

Municipal Broadband: Wired to Waste

NTU Policy Paper #129
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April 9, 2012

Introduction

As the 21st Century evolves and our economy begins to recover, there is near-universal agreement on the importance of expanding Americans' access to high-speed Internet service. President Obama, countless Members of Congress, the Federal Communications Commission (FCC), and consumer advocates from across the political spectrum have identified broadband network deployment as a vital national priority and an invaluable part of our communications infrastructure.

Widespread access to quality Internet service promises to connect more American families and businesses to the incredible wonders of our growing digital economy. The good news for consumers is that access to broadband is already quite robust and growing dramatically due to multi-billion-dollar infrastructure investments on the part of companies pursuing opportunities from the Internet boom. At the dawn of the millennium, just 8 million Americans had access to broadband. By 2009 that number swelled to 200 million, a remarkable ramp-up almost entirely attributable to private companies, not government. Much work remains to be done, of course, as gaps in service persist, but the current state of broadband penetration is hardly catastrophic.

Predictably, these gaps have led many to call for government on the federal, state, and local levels to intervene and accelerate the build-out. One way those calls have manifested themselves is in the form of municipal broadband systems, where a local government utilizes a mixture of taxpayer dollars and taxpayer-backed debt financing to build a network from scratch. What started as a one-off concept in a few small localities across the country has now become a way for cities and counties to look "hip" while claiming to attract businesses and help build a bridge to our technological future.

While many tout the benefits of these high-speed networks, few have analyzed the costs imposed upon the taxpayers who are forced to fund them. Several high-profile attempts have ended in utter failure due to mismanagement and taxpayers have been left to foot the bill for entrepreneurial adventurism gone wrong.

The State of the Broadband Nation

In its recent “National Broadband Plan,” the Federal Communications Commission (FCC) estimated that 123 million out of 130 million households, or 94.6 percent, have access to wired broadband service with at least 4 Mbps download and 1 Mbps upload speeds¹. If wireless broadband is included in the metric, that coverage number jumps to 98 percent of all Americans with access to quality Internet connections.

Of the remaining 7 million households that currently lack wired access, about 6.3 million are situated in rural areas in which it is difficult and prohibitively expensive to build a sufficient network. The FCC estimated that the cost of extending wired service to the last 5.4 percent of households could total as much as \$23 billion. Breaking that number down a bit more shows just how prohibitive this type of investment really is. Jerry Ellig, an economist at the Mercatus Center at George Mason University, recently wrote:

“If you read the plan carefully, you will also find that a whopping \$14 billion of that is required to bring broadband to the highest-cost two-tenths of one percent of American housing units — 250,000 homes (page 138). That works out to \$56,000 per housing unit!”²

Spending \$56,000 a piece in taxpayer money, an amount greater than the median household income in the U.S., to fill that gap is a questionable exercise at best. Further digging also reveals that the FCC’s arbitrary use of 4 Mbps as the threshold by nature excludes so-called “3G” wireless Internet capability, of which 98 percent of Americans may avail themselves.

While it’s clear that some families legitimately lack access to high-speed Internet service, it is far from clear that spending billions of taxpayer dollars to reach them is a proper investment. This is especially true given the fact that there is a very vigorous and competitive market of Internet providers putting down billions in resources to build out their own networks and earn the loyalty of currently-unserved consumers. According to the advocacy group Broadband for America, private industry spent a combined \$250 billion between 2008 and 2010 on investments to expand broadband access.³ This is not a portrait of widespread market failure; on the contrary, it shows that the market is working feverishly to bring all Americans onto the broadband “grid.”

In reality, the biggest impediment to universal adoption of broadband Internet service is not a lack of access but a lack of resources. All but a tiny fraction of Americans, most of whom live in far-flung rural areas, have broadband service available to them. Those who choose not to purchase such services may not need fast connections or may simply lack the financial wherewithal to do so. The best way to solve that problem is not widespread taxpayer subsidies to marginally expand access but instead to embark on careful tax and regulatory reforms to foster stronger economic growth. By making our economy stronger, and Americans richer, we can connect far more people without imposing enormous costs on taxpayers.

