

## Razzle-dazzle:

# The Case Against Public Broadband

Municipalities have no business building broadband networks; they've been misled by suppliers

By Dave McClure ■ *President, US Internet Industry Association*

Municipal networking is the latest confidence game to hit the street. A real razzle-dazzle, fast-talking, high-tech, keep-your-eye-on-the-peanut kind of pyramid scheme that keeps the intended marks – consumers and taxpayers – so mesmerized by the prospect of getting something for nothing that they don't see their wallets being lifted until it is too late.

When the game is done, municipal governments will have seized control of the Internet, telephone and cable systems for their communities; driven out competition by private companies; balkanized a communications infrastructure that once was the envy of the world; and secured for themselves a continuing stream of revenue with unlimited potential for rate increases.

This isn't the first time that cash-strapped municipalities have cast greedy eyes on private markets. There was a time that street lighting, health care, public transportation and even electrical power were provided by competing private companies. But when cities are no longer able to squeeze consumers for more tax dollars, they seize control of the most lucrative businesses they can find within the city limits.

Now it is broadband's turn. Only it turns out there isn't enough money in just broadband, so the goal of the game has morphed into the "triple play" of Internet, cable and telephony. Plus whatever else isn't nailed down.

Interestingly enough, it is not the elected officials who are behind this scheme. Sure, they like the idea of new

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sources of revenue in a time when taxpayers are resisting new sales and property taxes. But elected officials are also painfully aware of what happens to their careers when they are caught lying to the public or promising more than they can deliver. The real forces behind this new con game are the people who more directly benefit – the electric utilities and government agencies, the hardware manufacturers, and the paid consultants.

What's wrong with using public resources to bring people the broadband they want, particularly if you can bundle it with other services and operate it through a central government office? As it turns out, plenty.

### The Problems

The problems with the municipal networking model are so numerous and obvious that it is difficult to narrow them down to fit in one short article. One need only look to other developed nations around the world that are busy dismantling their government-run monopoly communications networks in order to emulate our success in the US.

But there are five problems that tower above all others – the widespread availability of low-cost broadband; voodoo

economics; marginal impact on the Digital Divide; marginal impact on business development; and consumer resistance.

These five don't include the obvious problem of small towns investing in technologies that turn over every two to five years, requiring massive re-investment and continuing upgrades just to stay current with the state of the art. Nor do they include the limitations inherent in some technologies, such as the high cost of Broadband over Powerlines, or the fact that we've never successfully deployed a massive-scale Wi-Fi mesh network. And they don't address obvious management problems, such as city officials entering a business they know nothing about, and the high levels of management distraction incurred as mayors and city managers spend time and resources dabbling in this new high-risk venture instead of doing their appointed or elected jobs.

### What's Killing Municipal Networking

It's not the technology problems that are killing municipal networking, but these and other management issues:

- **Widespread availability of low-cost broadband.** The publicly announced premise of these networks is that broad-

band is not currently available to those who want and need it. But such statements – other than in the most remote rural areas – border on being outright lies. The latest FCC report – now nearly 18 months old – shows that broadband use has tripled in the US since 2002. Broadband is available to more than 108 million US households, at an average monthly cost of \$35. And business broadband, which commands higher prices that can help defray the installation costs, is available to more than 99 percent of businesses through cable, telephone, private wire, satellite or optical wireless (FSO) systems.

Pundits claim that US deployment of broadband is falling behind, and that building municipal broadband monopolies is necessary because other countries offer higher speed broadband at lower prices. But the countries boasting higher penetration rates for broadband are tiny compared to the 3.8 million square miles that encompass the United States – Japan, the largest super-wired country, is smaller in area than California. These countries have very dense population patterns, allowing for easier reach by DSL, fiber and wireless. And they have built their networks largely through public-private partnerships rather than through municipal monopolies. They also make liberal use of incentives to private companies, including subsidies – a lesson not lost on the state of Arkansas, which this year is considering a bill to implement similar incentives as an alternative to government-run networks.

