

Painful extractions

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By Thomas Hazlett

Established wireless operators have long rebuffed rivals by gaming the system of spectrum regulation. The twist is that such anti-competitive forces have been reinforced by troops claiming to be fighting for consumers, advocates of preventing "corporate giveaways" by extracting maximum revenues through Federal Communications Commission licence auctions.

The crucial policy question is confronted when a wireless innovator applies for permission to offer enhanced services or deploy a novel technology. Licence rigidities block the path, forcing the enterprise to seek regulatory approval. Granting flexibility is seen by most economists to allow more productive use of airwaves, delivering customers improved communication choices at lower prices. To enhance efficiency, licence restrictions should be stripped away, with operators free to offer customers any service, via whatever technology, providing their emissions do not spill into rival airspace.

Liberalisation, however, smacks some legislators and advocacy groups as a "giveaway." If a loosening of the rules constitutes additional property rights for the licensee, then that is a "windfall" for which the lucky private firm should pay. This plays to standing ovations among those who seek protection from market forces.

Take satellite radio, where one of two US operators (XM) has patented a means to simultaneously use assigned frequencies for ground-level communications without degrading the 100 channels beamed from orbit coast-to-coast. The breakthrough has triggered an industry firestorm, as the new system - if deployed - would permit satellite radio programmers to offer custom content in each of the 269 local radio markets, unleashing thousands of new radio stations.

It will not be allowed. For radio station owners, no local satellite news is good news. Satellite licence restrictions, espoused in the "public interest" by industry incumbents and regulators, render the competitive threat moot. Ironically, these barriers are now buttressed by the "dental school" of spectrum regulation. When maximum revenue extraction becomes the aim of public policy, upstarts (like satellite radio in local markets) are simply unable to afford the toll.

A recent paper by the New America Foundation makes the argument explicit: withhold rights to drive up license auction receipts.* The economic justification is that such lump sum payments do not incur the distortions attendant to other forms of taxation, which cost society about \$0.33 for each \$1 raised by government (in addition to the dollar transferred from private citizens to the state).

But this game of "spectrum keep-away" protects a system of exclusion, imposing monopoly distortions that far exceed the inefficiencies of general sales or income taxes.

Suppose the government could issue five wireless licences in a particular band, triggering brisk competition. Licences would be worth nil; as consumers enjoyed low prices and state-of-the-art services, companies would struggle for profits and would bid accordingly. So revenue extractors propose setting aside three licences, say, and auctioning just two. The imposed scarcity drives bids higher, reflecting increased consumer prices tomorrow. The ripple effect from targeting

wireless markets - which are building some of the most important infrastructure of the emerging New Economy - dwarfs any tax savings made elsewhere. And the carnage multiplies as society writes off any benefit from the spectrum sent to the warehouse.

Perhaps a shot of novacaine would help us suffer the revenue extraction pain of the NextWave debacle. NextWave bid \$4.9 billion for PCS C block licences in May 1996, paid \$500 million of its debt to the government and then declared bankruptcy. The licences - allocated 30 MHz and covering about 80 per cent of the US - have been unused ever since, mired in legal dispute.

In December 2001, a deal was brokered by the FCC to break the impasse. Leading wireless phone carriers offered to pay \$5 billion to NextWave and \$10 billion more to the US Treasury. The C Block spectrum would then be used to bolster the networks' capacity, improving voice traffic and facilitating new data services.

Congress killed it. Waving the 'giveaway' banner, critics blasted the billion-dollar 'windfall' that would go to NextWave, a company that had never actually connected a cellphone call other than to conference with its lawyers.

There is still silence on the PCS C block. But NextWave's shareholders, deprived of 'windfalls' by policy makers, are not hurting. The Supreme Court recently ruled in the company's favour; after paying off about \$4.5bn to the government, it stands to net upwards of \$4.03bn, according to Legg Mason estimates based on NextWave's sale of about 16 per cent of its licence rights to Cingular in early August.

The effort to block the 'giveaway' led directly to NextWave's big problem today: paying what is anticipated to be a massive capital gains tax. Meanwhile, taxpayers lost over \$5bn (the \$10bn rejected in 2001 in favour of the \$4.5bn owed now), and valuable airspace has been idle while millions of mobile calls were needlessly blocked or dropped and innovative wireless web applications denied market access. Consumer protection? The public may come to prefer dental extractions.

* Michael Rothkopf and Coleman Bazelon, Interlicense Competition: Spectrum Deregulation Without Confiscation or Giveaways, New America Foundation Spectrum Series Working Paper No. 8 (Aug. 1, 2003).

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