

## **AEI-Brookings Joint Center Policy Matters 06-06**

### **The Misplaced Debate over "Net Neutrality." Robert W. Hahn and Scott Wallsten. March 2006.**

Politicians, businesses, techies, and consumer groups used to agree on one government policy: "Hands off the Internet!"

Now some Internet service providers like Verizon, AT&T, and Comcast want to upend the rules of the game. They want to stick it to both content providers like CNN and to regular consumers—instead of just charging end users as they do now.

Critics fret that this could be the end of the Internet as we know it. We think it may just be the beginning of a better Internet if the government puts on its thinking cap and weighs policy choices carefully.

Both sides agree that it's OK to price customer bandwidth capacity differently. So AT&T could charge different prices for slow, medium, and very high speed connections.

But that's where the agreement ends.

Some noted academics, consumer groups and Internet content providers like Google and Microsoft want the government to guarantee "net neutrality." Net neutrality usually means that Internet service providers charge consumers only once for Internet access, don't favor one website over another, and don't ask content providers to pay a dime for getting access to consumers.

So, for example, net neutrality enthusiasts argue that the government should make it illegal for Internet service providers to charge more for, say, streaming a full-featured movie than for sending instant messages, or for an ISP to charge a content provider like Google to send its bits over the ISP's high-speed fiber.

Of course, the people supplying the high-speed Internet see it differently. They're in the business of making money any way possible.

Fortunately, they face pressure from two sides to behave.

Competition among providers for end-users is the best way to spur them to innovate, invest, and keep prices down. In 2004, 83 percent of all zip codes in the U.S. had two or more broadband providers, and 67 percent had three or more. Whether that is enough competition is debatable, but the trend is good: more people are getting served by more providers.

But competition for subscribers isn't the only thing that keeps broadband providers in check. They also need content to attract subscribers, which is precisely why providers will think twice before they restrict it. Suppose AT&T tries to charge Google for the right to stream video over its high speed fiber and Google refuses to pay. AT&T might allow unfettered access to Google anyway because customers want it. The point is that even firms with market power in one part of the market will not necessarily be able to control content.

Other businesses that need different types of customers to be successful face similar challenges. Some newspapers charge advertisers and readers, while others give papers away. eBay only charges sellers.

There is not one “right” way to charge different customers in these markets. That is precisely why broadband providers should be allowed to charge however they want, unless there is a clear showing of consumer harm.

In a world of rapidly changing technology, the boundaries of “net-neutrality” blur rather quickly. Google, one of the louder advocates, may itself be poised to violate the principle it is endorsing with its bid to provide “free” WiFi in San Francisco. In particular, Google has not denied that it might deliver paid ads to people who use this service. If true, Google would control how some content goes from the Internet to your computer—just what net neutralists fear.

There would be nothing wrong with that plan. Broadband infrastructure is costly and someone has to pay for it. Many consumers may well be willing to see ads in return for free access. The point here is that while ‘net-neutrality’ sounds good, it isn’t that simple, and mandating it could have serious unintended consequences—like making Google’s much-hyped plan impossible.

Fortunately, there is a way out of the net-neutrality box. The way out is to drop the slogan and replace it with sound economics.

Suppose you believe that Internet service providers do not face enough competition to prevent them from behaving anticompetitively. Should we then necessarily mandate how they provide and charge for Internet service?

No. Rather than trying to artificially create what some believe today to be the best Internet architecture, policy should address the root cause of the problem.

Specifically, policymakers should consider whether some factors are preventing more competition in high-speed Internet access, and more choice for consumers.

Two artificial barriers reduce competition and choice today.

The first is restrictions on the use of spectrum—those valuable airwaves that carry wireless signals. Because of outdated regulations, much spectrum simply cannot be put to its highest-valued use. Congress and the FCC could give the economy a boost estimated to be in the hundreds of billions of dollars by making more spectrum available and allowing licenses to use it to be traded. One of these uses could very well be more wireless broadband options that would add more choices for consumers.

Second, local governments also block competition by arbitrarily determining who is allowed to enter the market and what types of services can be provided over broadband lines. New firms wishing to provide broadband services often must obtain local approval, access to rights of way, pay fees, and meet regulatory obligations regarding service provision. Firms already providing service must seek local regulatory approval regarding what information can flow across their broadband lines. Telephone companies hoping to provide video services, for example, must negotiate approval separately with each city. Congress could eliminate most of these wasteful and anti-consumer rules.

Both of these suggestions would improve competition, but government still has an important role to play through antitrust enforcement if the market is not workably competitive.

Say that a monopoly broadband provider favors itself in providing Internet phone service by charging a competitor like the leading Internet phone provider, Vonage, an arm and a leg. Antitrust laws allow the government to police such behavior, as it has in the past, by not permitting such self-dealing.

The basic message is that government should proceed with care and allow firms to experiment with different forms of pricing. The last thing we want is to snuff out the next Google, eBay or a competing new wireless access provider because it uses a pricing model that deviates from textbook economics or from the status quo, but actually makes sense for economic survival on the Internet.

The Internet and the broadband industry are highly dynamic, making it difficult to know what actually is best for consumers now and in the future. "Hands off the Internet" was good policy when the Internet was brand new, and it's good policy now.

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