The Rise of Municipal Broadband

Despite the billions of dollars being poured into expansion efforts by private entities, municipal broadband projects have taken off across the country. By the tally of *Broadband Communities Magazine*, there were just 16 government-owned networks in nine states in 2001. In 2011, that number had skyrocketed to 108 projects in 33 states.⁴ A more expansive view that includes services provided by Incumbent and Competitive Local Exchange Carriers and electric co-ops shows nearly 800 projects nationwide. Figures 1 and 2 show a map of government-owned broadband networks nationwide and the incredible growth in such projects over the last 15 years.

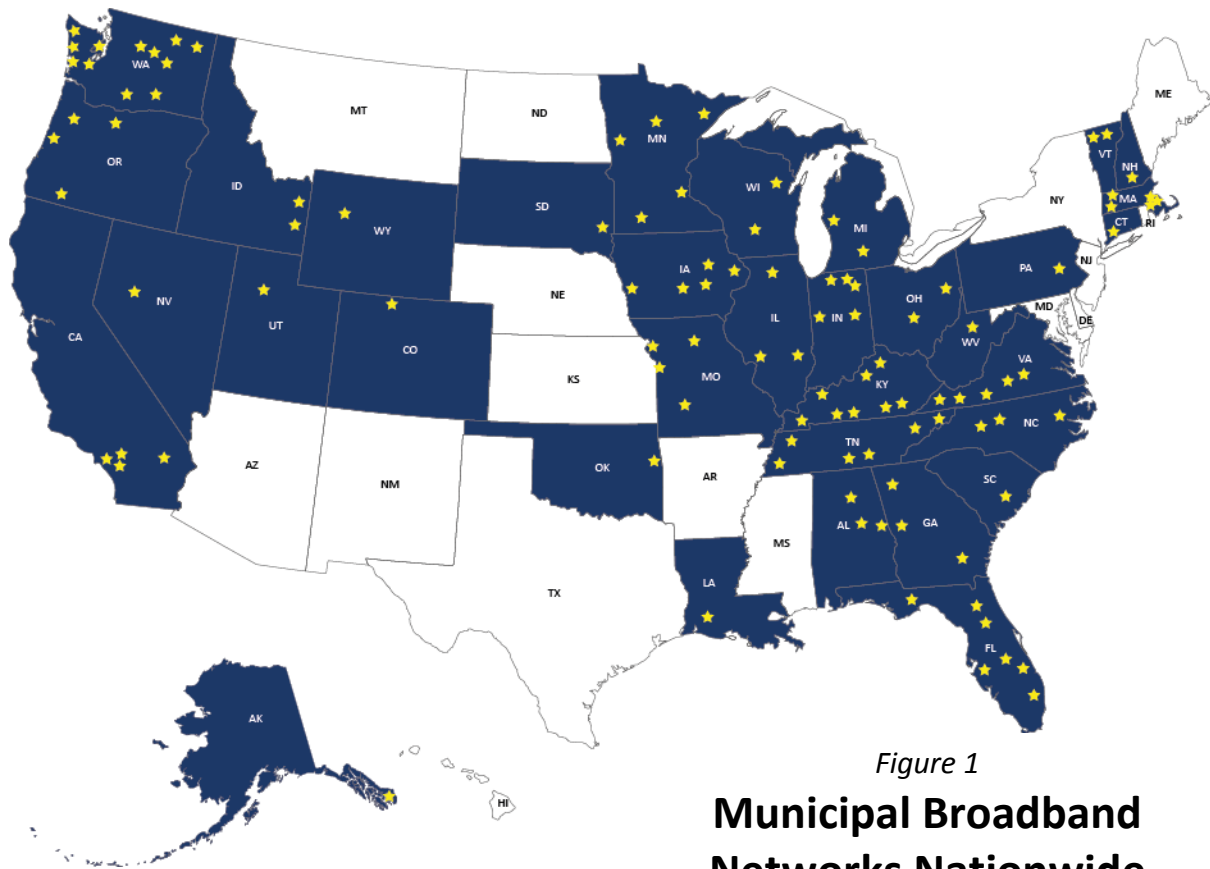


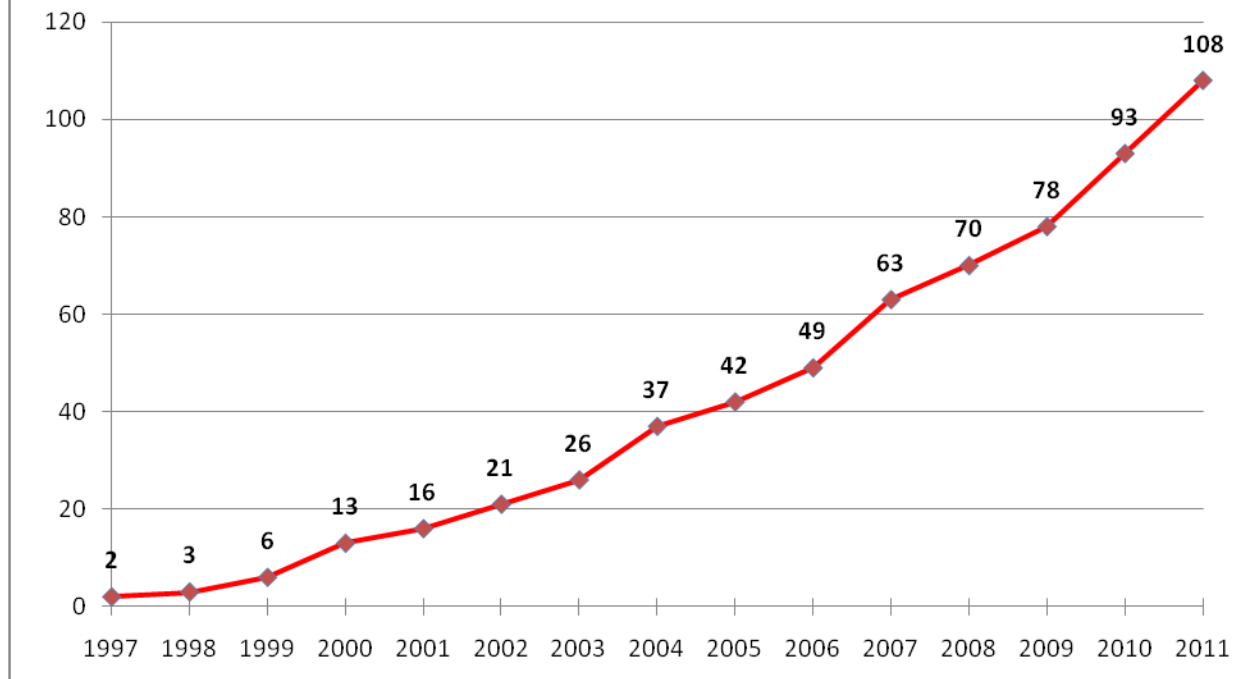
Figure 1

Municipal Broadband Networks Nationwide

Source: Broadband Communities Magazine

Figure 2
Number of Municipal Broadband Projects

Source: Broadband Communities Magazine



Municipal broadband advocates deploy a number of arguments in defense of these projects. They say that provision of high-speed, quality Internet service is a “public good” and thus, they argue, government can and should assume a key role in building and maintaining these networks just as they do other public goods like roads. They also claim that taxpayer-backed municipal broadband operations are necessary in order to bring competition to existing cable, wireless, telco, and satellite providers.

Municipal broadband as infrastructure

In Chattanooga, Tennessee, the publicly-owned Electric Power Board (EPB) made news in 2010 when it launched an ultra-high speed fiber-optic network capable of providing Internet speeds up to one gigabit-per-second as well as cable television service. The network was built almost entirely at taxpayer expense. EPB’s electric customers are responsible for financing a \$160 million loan to its telecom wing and federal taxpayers coughed up another \$111 million via the 2009 “stimulus” bill to build it. The remaining \$29 million will be borne by EPB’s new Internet and cable television customers.⁵

EPB officials have made numerous statements reflecting the notion that municipal broadband is a public good. Danna Bailey, an EPB spokesperson, said in an interview, “We believe that it [the fiber-optic network] is critical infrastructure for economic development and, ultimately, quality of life. That’s what government’s role should be.”

This contention fails on both technical and practical levels. Strictly speaking, municipal broadband is simply not a “public good” that the economics profession would recognize. In that field, public good is a term that refers to something with two important characteristics: it is “non-rivalrous” and “non-excludable.” In English, “non-rivalrous” means that the marginal cost of providing the good to an additional person is low (or nonexistent) while “non-excludable” means that one consumer can’t be prevented from accessing the good without impeding other consumers’ access.

