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Public Interest Comment¹ on
The Federal Communications Commission's Proposed Rule:
Restoring Internet Freedom

RE: WC Docket No. 17-108

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Administration²

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Introduction

This comment responds to the request in paragraphs 105-115 of the NPRM for comment on performing a cost-benefit analysis and following the guidelines contained in Office of Management and Budget's (OMB) Circular A-4. In summary, I argue below that it is desirable to try to perform a Regulatory Impact Analysis in accordance with the established procedures of OMB Circular A-4 and Executive Order 12866. The Federal Communications Commission (FCC) has sometimes in the past followed key elements of that guidance in its own choice of

¹ This comment reflects the views of the author, and does not represent an official position of the GW Regulatory Studies Center or the George Washington University. The Center's policy on research integrity is available at <http://regulatorystudies.columbian.gwu.edu/policy-research-integrity>.

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methods of analysis but it is useful to explicitly follow the guidance or explain why portions of it are inapplicable.

The FCC Should Perform a Regulatory Impact Analysis

As an independent regulatory agency, the FCC is not required to perform a Regulatory Impact Analysis (RIA) of major regulations but it is desirable to do so voluntarily because RIAs have become the standard method of ensuring careful analysis of proposed regulations. The OECD states:

Regulatory Impact Analysis (RIA) is a systemic approach to critically assessing the positive and negative effects of proposed and existing regulations and non-regulatory alternatives. As employed in OECD countries it encompasses a range of methods. It is an important element of an evidence-based approach to policy making.

OECD analysis shows that conducting RIA within an appropriate systematic framework can underpin the capacity of governments to ensure that regulations are efficient and effective in a changing and complex world. Some form of RIA has now been adopted by nearly all OECD members, but they have all nevertheless found the successful implementation of RIA administratively and technically challenging.³

Similarly, a group of nineteen RIA experts convened by GW's Regulatory Studies Center states:

Regulatory impact analysis (RIA) weights the benefits of regulatory proposals against the burdens they impose. Even regulatory policies that are ultimately decided on political, legal, ethical, or other grounds will benefit from the structured evaluation of tradeoffs and alternatives that a good RIA provides...

In the United States, presidential executive orders for more than 35 years have required agencies to conduct RIAs before issuing economically significant regulations, and to rely on those analyses in designing regulations. In the simplest terms, the goal of regulatory impact analysis is to present information to decision makers to help them ensure that proposed regulations do more good than harm. Presidential Executive Orders 12866 (1993) and 13563 (2011) set long-established principles of good regulatory decision-making, and the Office of

³ <http://www.oecd.org/gov/regulatory-policy/ria.htm>, accessed July 3, 2016

Management and Budget's (OMB's) Circular A-4 (2003) provides detailed guidance for developing RIAs.⁴

As discussed below, an RIA can strengthen the analytic foundation of a change in regulation even when it is difficult to predict and quantify the effects of the change. The procedures developed over many years and political administrations in the U.S. and other OECD countries provide a useful guide to what constitutes rigorous analysis of a proposed regulatory change. Those procedures can be helpful in improving regulation even when not required or when not all of the components can be carried out.

Three components of the guidelines help provide analytical rigor even when it is difficult to quantify the costs and benefits. First, the guidelines require a clear statement of the need for the proposed action and limit the justification to specific categories such as clearly identified market failure or other compelling social needs. The presumption is that regulation should not be added to a market that is functioning reasonably well. Second, the agency needs to present evidence that the actions required under the rule will have a causal relationship to solving the identified problem. It is often easier to identify a problem than to find specific regulations that will solve that problem. Nobel prize economist Oliver Williamson has developed the “remediableness criterion” to distinguish problems that can be solved with government intervention from those for which intervention is unlikely to be effective.⁵ Third, the agency needs to show that it has considered a variety of possible solutions to the identified problem and has chosen the particular form of regulation that will generate the greatest net benefits.

