PERSPECTIVES

PHOENIX CENTER FOR ADVANCED LEGAL & ECONOMIC PUBLIC POLICY STUDIES

Reclassification and Investment:

An Analysis of Free Press' "It's Working" Report

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May 22, 2017

Introduction

Free Press, a zealous proponent of Internet regulation, recently released a report on the capital expenditures of broadband service providers entitled, *It's Working: How the Internet Access and Online Video Markets are Thriving in the Title II Era* (hereinafter *"Free Press Report"*).[1] The *Free Press Report*, authored by S. Derek Turner, claims that capital spending by Broadband Service Providers ("BSPs") "accelerated" following the Federal Communications Commission's ("FCC") reclassification of broadband Internet access connections as a Title II common carrier telecommunications service in its *2015 Open Internet Order*, increasing by 5.3% between 2013-2014 and 2015-2016.[2] The Internet Alliance, a trade group representing the interests of companies supporting reclassification, appears to use the Free Press' data to support the same claim.[3]

Free Press' analysis, as usual, fails to meet the most basic of professional standards, and involves nothing more than the adding up of nominal total capital expenditures for a sample of BSPs and comparing the sums between two periods. Such simple-minded analysis is incapable of measuring the effect of a policy change.[4] The relevant question is not whether capital spending rises or falls in any given year or pair of years, but whether such expenditures are below the levels they would have been "but for" the regulatory intervention. To answer that question, we need a counterfactual. That is, if absent a regulatory intervention capital spending was scheduled to rise by 10% next year (the counterfactual), but rises by only 5% due to an intervention, the intervention reduces investment despite the fact expenditures were higher. Unlike recent research finding sizable harmful effects from reclassification, the *Free Press Report* offers no counterfactual, so their *Report* adds nothing serious to the analysis of Net Neutrality and reclassification.[5]

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That said, the *Free Press Report* does add something to the debate. Once the most basic adjustment to the data is made—accounting for inflation—Free Press' data show that capital spending fell significantly in 2016 (-2%). Had investment grown in 2016 by the amount claimed in the *Free Press Report* (another 3.5% in 2016), the difference between the predicted and actual capital spending would be $4 billion. Free Press' own data, therefore, provides support for the $3.7 to $5.1 billion investment decline cited by Chairman Pai when announcing his intent to review of the *2015 Open Internet Order*.[6] Like recently released data by USTelecom and CTIA, multiple sources are finding substantial declines in capital spending in 2016.[7] While Free Press wishes to peddle the fairy tale of positive investment effects, in fact their *Report* demonstrates that reclassification has been a nightmare for the rest of us.

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Free Press Shows a Decline in Investment

As Free Press has done in the past, its most recent *Report* draws strong conclusions about investment based on the flimsiest of evidence.[8] For example, Free Press compares the sum of 2013-2014 capital expenditures (in nominal dollars) to 2015-2016 capital expenditures, reporting a 5.3% increase.[9] Absent a counterfactual, such evidence says nothing about the policy change. Also, the FCC's *Open Internet Order* was released in March of 2015, long after investment decisions were made for that year (and perhaps a few more years out).

Separating the data into annual spending and adjusting for inflation tells a much different story than that offered in the *Free Press Report*. Table 1 summarizes the *real* capital expenditures for the BSPs on a year-to-year basis.[10] As shown in the Table 1, capital expenditures rise between 2013 and 2014, and again rise between 2014 and 2015. However, the year after the 2015 reclassification decision, capital spending fell by nearly 2%, or $1.3 billion. Investment after the *2015 Open Internet Order* is, in fact, down. This decline in expenditures is hidden by Free Press' summing of 2015 and 2016 capital expenditures data and by their failure to adjust for inflation.[11]

Table 1. Change in Capital Expenditures (2013-2016)

Year	Capital Expenditures (2015 dollars)	Change from Prior Year (%)
2013	$71,106,649	…
2014	$71,429,876	0.6%
2015	$73,738,162	3.2%
2016	$72,394,467	-1.8%

Source: Free Press Study; Author's Calculations.

The decline in capital spending demonstrated by Free Press is consistent with recent data from other industry sources. CTIA, for instance, showing a stunning 17% decline in real capial spending between 2015 and 2016.[12] Estimates of capital spending constructed by USTelecom, which are at present preliminary, also indicate that capital spending declined between 2016 and 2015.[13] These data are summarized in Table 3. For once, all sides of the debate agree—capital spending is down in 2016.

