Policy Update

Net Neutrality 2.0

BY TIM SABLIK

On Feb. 26, 2015, the Federal Communications Commission (FCC) announced a new version of what it calls its Open Internet rules. The rules, which went into effect on June 12, reclassify broadband Internet as a "telecommunications service" and make fixed and wireless Internet Service Providers (ISPs) subject to Title II of the Communications Act. Under these rules, ISPs are prohibited from blocking or slowing any legal Internet content or delivering some content faster in exchange for payment from the content provider (known as "paid prioritization").

Collectively, these principles are often referred to as "network neutrality" or "net neutrality," an idea that has been a point of contention in the United States for roughly a decade. The FCC issued its first rules aimed at enforcing net neutrality in 2010, but they were struck down by the U.S. Court of Appeals for the D.C. Circuit in a 2014 decision. The court held that the FCC did not have the authority to ban paid prioritization under its existing classification of ISPs. Reclassifying ISPs as "common carriers" under Title II is intended to give the FCC that authority.

Proponents of this regulation say that, in the absence of such rules, ISPs with market power could act as gatekeepers of Internet content. Currently, content providers pay only their own ISPs to transmit content. Without a net neutrality rule, content providers might also have to pay a fee to consumers' ISPs to avoid having their content transmitted more slowly. Alternatively, ISPs could block content providers who refuse to pay.

"Practically speaking, the ISPs would be able to determine the leading company in various sectors, such as search, video, and so on," says Nicholas Economides, a New York University economist who studies net neutrality.

The fixed broadband market is highly concentrated. While nearly all urban residents have at least two providers to choose from, fewer than 60 percent of rural residents do, according to the National Broadband Map maintained by the National Telecommunications and Information Administration in collaboration with the FCC. And only 60 percent of urban and 20 percent of rural areas have at least three providers.

Economides says that ISPs have a strong incentive to delay all but the highest paying content producer, creating monopolies in all of the various content sectors. "Monopolists make the highest profits. So as an ISP, if I create a content monopolist, I will be able to reap a large percentage of his profits through paid prioritization," he says.

But not everyone agrees that ISPs could get away with such behavior. If wireless providers are included, the market looks much more competitive: Nearly all urban and about 70 percent of rural residents have access to at least five ISPs. "How you view the market and its structure is really key to what you think about the FCC and what it has done," says Robert Litan, formerly a nonresident senior fellow at the Brookings Institution.

Economides notes that wireless is not currently a perfect substitute for fixed broadband given its much higher cost for comparable service. But he agrees that greater competition would likely prevent many of the concerns raised by net neutrality proponents. "If we had more competition in fixed broadband, it would be a different story," he says.

Critics of the new rules argue that, in spite of this, there have been relatively few cases of anticompetitive behavior by ISPs over the last decade. Moreover, Litan and others say that any anticompetitive actions could be handled on a case-by-case basis through existing rules and regulators. The FCC has used its Enforcement Bureau to investigate ISPs and address claims of anticompetitive behavior in the past. And former Federal Trade Commission Commissioner Joshua Wright testified before the House Judiciary Committee in May 2015 that the new rules are unnecessary because existing antitrust laws are already "well-suited to handle any such problems as they arise."

The new rules could also lead to unintended costs. Under Title II, the FCC has the authority to regulate ISP prices or mandate the unbundling of services. Although the FCC explicitly stated that it would not use these powers on broadband ISPs, Litan and others argue that it has nevertheless had a chilling effect on network investments. Capital expenditures by several major broadband ISPs declined in the first half of 2015, after the rules were announced. That has only happened in two other periods: the dot-com crash and the Great Recession. Some have suggested this is just a response to recent changes in consumer behavior such as cable "cord cutting," but there is evidence that a similar decline in investment occurred when Title II was applied to telephone companies in the mid-1990s.

The net effect of paid prioritization on innovation by content producers is also unclear, according to a 2014 paper by Litan and Hal Singer of the Progressive Policy Institute. While some startups might be discouraged from competing with prioritized incumbents, the availability of "fast lanes" could also encourage the development of some high-value, speed-dependent applications like telemedicine. "I view paid prioritization as price discrimination based on different levels of service, which is a core feature in all kinds of markets that are competitive," says Litan, pointing to different tiers of package shipping as an example.

The ultimate impact of the FCC's new rules remains to be seen. Like the original 2010 rules, they are facing legal challenge in federal court. **EF**