Past FCC Analyses Comparable to RIA Procedures

While the FCC has not normally followed the OMB guidelines for RIAs in its proceedings, it has performed analyses similar to that required by the OMB guidance in some of its major proceedings. The issues involved in following those guidelines can be clarified by considering

⁴ Susan Dudley, Richard Belzer, Glenn Blomquist, Timothy Brennan, Christopher Carrigan, Joseph Cordes, Louis A. Cox, Arthur Fraas, John Graham, George Gray, James Hammitt, Kerry Krutilla, Peter Linquiti, Randall Lutter, Brian Mannix, Stuart Shapiro, Anne Smith, W. Kip Viscusi & Richard Zerbe. “Consumer’s Guide to Regulatory Impact Analysis: Ten Tips for Being an Informed Policymaker.” *The George Washington University Regulatory Studies Center*. (2017), https://regulatorystudies.columbian.gwu.edu/sites/regulatorystudies.columbian.gwu.edu/files/downloads/RIA-Consumers_Guide_Format_vf_1.pdf, accessed July 3, 2017, pp 1, 3. (forthcoming in *Journal of Benefit-Cost Analysis*)

⁵ Williamson states: “The remediableness criterion is an effort to deal symmetrically with real world institutions, both public and private, warts and all. The criterion is this: an extant mode of organization for which no superior feasible form of organization can be described and implemented with expected net gains is presumed to be efficient.” “Transaction Cost Economics: The Natural Progression,” 100 *American Economics Review* 673-690 at 684 (2010).

two historical examples where the Commission's analysis supporting its decision used different aspects of the current OMB guidelines.

Computer II

The 1980 Final Decision in the Computer II inquiry made major changes to the 1979 Tentative Decision and set up the regulatory framework for the early development of data communications services. In that crucial decision, the Commission made no attempt to develop anything resembling a cost-benefit analysis to justify its substantial departures from the Tentative Decision. Instead, the Commission emphasized freedom and market forces as justification for its new approach:

There are literally thousands of unregulated computer service vendors offering competing services connected to the interstate telecommunications network. ...The only limitation on the types of services offered are those arising from the constraints of their own entrepreneurial capabilities and, in a very real sense, the implicit requirement that they structure their services so as to avoid crossing a regulatory boundary that would subject them to regulation... The interaction of the implicit requirement to avoid crossing the regulatory boundary and the competitive nature of the enhanced service market is crucial. ...By removing this barrier the entire market for enhanced services should be even more competitive than it has been in the presence of that barrier. ...The record in this proceeding makes clear that even when the Commission's stated policies are in favor of open entry, the very presence of Title II requirements inhibits a truly competitive, consumer responsive market.⁶

Although no cost-benefit analysis was performed, the Commission's Computer II order did conform to an important part of the later guidance on regulation. EO 12866 contained as its statement of regulatory philosophy:

Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people.⁷

OMB Circular A-4 elaborated on that section as follows:

Before recommending Federal regulatory action, an agency must demonstrate that the proposed action is necessary. If the regulatory intervention results from a

⁶ Second Computer Inquiry, Final Decision 77 F.C.C. 2d 384 at 426, para. 109 (1980).

⁷ Executive Order 12866, "Regulatory Planning and Review," September 30, 1993. §1(a)

statutory or judicial directive, you should describe the specific authority for your action, the extent of discretion available to you, and the regulatory instruments you might use. . . . If the regulation is designed to correct a significant market failure, you should describe the failure both qualitatively and (where feasible) quantitatively. You should show that a government intervention is likely to do more good than harm. For other interventions, you should also provide a demonstration of compelling social purpose and the likelihood of effective action.⁸

In the Computer II proceeding, the Commission concluded that it did not have a legal obligation to regulate enhanced services and that the market was likely to work well enough that no specific regulatory intervention that they could undertake was “likely to do more good than harm.” While they did not perform a cost-benefit analysis, such an analysis was unnecessary according to current OMB guidance because they concluded that there was no “compelling public need” for regulation of enhanced services and therefore did not need to proceed further to conduct a cost-benefit analysis of the various possible regulations that they had already concluded were unnecessary.

Circular A-4 notes that “Government actions can be unintentionally harmful, and even useful regulations impede market efficiency” and goes on to state that “a particularly demanding burden of proof is required to demonstrate the need” for regulations that impose controls on competitive markets.⁹ The FCC could not have reasonably provided a cost-benefit analysis of its Computer II decision. The explicit goal of the decision was to provide a flexible structure for the expected development of data communications which was then in its infancy. The Commission’s generalized prediction that many new services would be developed was correct but any attempt to provide alternative scenarios with different styles of regulation would have been so speculative and uncertain as to render meaningless any computation of the costs and benefits of the alternative paths. However, given its conclusion that there were no major impediments to a market solution for enhanced services, there was no need to perform a cost-benefit analysis. Those analyses are designed to show that government intervention will do more good than harm and in this case the Commission decided that no intervention was needed.

