

# **The Free State Foundation**

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## **Devaluing Spectrum**

**by**

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FCC Chairman Kevin Martin's proposal to encumber the next advanced wireless service spectrum auction ("AWS-3 in FCC lingo) devalues the spectrum at a time America's taxpayers are in no mood to condone quixotic prone-to-failure government handouts. Chairman Martin proposes, as an auction condition, that the winning bidder devote 25% of the spectrum capacity to a free broadband service offering. And, as a further condition, the free service must include a filter that allows blocking of indecent content.

Martin's proposal has several serious deficiencies. Most fundamentally, it would be yet another departure from the use of a market-based mechanism to award spectrum to the bidder that assigns the highest value to the spectrum. There is absolutely no doubt that encumbering spectrum auctions with extraneous conditions reduces the amount of the winning bid, thus depriving the U.S. Treasury of the difference between the amount raised in the encumbered auction and the amount that would have been raised in an auction unencumbered with special interest conditions.

Richard Epstein, one of the nation's foremost "law and economics" scholars, and a Distinguished Adjunct Senior Scholar at the Free State Foundation, explained very

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clearly why encumbered auctions devalue the spectrum in his July 2007 FSF paper, ["Net Neutrality and Spectrum Auctions: Lessons from History."](#) That paper was written as the FCC was considering Chairman Martin's proposal to encumber the 700 MHz wireless auction with a net neutrality condition. Professor Epstein warned then: "If the FCC plays the conditions game, it will reduce both market and social value of the spectrum. The bottom line: The FCC should not impose any open access/net neutrality conditions in the 700 MHz auction." Professor Epstein explained that the fewer the conditions, the stronger the property right. And, "the stronger the property right, the greater the return from the spectrum to be auctioned, and the greater the enhancement of long-term consumer welfare." Pretty simple really. But pretty fundamental to the development of sound policy.

Chairman Martin, along with three fellow commissioners (including fellow Republican Deborah Taylor Tate), ignored fundamental market principles to engage in a bit of unwise social engineering. They included a net neutrality condition for a portion of the to-be-auctioned 700 MHz spectrum. The predictable result: Using very conservative estimates that examine the bids for comparable unencumbered and unencumbered spectrum blocks, the auction raised about \$7 billion less than it would have without the net neutrality condition. The loss to American taxpayers was probably even greater.

The Commission should not adopt Chairman Martin's proposal to encumber the AWS-3 auction with a "free" broadband requirement that appears tailor-made for one bidder, M2Z, a company backed by Silicon Valley venture capitalist John Doerr. Just to contemplate Martin's proposal is appreciate that its problematic nature. Why does he think the government is in a position to determine that 25%, rather than 15% or 35%, of the auctioned spectrum is the right amount for an operator to be able offer a viable, yet not inefficient, broadband service? Why does he think that a requirement for a nationwide wireless service offering is a good use of the government's funds when broadband access is already available in most of the country? Why does he think the government can devise build-out requirements that are sensible in light of evolving market and technological developments? Why does he think the government ought to be in the business of designing and dictating the parameters of content filters to be used by broadband providers? How will the government enforce the content filtering requirement on an ongoing basis? There are more questions that could be asked for which the lack of satisfactory answers ought to be obvious.

It is true that approximately 6-7% of U.S. households have no broadband access. But 93-94% of American households do. It is foolish not to acknowledge the remarkable progress that already has been made by the private sector since 2000 – at a cost of well over a \$100 billion in private investment – in achieving near nationwide broadband ubiquity. Nevertheless, it is an important policy goal to bring broadband access to those 6-7% of American households presently lacking it. As I pointed out recently in a Legal Times column, ["Don't Foil the Digital Age,"](#) the way to do this is to focus on the mostly rural unserved areas.

If there is going to be an infrastructure stimulus package in any event, and I am not here arguing for one, devoting some of the funds to support broadband infrastructure

deployment in unserved areas may make sense. There is no doubt that increased broadband availability and usage (a whole other question with many dimensions) benefits the nation's productivity and has other positive economic and social effects. Whether support is provided through a government infrastructure stimulus package or through some other means, it is important that funds be targeted only to unserved areas, not to areas where service is already available. And reverse auctions or some other form of competitive bidding should be used to determine which provider receives the government support. In that way, at least a market mechanism would be employed to ensure that the public's money is used as efficiently as possible to achieve the public goal.

Finally, back to the Commission's upcoming decision regarding the AWS-3 auction tailored to fit M2Z's business plan – and back to fundamental principles. For most of the FCC's history, spectrum was allocated and assigned based on a command-and-control model under which the agency devised intricate rules governing the award and usage of the spectrum. Over time, and long after economists almost universally had come to agree that this command-and-control regime led to inefficient and wasteful spectrum use, the government finally adopted auctions as a means of substituting an efficient market allocation mechanism for an inefficient government micro-management scheme.

For a while, this new regime worked well as the FCC conducted auctions on a basis that, for the most part, were unencumbered with special conditions, such as the net neutrality condition or the free broadband requirement. The Personal Communications Service auction in the mid-90s was a good example of such an unencumbered auction. As then-FCC Chairman Reed Hundt said at the time (in a 1995 article with Gregory Rosston, then deputy chief economist at the FCC, published in *IEEE Communications Magazine*): "The key to this investment boom is the FCC's decision to grant *flexibility* in the use of PCS spectrum."

Reed Hundt may have changed his view now. He certainly was a supporter of the ill-fated encumbered 700 MHz auction. But he was right in the mid-90s about the importance of conducting auctions that allow for maximum flexibility in the use of spectrum.

It is time for the FCC to abandon its recent habit of encumbering auctions with various social engineering proposals. It should go back to conducting unencumbered auctions. That way market forces will determine the highest and best use for the spectrum, not government officials responding to special interest pleading. America's taxpayers will be grateful too.