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Now Available: A Concise Explanation of the FCC's Economic Analysis on Net Neutrality

By: [Jerry Ellig](#) | November 19, 2018

Since leaving the Federal Communications Commission (FCC) in July 2018, I have spoken with a number of individuals and community groups about the [Restoring Internet Freedom](#) order adopted in 2017 that repealed and replaced the FCC's 2015 [net neutrality rules](#). Given that this issue tends to generate more heat than light, the order itself is quite long, and the economic analysis that is provided is interspersed throughout it, many people have sought a clear and concise explanation of the economic thinking behind the Restoring Internet Freedom order.

I, along with several others, have written that concise explanation for the [Review of Industrial Organization](#), which is edited by [Lawrence J. White](#) at New York University. They publish an annual special issue with articles that explain major new developments in economics at the FCC, and leading competition agencies in the U.S. and Europe. This year's FCC article includes an 8-page summary of the economic analysis in the Restoring Internet Freedom order, and the pre-publication version has just become available [online](#).

The Restoring Internet Freedom order removed the 2015 net neutrality order's prohibitions on blocking, throttling, and paid prioritization of broadband traffic. It eliminated a "general conduct rule" that prohibited unspecified conduct that the commission might decide to ban after-the-fact. The order also reversed the 2015 order's classification of broadband as a telecommunications service under Title II of the Communications Act. The FCC reclassified broadband as telecommunications in 2015 to ensure that it had legal authority to impose the net neutrality rules, but the reclassification also made broadband eligible for numerous other public utility regulations that the FCC promised not to impose.

The Restoring Internet Freedom order addresses four major economic issues, utilizing relevant economic research in each case. The order cites and discusses published economics literature on two-sided markets, competition in broadband markets, the welfare economics of conduct rules, and the effect of regulatory risks on firms' incentives to make investments in productive assets with few good alternative uses ("sunk investments," in economics jargon). These topics are directly relevant to the commission's decisions in the Restoring Internet Freedom order on blocking and throttling, paid prioritization, general conduct, and reclassification of broadband as an information service rather than telecommunications.

Blocking and throttling: Economic theory shows that blocking or throttling can harm consumers. In practice, there are few documented instances of blocking or throttling. Economic analysis provides two of the most important reasons for the paucity of empirical examples.

First, the broadband market is a two-sided market; broadband providers maximize profits by attracting as many users on both sides of the market as possible. Thus, even a broadband monopolist has significant incentives to make use of the network as attractive as possible both to subscribers and to content providers. Deliberate blocking or throttling would make the network less attractive to subscribers, potentially diminishing the network owner's profitability.

Second, most wireline broadband providers face at least one wireline competitor, and there are multiple wireless broadband competitors. Thus, although competition is far from "perfect," broadband providers have competitive incentives to provide subscribers with openness, to the extent that subscribers value openness.

Many broadband providers have also publicly committed not to block or throttle, and these commitments are enforceable under the Federal Trade Commission's prohibition on [unfair](#) or [deceptive](#) trade practices. The FCC concluded that disclosure, competition, broadband providers' public commitments, and the antitrust and consumer protection laws are sufficient to deter blocking and throttling.

Paid prioritization: Economic research on paid prioritization for broadband consists wholly of theoretical modeling. Most of the models show that regulations which prohibit differential pricing or quality of service differentiation make network users worse off. (For example, if the network can only offer one class of service, users with applications that need quality of service guarantees cannot buy higher-priority service, and users who do not need these guarantees may have to pay for better service than they need.) Given this result, a total prohibition on paid prioritization is clearly not the appropriate policy. Paid prioritization that has anticompetitive effects can still be challenged under the antitrust laws and would be subject to the antitrust "rule of reason," which involves economic analysis of the specific facts and circumstances to determine whether the practice in a particular case is anticompetitive and harms consumers.

General conduct: The general conduct rule prohibited unspecified business practices that might violate a non-exhaustive list of considerations that went well beyond welfare economics. The danger of this approach is evident when one considers the only practice the FCC investigated under this rule after it was adopted: wireless carriers' "zero rating" plans that allowed subscribers to download certain types of data without having it count against their monthly data allowances. The commission concluded that the antitrust laws provide better protection against any unanticipated broadband business practices that could actually create consumer harm.

Reclassification: Network owners must make sunk investments with few good alternative uses. The risk that a utility regulator could renege on past commitments and impose new regulations

that prevent the owner from recouping its investment is well-known to [public utility economists](#). The 2015 order made broadband companies eligible for public utility regulations (such as rate regulation), which the commission promised to forbear from for the moment. When it revisited this classification decision in 2017, the FCC placed little confidence in studies that purported to show that investment increased or decreased a year or two after adoption of the 2015 order. But several published empirical studies ([here](#), [here](#), and [here](#)) used natural experiments to examine how broadband subscribership and investment responded to changes in broadband's regulatory classification, suggesting that Title II regulation deters investment and subscribership.

Former FCC Chairman Tom Wheeler recently [claimed](#), “There is a strong case that the Trump FCC acted in an arbitrary and capricious manner when it repealed the 2015 Open Internet Rule...” In my view, if any FCC action on net neutrality was arbitrary and capricious (in the ordinary layman’s sense of those terms), it was the utter disregard the FCC displayed for mainstream economic analysis in its 2015 order.

That order cited just six articles in peer-reviewed economics journals. Half of them were authored by former FCC chief economist Michael Katz, who [said](#) they do not prove what the FCC claimed they proved. In a [roundtable discussion](#) published in *Forbes* magazine, Katz noted, “I have always suspected that the FCC cited my papers as an inside joke, because they know how much I think net neutrality is a bad idea.”

The Restoring Internet Freedom order corrected the FCC’s grievous disregard for economic analysis in the 2015 order. And now you can find out how, without slogging through the entire document.

Jerry Ellig served as the FCC’s chief economist from July 2017–July 2018.

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