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FINANCIAL TIMES
New economy policy forum

Entrepreneurs need not apply

January 15, 2004

By Thomas Hazlett

On Wednesday the US government opened an auction to assign a licence for MVDDS ("multi-channel video distribution & data service"), a new way to cheaply deliver 100 cable networks, local TV signals and high-speed internet access to virtually every household in America. The innovative technology shares the spectrum already beaming satellite TV, using ground-level wireless relays from transmitters placed just to the north of each television market. Satellite TV dishes face south to receive their signals (from satellites orbiting the equator) and are unaffected. Presto - new market choices in airwaves thought to be packed.

Northpoint Technology first came to the Federal Communications Commission with the idea for MVDDS in 1994. The company's concept was then tested, proved and ultimately adjudged to be in the "public interest" by regulators, but its request for a licence was denied. On Wednesday the government started the process of selling its business plan to a rival, from which it will pocket an estimated $80 million. It is perhaps the most costly revenue it will ever raise.

Start with consumers. The FCC's own models predict that a new nationwide entrant in multi-channel video, as Northpoint attempted to be, would lower prices for 90 million cable and satellite subscribers by more than 5 per cent. That amounts to price savings of about $3 billion annually, or $250 million per month. Denying Northpoint's petition for a licence, officially filed in January 1998, has already cost customers many billions.

Even more damaging is that economic policy makers - including those in the Bush White House - have appropriated an entrepreneurial company caught in the act of innovating. When Congress sought last year to enact legislation awarding Northpoint a licence, the administration - after strong lobbying from cable and satellite interests - strongly opposed the measure. Congress backed off. Barring a deathbed reprieve from the courts, Northpoint will realise nothing.

That is why an April 2002 headline from Forbes Magazine - "Northpoint Wins Half a Loaf from the FCC" - is both factually correct and wildly inaccurate. What the company won was its years-long campaign to convince federal regulators that its proposed service could utilise airwaves with minimal interference. Its idea worked and would be authorised.

Yet, instead of allowing the innovator to launch the service and compete with established players, the FCC would hold an auction. Northpoint, like any other company, was free to bid, buying back its business plan. It had invested heavily to push this opportunity through the regulatory labyrinth - over $10 million in regulatory costs by 2001 - but gained no preference over companies that had done nothing, or energetically opposed it. This outcome socialises gains and privatises costs - not exactly "half a loaf" from the perspective of a company trying to gain access to the market.

Competitive bidding for licences was authorised by Congress in 1993 and has raised about $15 billion since. It is both efficient and equitable when potential licensees are difficult to distinguish. Yet when they are not, selling a licence to the highest bidder can destroy crucial investment incentives. In some contexts, regulators see this. Licence renewals, for instance, are not subject to competitive bids. Forcing established systems to outbid rivals to keep operating would create perverse incentives. Predictably, owners would let wireless networks depreciate in the years leading up to renewal so as to avoid being stuck in a bidding contest just to keep valuable assets intact.

With new entrants, auctions can be similarly destructive if newcomers must first undertake substantial investments to create the competitive opportunity. Were policymakers to enact reforms broadly enabling spectrum markets, entrepreneurs could introduce wireless innovations by simply raising capital and buying bandwidth along with other inputs. But this path is barricaded. Regulators forced Northpoint to submit its technology to an unreformed spectrum allocation system. A licence may be assigned by the market via auction, but it must first be created by bureaucrats in Washington.

Occasionally, a new technology runs the gauntlet. But it takes time, resources and economic incentive. Central planning of spectrum blocs (spelled, appropriately, as in Eastern Bloc) officially proceeds top-down. Only if private parties spend years pushing a proposal through the regulatory maze will entrepreneurial use of spectrum be realised.

Northpoint did the time. Michael Powell, the FCC Chairman, graciously thanked the company, noting that the innovation would have been impossible without its efforts. He then invited the start-up to bid for a licence at auction. "If Northpoint's service model is a winner," counseled Powell, "the market will reward it just as it has done for other technology companies."

This confuses the rhetoric of capitalism with the reality of bureaucracy. When free markets allow investors to bid for resources, the best service models will appear most profitable and the highest bid is likely to be cast by the most efficient provider. But here the key competitive battle is not for consumers but for government approval, and it has already been waged. To deprive the victor of its fruits sends a clear message to wireless technology markets: entrepreneurs need not apply.

And it misses what could be the auction's dismal end should EchoStar, an incumbent satellite TV network now bidding through a subsidiary, emerge an MVDDS licensee. The company's bids will be driven by hefty "preclusionary" value, meaning that buying licenses profitably denies new rivals the chance to lower prices. EchoStar is free to purchase this "competition insurance", a policy whose billion-dollar premiums will be paid by consumers. All so the government can collect a tiny one-time gratuity and select a "service model winner."

The writer is a senior fellow at the Manhattan Institute and a former chief economist of the Federal Communications Commission. He has previously consulted for various telecommunications firms, including Northpoint, EchoStar and DirecTV.