• **Voodoo economics.** Where the municipal networking con game breaks down completely is in the numbers. It's not just that the assumptions used to derive the numbers are hopelessly optimistic or that monopoly utilities have little concept of the cost of customer acquisition or retention, much less marketing. It's that the majority of muni networks to date have failed to meet their published objectives for revenue or for subscriber levels.

Some of the failures have been catastrophic – like Tacoma, Washington,

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which built the Click! Network to provide broadband in the late 1990s with an initial estimate that capital costs would be \$40 million. By 2002, the city had spent more than \$100 million on Click! In Ashland, Oregon, a municipal broadband network fell 18 months behind schedule during construction. The city's initial 1998 plan called for profitability by 2004, with a 10-year gain of \$3.8 million. After the income did not meet original estimates, the plan was revised and now projects a 10-year loss of \$6.9 million. The network in Marietta, Georgia suffered a \$24 million loss; a Washington public utility district has been absorbing losses of \$15,000 to \$17,000 per year; and the Iowa Communications Network has yet to achieve breakeven – it cost taxpayers \$21 million last year alone.

### **The Truth About Failure Rates**

Advocates for municipal networking argue that such failures are the exception, not the rule. But to make their case, they have to combine different kinds of networks – wireless, fiber, wired, public, private, large and small – into one great jumble. When you consider only large-scale municipal networks that sell services to the public, the failure rate becomes much more daunting.

Success is not defined simply as the absence of catastrophic failure, or the ability to use continued grants or cross-subsidies to attain break-even. Success is the attainment of the stated business goals and objectives in the time frame established for their attainment. And by that measure, there are few successes.

The problem is this: In order to keep prices lower than competitive private services – where prices continue to drop almost every month – municipal net-

works are excused from paying some or all of the fees and taxes paid by private competitors. Bristol, Virginia's OptiNet municipal network claims that consumers of its phone services save about \$10 per month because they don't have to pay the access fees, number portability fees or contributions to Universal Service required of other phone services. Cable and other services are also advertised as being "more economical." Even where the system contributes "fees" to the government, these are often lower than the total taxes – including income, payroll and property taxes – paid by private business entities.

This leads to three problems for consumers. First, of course, is that many of these fees will eventually catch up with the system and the "savings" will evaporate. Federal proceedings regarding access charges and Universal Service are already underway, and the bootleg networks will not for long escape their fair share.

Second, the tax bills not paid by muni network services don't simply disappear into thin air. Since municipal budgets are not shrinking, and the revenue from the broadband and cable services is used to fund future growth, taxpayers are expected to make up the difference either directly or by guaranteeing bonds.

Third, the equation fails to recognize the further loss of administrative fees, license fees, property taxes, payroll taxes and income taxes, paid by the existing broadband providers who will be driven out of the community to make room for the new municipal monopoly. Nor does it recognize the loss of the employees of those companies, who will likewise no longer pay sales, income, property and other taxes. The result is a devastating

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but hidden blow to the municipal economy and its taxpayers.

### **Artificially Low Prices**

Finally, there is the whole issue of lower prices. The municipality may be able to artificially hold prices low for a while, or claim that government intervention has led to lower market prices through competition. But the reality is that competition is only one component of lower prices – and a relatively small component at that. Much more critical to the overall pricing of these services are the economies of scale that large private companies with a national footprint can amass; technological change and innovation unmatched by utility monopolies; and the bargaining power that allows private companies to command premium content at lower prices than the municipalities can negotiate. None of these are accounted for in the muni networking plans.

Competition is a strategy, not a goal. The goal for broadband is rapid deployment of high-speed services throughout the nation. To achieve that goal, companies must recover the hundreds of billions of dollars invested in the broadband networks – including the cable industry’s \$100 billion to date – plus borrow hundreds of billions more from the capital markets. If the ability to make a return on that investment is jeopardized by municipal monopolies, the deployment could take decades or longer.

• **Marginal impact on the Digital Divide.** Virtually every plan for a municipal network heralds the positive ways in which the network – and associated low-cost or free broadband – will help bridge the Digital Divide. PBS, in its “Now” program advocating municipal

networks, went so far as to infer that the Philadelphia Wi-Fi network would somehow end homelessness.