Price Caps for AT&T

The price caps proceeding provides a contrasting case in which the Commission was changing the form of regulation instead of removing it and where it did perform a version of a cost-benefit analysis. In the late 1980’s at the direction of then Chairman Dennis Patrick, the FCC staff sought ways to provide better efficiency incentives than the long established rate-of-return

⁸ Office of Management and Budget (OMB). 2003. “Circular A-4, Regulatory Analysis.” Pages 3, 4

⁹ Office of Management and Budget (OMB). 2003. “Circular A-4, Regulatory Analysis.” Pages 6, 7.

regulation¹⁰ After extensive proceedings, the Commission adopted the price cap form of regulation for dominant long distance telephone providers (a category which included only AT&T at the time). That proceeding concluded in March, 1989 with a Report and Order adopting the price cap system for AT&T.¹¹

Although the current version of OMB guidance had not yet been issued at that time, the FCC followed the major components of the current guidance in the analysis supporting that order. It described the need for regulatory action (the lack of efficiency incentives in rate of return regulation that had been extensively discussed in the economics literature), defined the baseline as the continued use of the existing form of regulation, computed expected future prices under both the status quo and the new form of regulation in order to develop an approximation to a cost-benefit analysis, and concluded that the new system should create net benefits of \$900 million over four years.¹² The Commission recognized the uncertainty inherent in a new form of regulation and provided for retrospective review as now required for executive agencies by Executive Order 13563 (2011). With regard to review, the Commission stated:

In embarking on a modified regulatory approach for AT&T, we run the risk that the regulatory controls that we have carefully crafted will produce unintended and unexpected results. ...The price cap formula we find reasonable today may become less so over time and may no longer help ensure that rates are just, reasonable, and nondiscriminatory.¹³

While not explicitly following the guidance in effect at that time (President Reagan's Executive Order 12291 which remained in effect until President Clinton issued the currently effective Executive Order 12866 which modified details but kept the same major components as 12291), the Commission completed most of the steps in its own effort to be analytically rigorous about what was at the time a highly contentious major item (including two NPRMs, 10,000 pages of comments, and five Congressional hearings).¹⁴

It was feasible to perform extensive analysis because the change affected a specific market segment (the interstate long distance market) for which it was possible to make reasonable predictions on both the baseline path and the alternative path under the new form of regulation. In this case, the Commission could not rely on a market solution as in CI-II. Instead it needed to show that its new solution to the previously identified problem of AT&T's market dominance was superior to the previous solution. A more complete analysis could have compared additional alternatives as is expected under the current OMB guidelines, but that was not done.

¹⁰ The author was chief of the Common Carrier Bureau at the time and led the staff effort to develop the price cap plan.

¹¹ Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Record 2873-3380 (1989).

¹² 4 FCC Record 2873 at 3373.

¹³ 4 FCC Record 2873 at 3141.

¹⁴ 4 FCC Record 2873 at 3376

Application to the current NPRM

OMB Circular A-4 states regarding the baseline:

You need to measure the benefits and costs of a rule against a baseline. This baseline should be the best assessment of the way the world would look absent the proposed action. ...For review of an existing regulation, a baseline assuming “no change” in the regulatory program generally provides an appropriate basis for evaluating regulatory alternatives. When more than one baseline is reasonable and the choice of baseline will significantly affect estimated benefits and costs, you should consider measuring benefits and costs against alternative baselines. In doing so you can analyze the effects on benefits and costs of making different assumptions about other agencies’ regulations, or the degree of compliance with your own existing rules.¹⁵

According to that guidance, the default baseline in this case is one in which the Title II order remains in effect and the effects of the proposed changes should be measured against that baseline.

In general, costs and benefits will not be symmetric between adding a regulation and repealing that regulation because costs incurred to comply with the regulation cannot be fully recovered if the regulation is repealed. For example, if a stricter air pollution standard is implemented and firms undertake investments to meet that standard, much of that investment is likely to be a sunk cost that cannot be recovered if the regulation is repealed. In that case the benefits and costs of adding the rule will not be the mirror image of the benefits and costs of repealing the rule and it would matter whether the baseline was with the rule or without it.

However, in this case the Title II order is relatively new and its effects on industry practices not yet complete and therefore it is likely that the effects of removing some or all of the regulations adopted in that order will be reasonably symmetric with the effects of adopting those regulations. That is, the costs created by adding the regulations should be close to the benefits of removing them and the benefits of adding the regulations should be close the costs of removing them.