Perhaps the classic example of a public good in the modern realm of municipal governments is a residential street. A paved road in a neighborhood is non-rivalrous because once it’s been built, the cost of allowing an additional person to access it is very small, essentially encompassing whatever small amount of wear and tear the individual imposes. A street of this sort is also non-excludable because any legal driver can’t be prevented from accessing it unless others are kept out too. A government could impose tolling, but as a practical matter that is generally confined to large highways or bridges.

A municipal broadband system does not meet any reasonable definition of a public good. It’s not only easy but highly necessary to achieve excludability, since free-riders could devour huge amounts of bandwidth and degrade performance for other consumers. Most services achieve this through a subscription or password requirement that weeds out all but the most dedicated of thieves. And in most cases, municipal broadband is subject to *rivalrous* consumption. With wired networks, which are more prominent than wireless, there is a not-insignificant marginal cost associated with delivering service to an additional household or business because the municipality must string the wire into the location.

Practically speaking, when advocates refer to municipal broadband as a “public good,” what they’re really saying is that they believe it would be “good for the public.” That, of course, is a very different prospect from a true public good. After all, quality coffee at an affordable cost would be good for the public as well, and yet no sane person is suggesting that we subsidize coffee consumption with taxpayer dollars, much less create from scratch a taxpayer-subsidized retail coffee shop.

That may seem like a frivolous analogy, but it’s actually not all that silly. Management consultants have come to the conclusion that providing a coffee machine in the workplace can yield small but measurable increases in productivity. Coffee in the office can allow sleepy workers to fuel up in the morning or during the dreaded post-lunchtime lull so as to keep them more alert and active. But no government official in their right mind would suggest that taxpayers subsidize the purchase of coffee machines in the private workplace because it simply isn’t government’s role to do so. Why should Internet service be any different?

A less frivolous analogy would be to compare broadband Internet service on the local level to air transportation on the national level. Just like high-speed Internet, there is widespread agreement that access to low-cost air transportation can foster economic growth and individual mobility. And yet, the federal government does not operate its own airline to compete with the likes of American, Delta, and U.S. Airways. In fact, the last several decades

have been marked by dramatic reductions in federal involvement in direct rate and route regulation. There have even been discussions in Congress over placing limits on the federal Essential Air Service program, which subsidizes little-used passenger routes. Overall, the reduced role of government has helped to spark a huge increase in ridership, thanks in large part to private innovation and efficiencies that have brought the price of a ticket within reach of more and more Americans.

Furthermore, it can be argued that much of what remains in the way of a more vibrant air transportation industry is the federal government's highly-restrictive approach to modern air traffic control technology. While our Canadian neighbors and allies in Western Europe have looked intently at satellite-based systems that allow for more efficient traffic management, the feds have dragged their feet and for many years kept America locked into antiquated radar-based air traffic control that causes costly bottlenecks, raising prices for consumers and hindering efforts to reduce fuel consumption and resultant pollution. As the Reason Foundation's Bob Poole and the Cato Institute's Chris Edwards have explained:

As a government agency, the FAA is not designed to judge risks, aim at the most efficient investments, manage people to produce results, reward excellence, or punish incompetence. It is therefore not equipped to fundamentally reform the [air traffic control] system.⁶

Municipal broadband as competitor

Another argument often made by supporters of taxpayer-backed municipal broadband systems like Chattanooga's EPB is that they are necessary to compete with big established firms, which (in their opinion) aren't serving enough residents or aren't serving them sufficiently. If incumbent providers are forced to compete with a well-financed taxpayer-backed entity, their logic goes, then they'll have to improve their prices and service level.

EPB supporters have proffered this justification repeatedly. Jack Benson, a member of Chattanooga's City Council who supported the creation of the fiber-optic network, said in an interview, "I voted for it mainly because Comcast had failed to be service friendly here in Chattanooga, and we had a number of complaints that they were hard to get a hold of."