Table 3. Investment Growth into 2016

Year	Free Press	CTIA	USTelecom
2014	0.6%	-3.0%	0.1%
2015	3.2%	0.0%	-1.7%
2016	-1.8%	-17.0%	-4.5%

Of course, investment levels vary year-to-year for a variety of reasons, sometimes substantially. In some cases, it is the FCC's "objectionable and questionable" actions that alter investment levels.[14] As a consequence of the FCC's DirectTV merger *Order*, for instance, the Commission is forcing AT&T to make substantial investments in building network to places it may not have gone otherwise.[15] The Charter-Time Warner merger included similar conditions.[16] Such mandates show up in capital spending but do not reflect genuine economic incentives or necessarily increase social well-being. The true effects on investment of reclassification are hard to decipher given former FCC Chairman Tom Wheeler's forceful attempts to cover up such effects using what amounts to extortion during merger reviews.[17]

Anything Useful from the Data?

Two interesting questions come to mind when looking at the decline in investment indicated by the Free Press data. First, does this $1.3 billion decline in investment measure the true effect of reclassification, or is the actual investment effect smaller or larger? Second, is the 1.8% decline in capital spending consistent with the annual variability in capital spending or is it extraordinary in its size? Free Press answers neither question.

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With such limited data, it is difficult to say much of anything about the effects of reclassification on capital spending, since so little data precludes the construction of a counterfactual. All we really know from the *Free Press Report* is the capital spending fell in 2016. If capital spending in 2016 would have grown by the amount claimed in the *Free Press Report* (5.3%), investment would have increased by 3.5% in 2016, then total spending in that year would have been $77.3 billion.[18] The loss in capital spending from reclassification is nearly $4 billion dollars.

In support of its new *Report*, Free Press' press release barked: "Sorry, Chairman Pai: Your Investment Numbers Don't Add Up."[19] Yet, Chairman Pai's claims of a $3.7 to $5.1 billion reduction in capital spending following reclassification is entirely consistent with the data and claims of the *Free Press Report*.[20] Rather than rebuttal, Free Press' data supports Chairman Pai's claims (at least under the assumptions I've made).

Conclusion

While the central problem with the FCC's reclassification decision is legal, the debate over the investment effects rage on.[21] Free Press' latest entry into the controversy claims to show that investment has risen since the reclassification decision. Yet, the Free Press data indicate otherwise: investment in 2016 is down, and down $4 billion below the political-interest group's claim. The downward move in capital spending is consistent with the investment estimates by other industry sources.

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While Free Press hoped its study would counter Chairman Pai's recent observation that investment in the industry in down after reclassification, their *Report* actually lends support to the Chairman's claims. Perhaps inadvertently, Free Press has added to the growing body of evidence of the harmful effects of Title II on industry investment. That said, my official position is that Free Press' analysis is too poorly done and their data are too limited to say much of anything about the policy effects of Net Neutrality or reclassification.

NOTES:

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1 S. Derek Turner, *It's Working: How the Internet Access and Online Video Markets are Thriving in the Title II Era*, Free Press (May 2017) (available at: https://www.freepress.net/sites/default/files/resources/internet-access-and-online-video-markets-are-thriving-in-title-II-era.pdf).

2 *Id.* at p. 2; *Protecting and Promoting the Open Internet*, REPORT AND ORDER ON REMAND, DECLARATORY RULING AND ORDER, GN Docket No. 14-28, FCC 15-24, 80 Fed. Reg. 19738 (rel. Mar. 12, 2015) (hereinafter "*2015 Open Internet Order*"), *aff'd, United States Telecom Association v. FCC*, 825 F.3d 674 (D.C. Cir. 2016), *pet. for rehearing en banc denied*, __ F.3d __ (May 1, 2017).

3 INTERNET ASSOCIATION REPORTS: PRELIMINARY NET NEUTRALITY FINDINGS, Internet Association (available at: https://internetassociation.org/net-neutrality-facts) (claiming a 5.3% "increase in telecom investment among Publicly traded companies from 2013-2014 to 2015-2016").

4 *See, e.g.*, J.D. Angrist and J.S. Pischke, MOSTLY HARMLESS ECONOMETRICS: AN EMPIRICIST'S COMPANION (2008).