This is nonsense. Those who work with Digital Divide issues know that the cost of broadband is only one element – a fairly insignificant element when compared to low literacy, poor computer education, the lack of computer technical support, and the lack of computers. What’s more, there are more than one “divides,” including those for the elderly, those for the technically challenged, those for disabled persons, and those who are geographically remote. If all it took was cheap broadband to close the Digital Divide, municipalities would accomplish a lot more by giving their residents “broadband coupons” at say, \$20 per month, to buy the services of their choice.

• **Marginal impact on Business Development.** Clearly, access to broadband services has a positive effect on business performance, both through higher productivity and through enhanced efficiencies in business processes. But since private companies have successfully deployed broadband in nearly every community in America already, the additional impact on business development factors such as increased jobs and higher salaries is minimal. Replacement of private competition with a government monopoly reduces, not increases, the net numbers of jobs.

### **We Need Data, Not Anecdotes**

Proponents of municipal networking are fond of using anecdotal evidence of a single company that enters or leaves a community. But hard econometric data in favor of municipal networks – that also properly factors in the effects of

other variables such as education, training, business loans, tax policies and consumer confidence – doesn’t lead to a net gain to the community if private competitors are already in place.

• **Resistance by Consumers.** Often overlooked in the debate over municipal networking is the fact that taxpayers across the nation have taken a close look at the numbers and, recognizing a scam when they see one, have acted to oppose and reject such plans.

### **Voters Are Opposing These Plans**

In the tri-cities of Illinois, voters have twice rejected a municipal network. In Oregon, consumers have pushed for legislation that not only requires a community vote to consider a municipal network, but also requires a review of the effectiveness of the network – whether it is meeting its stated goals – three years into its implementation. St. Louis considered implementation of a network and rejected it as a low priority and a poor use of public funds. In Philadelphia, they forced the city to can plans to spend millions of tax dollars in favor of a network built and operated by private companies.

Consumer groups have risen in opposition to municipal networks in virtually every community in which they are proposed, and where their voices are heard and their votes counted, municipalities often turn to better uses of the public trust.

Then, of course, there are the policy issues, because bad policy, whatever its intentions, will eventually come back to haunt us in the worst possible ways. And there are some involved here that won’t easily go away.

First and foremost, do we really want local governments controlling the media and access to content? Proponents of municipal networks run from the label “socialism” like they’d been bee-stung, yet that’s the correct term for what these networks represent. And if they can successfully seize control of telecommunications networks, how long before municipalities begin to cast their eyes

on control of the gas stations, grocery stores, newspapers, television stations and other private enterprises?

What becomes of the diverse selection of religious programming available on cable systems today when those cable systems are operated by the government? What happens to popular adult content? Will some taxpayers object to their municipality "endorsing" or "censoring" certain programming by virtue of making it available or not offering it as an alternative? Will we face censorship of some channels and sites "in the public interest?" If it turns out the network is a horrible mistake, can we easily dismantle the local monopoly and return to a competitive free market? (Hint: take a close look at the electrical utilities and their struggle with competition.)

And what becomes of national security when we merge the networks used to control our utility grid and other safety and critical infrastructures with popular Internet systems or Wi-Fi networks targeted by hackers?

It is these policy issues – not nefarious lobbying by incumbent service providers – that have caused legislatures in 15 states to pass laws restricting municipal networks. And is causing 11 more to take up such legislation this year.

There is nothing inherently wrong with communities wishing to increase the number of communications services to their residents. There are legitimate ways to use public policies and resources for land use, rights of way, taxation, education and zoning to make such increases possible. Likewise, there is nothing wrong with hardware vendors and communications consultants assisting the development of public-private partnerships for the deployment of broadband.

But for advocates of government-owned networks to use misinformation and voodoo economics to make the sale is wrong. Using of the plight of the poor and under-educated to sell these networks is wrong. Using public tax funds and public resources to cripple

competition and private investment is wrong. Creating these monopolies with no public debate over their serious policy implications is wrong. The efforts of hardware vendors and paid consultants to push municipalities into these networks in order to line their own pockets is wrong.

And to do so in the face of strong

evidence that consumers ultimately will be harmed by these actions is more than wrong, it is criminal. ♦

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