realignment of the 800 MHz spectrum.⁴⁷ This “rebanding” process, as industry and the FCC refer to it, has gone nowhere. Sprint Nextel already has its high-priced spectrum while emergency responders wait for the promised rebanding. The company has asked for a delay of at least another two years, and last September blamed the lack of action on the emergency services community.⁴⁸

The bottom line on the Consensus Plan is discouraging but simple. A deal was made. A timeframe was agreed to for completing the process. Billions of dollars worth of spectrum went to Nextel rather than being auctioned for the benefit of the public treasury. And promises were broken. Worst of all, the unkept promises of the Consensus Plan mean there have been few improvements in public safety communications.

Morgan O’Brien, the former chairman of Nextel, is looking for another government handout, this time in the form of a company called Cyren Call. In some ways, the government giveaway Cyren is looking for is more audacious than Nextel’s Consensus Plan. It would roll back the progress made by the DTV provisions of the Deficit Reduction Act.

Cyren Call wanted the FCC to pull out about 30 MHz of the 60MHz in the 700 band of spectrum designated for auction in January 2008 and essentially give it to the company. Cyren Call hired lobbyists to win control of this public property, worth as much as \$10 billion at auction. Rather than bidding on this spectrum, Cyren Call wanted to be paid to create a commercial network that would

manage emergency communications as well as commercial traffic. They would profit handsomely from that network. Meanwhile, taxpayers and first responders would have to do without the billions of dollars the spectrum would have generated at auction.

The new company's appetite for public money appears bottomless. They have promised to make the Treasury "whole" as a result of the money the U.S. would sacrifice by not auctioning off the 30 MHz of spectrum Cyren wants for free. These vague promises are reminiscent of the unkept Nextel pledges under the Consensus Plan. The pay-back assurance offered by Cyren Call was only made after a firestorm of criticism of its proposal as a giant money-grab that endangers the nation's first responders. Cyren Call's preference was to have the spectrum placed in trust without any fees from Cyren Call to the U.S. Treasury. They retreated from that position, then offering to pay \$5 billion for the spectrum, but they wanted federal loan guarantees to do it.

The FCC rejected Cyren Call's plan on November 6, 2004, despite putting it out for public comment. The FCC cited a lack of authority from Congress, and stated that the proposal was contrary to auction law.

Open Access Giveaways in the 700 MHz Auction

When the DTV Act authorized a switch from analog to digital broadcasting, Congress made no mention as to whether the winners of the spectrum auction would be forced to allow any device or software to run on the network – a requirement known as "open access." But on July 31, 2007 the FCC approved open access for about a third of the 60 MHz of spectrum to be sold in the January auction.⁴⁹

Companies like Frontline Wireless and Google have pushed for open access in the name of increased competition. Mark Fowler, a former FCC chair and founding partner of Frontline Wireless, claims that open access regulations are necessary to "promote competition when dominant players control important network facilities."⁵⁰ The players he is referring to are companies like AT&T and Verizon Wireless. But the bottom line for Fowler is his belief that his smaller company will benefit when open access restrictions drive down the value of the spectrum to a price that Frontline can more easily afford.

Conversely, the opposite side has fought against such provisions. On September 10, Verizon sued the FCC over its open access stipulations for the January auction, saying the rules were "arbitrary, capricious, unsupported by substantial evidence and otherwise contrary to law."⁵¹

For his part, FCC Chairman Kevin Martin defended open access, saying, "Whoever wins this spectrum has to provide ... truly open broadband network – one that will open the door to a lot of innovative services for consumers."⁵² But just like the lottery system and the Nextel deal, open access is a giveaway of taxpayer dollars.

The real effect of open access will be that the spectrum, which should be valued at the price of a Cadillac, will be valued at the price of a clunker. Taxpayers will be the biggest losers in this scenario. Because of these provisions, revenue will be lost and innovation will diminish.

Open access will act like a "poison pill" during the 700 MHz auction. Telecom companies will not want to pay as much for slices of the spectrum if they must allow any device to use the spectrum. Currently, iPhones only work on AT&T's network. As part of its exclusive deal with Apple, AT&T need not allow every iPhone knock-off to use its network. The ability to exclude unlicensed competitor devices from using its portion of the spectrum greatly increases the value of the network to AT&T.

Companies like Sprint Nextel are free to offer iPhone-like devices on their own networks, and they do. But it is precisely the exclusive control each company has over its network that gives it an incentive to invest in and develop these new technologies. Open access restrictions threaten to remove that incentive, driving down revenues from the spectrum auction in the process.

Wireless companies will not pay as highly for portions of the spectrum if they cannot devote those sections exclusively to partnership organizations, the way AT&T has done with Apple. That relationship and the technological investment would be difficult if open access restrictions prevent companies from exercising exclusive control over their portions of the wireless spectrum.

Fewer dollars will be realized if the FCC imposes open access restrictions on future auctions. Companies like Frontline Wireless will benefit at taxpayer expense. The lottery giveaways of the 1980s and the Nextel fiasco after 9/11 should teach the FCC a lesson. Open access is the latest way for the federal government to miss a prime opportunity to get a premium price for a premium resource. This “invisible” spectrum can mean very visible dollars to taxpayers. Hamstringing this opportunity is a bad idea.

Conclusion

The telecommunications industry is a dynamic part of the U.S. economy, as countless innovations have benefited consumers and businesses. Vibrant competition, not excessive regulation, will be the driving force behind any future growth.

Congress and the FCC are poised to make critical decisions about cable television viewing (a la carte), the Internet tax moratorium, network neutrality, and the sale of spectrum.

A la carte is the classic case of fixing something that isn't broken. Cable television is low cost and diverse. Forcing cable television companies to stop bundling their programming and sell individual channels separately would increase costs to consumers and decrease channel diversity.

Making the Internet tax moratorium permanent will allow the Internet to thrive and grow. States are selfishly looking to tax goods and services on the Internet to pay for their bloated bureaucracies. They should cut wasteful spending instead of raising taxes, especially those that will adversely affect the ability of consumers and businesses to benefit from increased e-commerce.

Net neutrality is based on a false premise that Internet content is being or will be denied to any user. It is not in the best interest of any business to deny access to the Internet. Governments at all levels should resist the temptation to mandate Internet availability or create a bureaucracy to "monitor" Internet usage.

Spectrum sales are a unique opportunity for the federal government to cash in on a resource as well as to help first responders do their job. Spectrum should be competitively sold so businesses and taxpayers can get the biggest bang for their buck.

Over-regulating and underutilizing the telecommunications industry will have detrimental effects on both the diversity of goods and services provided while wasting billions of tax dollars. The next "big" innovations will come about because of less – not more – government interference.

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