5 G.S. Ford, *Net Neutrality, Reclassification and Investment: A Counterfactual Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-02 (April 25, 2017) (available at: http://phoenix-center.org/perspectives/Perspective17-02Final.pdf); G.S. Ford, *Net Neutrality, Reclassification and Investment: A Further Analysis*, PHOENIX CENTER POLICY PERSPECTIVE No. 17-03 (May 16, 2017) (available at: http://phoenix-center.org/perspectives/Perspective17-03Final.pdf).

6 Remarks of FCC Chairman Ajit Pai at the Newseum (Washington, DC), *The Future of Internet Freedom* (April 26, 2017) (available at: http://transition.fcc.gov/Daily_Releases/Daily_Business/2017/db0426/DOC-344590A1.pdf). The $3.7 billion figure is for 12 firms, but the largest 12 firms make up nearly all the total industry investment.

7 P. Brogan, *Broadband Investment Heads in the Wrong Direction*, USTELECOM BLOG (May 5, 2017) (available at: http://www.ustelecom.org/blog/broadband-investment-heads-wrong-direction). More detail was provided in a telephone conservation with Patrick Brogan (May 19, 2017); *Annual Year-End 2016 Top-Line Survey Results*, CTIA (May 2017) (available at: https://www.ctia.org/docs/default-source/default-document-library/annual-year-end-2016-top-line-survey-results-final.pdf?sfvrsn=2).

8 *See, e.g.*, G.S. Ford, *Finding the Bottom: A Review of Free Press's Analysis of Network Neutrality and Investment*, PHOENIX CENTER PERSPECTIVE NO. 09-04 (October 29, 2009) (available at: http://www.phoenix-center.org/perspectives/Perspective09-04Final.pdf).

9 *Free Press Report, supra* n. 1 at Figure A1.

10 Nominal values are converted to 2015 dollars using the GDP deflator (available at: https://fred.stlouisfed.org/series/GDPDEF#0).

11 It may be, of course, that 2015 is the peculiarity here, not 2016.

12 CTIA, *supra* n. 7.

13 Brogan, *supra* n. 7.

14 Statement of Commissioner Michael O'Reilly, *In the Matter of Applications of Charter Communications, Inc., Time Warner Cable Inc., and Advance/Newhouse Partnership*, FCC 17-34, ORDER ON RECONSIDERATION, __ FCC Rcd __ (rel. April 3. 2017) (available at: https://apps.fcc.gov/edocs_public/attachmatch/FCC-17-34A4.pdf).

15 *See* T.R. Beard, G.S. Ford, L.J. Spiwak, and M. Stern, *Eroding the Rule of Law: Regulation as Cooperative Bargaining at the FCC*, PHOENIX CENTER POLICY PAPER NO. 49 (October 2015) (available at: http://www.phoenix-center.org/pcpp/PCPP49Final.pdf).

16 J. Eggerton, *FCC Votes to Reverse Charter Overbuild Condition*, BROADCASTING & CABLE (April 3, 2017) (available at: http://www.broadcastingcable.com/news/washington/fcc-votes-reverse-charter-overbuild-condition/164581).

17 *See Charter Order on Reconsideration, supra* n. 13 at ¶ 8 ("The Commission's transactional review is not an opportunity for the Commission to advance unrelated policy objectives by extracting commitments from the transacting parties in exchange for regulatory approval.") (available at: https://apps.fcc.gov/edocs_public/attachmatch/FCC-17-34A1.pdf); *see also* Beard *et al., supra* n. 11.

18 This figure assumes an average 5.3% growth rate between 2013-2014 and 2015-2016.

NOTES CONTINUED:

19 D. Floberg, *Sorry, Chairman Pai: Your Investment Numbers Don't Add Up*, Free Press Press Release (May 17, 2017) (available at: https://www.freepress.net/blog/2017/05/17/sorry-chairman-pai-your-investment-numbers-dont-add).

20 Remarks of Chairman Pai, *supra* n. 6.

21 G.S. Ford and L.J. Spiwak, *Tariffing Internet Termination: Pricing Implications of Classifying Broadband as a Title II Telecommunications Service*, 67 FEDERAL COMMUNICATIONS LAW JOURNAL 1-19 (2015) (available at: http://www.fclj.org/wp-content/uploads/2015/02/Tariffing-Internet-Termination.pdf).