If the costs of adding regulation and removing it are symmetric then the analysis is simplified because it is feasible to use the baseline that is easiest to analyze. In this case, it is easiest to use the situation before the Title II order as a baseline and to consider the costs and benefits of each of the rules adopted in that proceeding. The current proceeding is more analogous to Computer II than to the price cap proceeding. It is not possible to reasonably predict the kinds of innovations that will be developed either in the Internet itself or the myriad uses of it. However, the first

¹⁵ Office of Management and Budget (OMB). 2003. “Circular A-4, Regulatory Analysis.”, p. 15.

principle of whether a need for regulation exists can be used as a guideline as it was in the Computer II proceeding.

From an RIA perspective, the Title II Order was weak in its justification of the need for additional regulation and in its analysis of the relationship between that need and the specific rules that it adopted. The order cited possible incentives for Internet access service providers to abuse a dominant position but did not fully develop the market power analysis to support the assertion of dominance or attempt to quantify the possible costs that would be incurred from the suggested market failure or consider alternative ways of remedying the problem. If the Commission were to conclude that the Internet Access market was reasonably competitive, for example, then a rule such as “no paid prioritization” would be hard to justify because Circular A-4 contains a presumption against price controls in competitive markets.

On the other hand, if the Commission were to conclude that the Internet Access market is subject to substantial market power, then it would be appropriate to consider the costs and benefits of alternative methods of mitigating that problem because Circular A-4 acknowledges market power as a market failure that may support regulation. Part of that analysis should consider whether the market power is likely to be persistent or whether it is likely to diminish over time through technological change. Circular A-4 notes that “technological advances often affect economies of scale. This can, in turn, transform what was once considered a natural monopoly into a market where competition can flourish.”¹⁶ The rapid development of mobile broadband is an example of technological progress increasing the options for many users who have only one or two wired broadband providers available to them. If the Commission were to conclude that there are no substantial correctable market failures, then from an RIA perspective, it would reasonably conclude that the proposals in the current NPRM are appropriate without doing a detailed examination of costs and benefits. The presumption in RIA analysis is that market forces generally work better than regulation and that we need a specific reason for regulating. If no good reason can be developed that plausibly has higher benefits than costs, then there is no need to develop a detailed analysis of costs and benefits.

It would be difficult to perform a meaningful cost-benefit analysis using the baseline of the regulations adopted in the Title II order and considering the effects of repealing some or all of them. That baseline is uncertain because of likely evolution of regulations under the Title II order and of future changes in private decisions in response to the incentives created by the order. The particular boundary lines drawn in that order (Internet access providers are subject to Title II but backbone providers are not) and the particular set of waivers and forbearance arrangements (forbear from applying 30 statutory provisions and 700 codified rules) are unlikely to remain stable even if the current NPRM is not adopted. Thus the existing order creates an evolving baseline of uncertain development. Developments under the NPRM proposals are also uncertain.

¹⁶ Office of Management and Budget (OMB). 2003. “Circular A-4, Regulatory Analysis.” Page 5.

As the Commission stated in Computer II long ago, a market oriented platform is designed to allow new developments and it is not possible to accurately forecast all of the developments that will occur. With an uncertain baseline and an uncertain alternative path under the NPRM proposals, it is unlikely that a cost-benefit analysis can be performed with any substantial expectation of accuracy. When there is great uncertainty, quantification can even be misleading because of its false impression of specific knowledge.

Conclusion

I support the Commission's proposal to follow the guidelines in OMB Circular A-4 in order to rigorously analyze the proposed regulatory changes. Regulatory Impact Analysis has been a valuable tool for improving regulation in the U.S. and other major countries. Even though the fundamental decisions are often made on political or legal grounds and then justified after the fact through a cost-benefit analysis and other RIA components, the RIA requirements to clearly state the problem to be solved, to demonstrate why the proposed set of regulations is the best choice among identified alternative ways of solving the problem, and to show why the proposed regulations are expected to do more good than harm provide transparency and help to limit inadequately considered regulations. While the OMB guidelines provide a valuable list of established good practices, considerable skill and judgment is required to apply the guidelines to any particular case. In this case, a cost-benefit analysis of the various components of the NPRM proposals is likely to be of questionable value because of the high level of uncertainty, but other aspects of the RIA guidelines can be followed more accurately and should be used to help determine the Commission's decision in this proceeding.