



Ex Post v. Ex Ante Regulatory Remedies Must Consider Consumer Benefits and Costs

Some advocates are calling for blanket Internet regulations to limit or prohibit Internet providers from differentiating broadband services, developing Internet content and managing network congestion in fear that Internet providers could engage in anticompetitive behaviors, even though these proposed regulations may invariably decrease consumer welfare. While our system of jurisprudence stresses the presumption of innocence – “it is better than ten guilty persons escape than one innocent suffer” – these advocates are willing to err on what may be good conduct upfront, rather than remedy bad conduct later.

Ex Post v. Ex Ante Regulatory Remedies

The line dividing advocates in the Net Neutrality debate is defined substantially by faith in the power of government regulations versus faith in the discipline of markets as the guarantors of consumer welfare. Some believe in the wisdom of government regulators, subject to broad statutory guidelines and political pressure; others advocate placing our trust in decision makers in the private sector subject to the discipline of market competition and shareholders. Consumers are less doctrinaire and, having been burned by both private and public decision makers, are in a bit of quandary.

The government vs. market debate has morphed in part into disagreement over the form and timing of government intervention. One camp urges a presumption of the likelihood of bad conduct and thus a need to resort to preventive government measures (*ex ante* regulation or anticipatory government intervention). The other urges regulatory restraint and government action when bad conduct materializes (*ex post* regulation or remedial government intervention).

Most consumer advocates recognize that consumers are harmed by bad business conduct and by poorly conceived and executed government regulation. The balance is an empirical matter to be considered case by case. It is a truism, however frequently ignored, that both markets and government agencies are imperfect and subject to various sorts of “failure.” Thus, in choosing

the mix between disciplines imposed by markets and government action, well-informed consumers query about real world costs and benefits of each. Consumers are exposed to different potential harms resulting from imperfections in markets and in flawed government processes.

In what follows, we attempt to frame the issue in general cost/benefit terms, but note at the outset that the dearth of evidence of impact on consumers in the voluminous record.

To Err is Human, but Can Be Very Costly to Consumers

Statisticians and policy scientists call attention to two kinds of errors: **Type I** and **Type II** errors or, in legal contexts, false positives and false negatives. The two errors typically have different associated costs, thus we generally have a basis for preferring one over the other, if both cannot be avoided. A well-known example relates to our system of justice in which we prefer to find a guilty party innocent (false positive) to finding an innocent party guilty (false negatives). In evaluating drugs, the FDA must weigh the harm from denying “good” drugs against the risk of permitting those with bad side effects. The core of the problem is where to “give the benefit of doubt” when outcomes are uncertain.

Similar dilemmas present themselves in a variety of other contexts, including in the net neutrality debate. Prescriptive approaches are recommended as strong in preventing “bad” behavior, but they also prevent good behavior – “tossing out the baby with the bath water,” as it were. Remedial approaches largely avoid the trap of preventing good behavior, but are criticized as permitting bad behavior. Consumers of course suffer the costs of both errors, though *ex post* regulations can still offset some of the costs. The relevant question is which is greater – errors caused by preventing consumer welfare enhancing good conduct or those caused by reducing consumer welfare by permitting bad conduct.

ERRORS IN PROACTIVE AND REACTIVE REGULATION

	Good Conduct	Bad Conduct
<i>Ex Ante</i> Regulation	Consumer Costs of False Negatives	
<i>Ex Post</i> Regulation		Consumer Costs of False Positives

Reflecting on an FTC Staff Report addressing competition generally and issues in the net neutrality debate more specifically, FTC Chairman Deborah Platt Majoras warned that

preemptive regulation of an increasingly competitive market may have serious adverse consequences for consumers:

This report recommends that policymakers proceed with caution in the evolving, dynamic industry of broadband Internet access, which generally is moving toward more – not less – competition. In the absence of significant market failure or demonstrated consumer harm, policy makers should be particularly hesitant to enact new regulation in this area. (Emphasis added)

Similarly, then-FCC Chairman William Kennard argued against *ex ante* regulation:

The Internet has evolved at an unprecedented pace, in large part due to the absence of government regulation. Consistent with the tradition of promoting innovation in new communications services, regulatory agencies should refrain from taking actions that could stifle the growth of the Internet. During this time of rapid telecommunications liberalization and technology innovation, unnecessary regulation can inhibit the global development and expansion of Internet infrastructure and services.

Thus, the FTC Chairman and a former FCC Chairman, oppose *ex ante* regulatory approaches on grounds that the costs of imposing *ex ante* regulations in a dynamic market environment are likely to outweigh the potential benefits.

Benefits and Costs of *Ex Ante* Regulation

The benefits of *ex ante* regulation are almost exclusively a matter of conjecture. There is no systematic analysis of consumer benefits in the record. Advocates concede that it is impossible to estimate damages occasioned by carrier conduct (for example, degrading applications left unchecked by either market discipline or the presences of *ex ante* rules (according to the Free Press Petition with the FCC at p. 33). To date the expression of benefits by advocates has been limited to citing a handful of isolated “incidents” as omens of future harm in the absence of regulation. Irrespective of the consumer benefits of *ex ante* regulation, which have yet to be documented, the associated costs are assured to be substantial. *Ex ante* regulation:

- Invites litigation, gaming, rent seeking and general exploitation of regulatory processes by special interests, not consumer interests;
- Results in false negatives that prevent consumer welfare enhancing conduct;
- Creates uncertainty, delay and costly interference with efforts by suppliers to compete and win consumer favor with innovative services and applications;
- By creating uncertainty and delay, it deters innovation, experimentation and investment;
- Creates vague, overly restrictive and discriminatory regulatory standards and benchmarks for ISP market conduct.

It is ironic in this regard that advocates, who favor *ex ante* responses to potential market failures, are also extremely critical of the conduct and performance of government agencies and processes in implementing the very kinds of regulation they commend. There is no principled, consumer-oriented basis for imposing one set of imperfect institutions in place of another without some analytical comparison. More regulation is no antidote for consumer losses from poor regulation. Finding the correct, consumer-oriented balance between imperfect markets and imperfect government processes demands a full and fair assessment of the consumer welfare impact of imperfections in both markets and government processes.

Minimize Regulatory Error and Maximize Consumer Welfare

The available record suggests that the costs of *ex ante* regulation outweigh conceivable consumer benefits. If and when *ex ante* regulation leads to type I errors, consumers will pay in the form of lower service quality, fewer options, higher prices and slower innovation. Consumers would likely be forced to forgo the benefits of market practices that firms otherwise would have performed, but for the threat of prosecution under well-meaning preventive regulation.

While *ex post* regulation permits mistakes to be made, government can remedy these mistakes quickly and precisely after the fact. *Ex post* regulation is widely regarded as sufficient, if imperfect, in matters of competition policy enforcement. For instance, the FCC has authority to react under the Telecommunications Act of 1996, and the Department of Justice has broad authority to react under the antitrust laws. To be sure, these are not simple, quick, or perfect remedies. They are subject to well-known shortcomings. That said, we rely, and have relied on, them for nearly a century to prevent anticompetitive behavior in most sectors of the economy.

Calls for government intervention on the basis of “neutrality,” “openness,” “fairness,” and “freedoms” are rhetorically appealing, but they ignore unanticipated costs to consumers of inevitable regulatory error.

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