This argument, too, fails on both technical and practical levels. First, and most important, the way that outfits like EPB "compete" with companies like Comcast is by siphoning off scarce taxpayer resources in order to build their networks and pay for their operations. That means taking money, whether through taxes or shifted resources out of related businesses like electric service, from the very same citizens that elected officials hope to benefit by standing up a municipal broadband company. In short, it amounts to taking a bucket of water out of the deep end of the pool, adding it to the shallow end, and claiming that the pool has been made deeper in the process. If Chattanooga officials were intent on benefiting the consumers of Comcast services, the best thing they could do would be reduce their tax burdens and improve the business climate to attract more private competitors.

And as far as the practical goes, it's not at all clear that there is strong market demand for some of the services EPB is offering. After all, how intense is the actual, as opposed to government-perceived, demand for Internet service that is 250 times faster than the FCC's (perhaps arbitrarily-high) standard for what constitutes broadband? Private markets are driven to find economically balanced answers to questions like these, but in EPB's case, the early results suggest public officials are not the best guessers. Spokeswoman Danna Bailey said, "We have a handful of residential gigabit-per-second subscribers and nearly two dozen businesses."⁷ Gigabit Internet speeds may be press release gold, but are they really worth the \$270+ million swiped from taxpayers in order to serve a "handful" of residents and 20 or so businesses?

Even EPB's less flashy Internet services pose serious problems that are not necessarily intuitive but nonetheless could prove damaging to consumers. With its \$270 million taxpayer-provided leg up in the marketplace, EPB is now competing directly with private companies. Should the municipal entity's artificial advantage enable it to gain market share, that means less revenue for existing private entities and much smaller incentives to invest in the Chattanooga market. After all, if the commercial servicers cannot make a profit in the city because they can't compete with taxpayer-backed EPB, they'll simply reduce their investment and look elsewhere to build up their networks. This "crowding out" effect may actually lead to *fewer* competitors and options for consumers as private entities throw in the towel rather than slug it out with a government-owned network that can command money rather than lure it from investors. Supporters like Councilman Benson might find a marketplace in which government-owned EPB is the only viable option more distressing than one in which several private competitors currently operate.

Unintended competitive consequences such as these are not completely unknown. Rural Electric Cooperatives, creatures of Washington's Depression-era attempts to bring modern services to remote areas, have been criticized for entering controversial lines of business that have led to propane dealerships and ownership of restaurants. But critics' major complaint with RECs is that they enjoy government-conferred advantages that investor-owned utilities do not.⁸

In any case, federal policies have helped to give localities an edge over private broadband companies in some markets. Millions of dollars from the 2009 economic "stimulus" bill have been devoted to so-called "overbuilds," where a government-owned network is built in an area already served by several private competitors.

In fact, the 2009 stimulus law's Broadband Technology Opportunities Program (BTOP) and Broadband Initiatives Program (BIP) have come under serious scrutiny from watchdogs inside and outside of government. Although the stimulus' funding for BTOP and BIP grants and loans (amounting to more than \$7 billion) expired at the end of September 2010, questions persist about how that funding is being used for projects still underway. At a Congressional hearing in early 2011, Mark Goldstein with Congress's Government Accountability Office noted that, "Even with steps taken to address project oversight, risks to the success of the broadband programs remain."⁹ Last year, the House passed legislation authored by Rep. Charlie Bass (R-NH) to protect taxpayers by terminating poorly performing or wasteful broadband projects and

ensuring the return of those funds to the Treasury.¹⁰ Unfortunately, the Senate has yet to follow suit.

Municipal broadband networks are not a public good and they don't provide "necessary" competition for existing providers, but even if they satisfied both of those conditions they'd still pose unacceptable risks to the taxpayers who fund them.

Hidden Costs for Taxpayers

While many tout the benefits of government-owned broadband networks, very few have seriously analyzed the cost to taxpayers. How much debt is associated with these projects? How high is the risk of a project failing? If it does fail, how much will taxpayers be on the hook for? Can government officials ever hope to run a business when many of them can't even balance a budget or restrain spending? These are just some of the questions that remain unanswered in the case of many municipal broadband projects.

Municipal broadband debt

The debt loads connected with municipal broadband projects tend to be substantial. Though some dismiss the issue as a necessary part of the process of building a full-featured network, the fact of the matter is that servicing debt (i.e., making periodic principal and interest payments) can be quite expensive over the long term while posing a threat to the future finances of the city or county that incurs it.

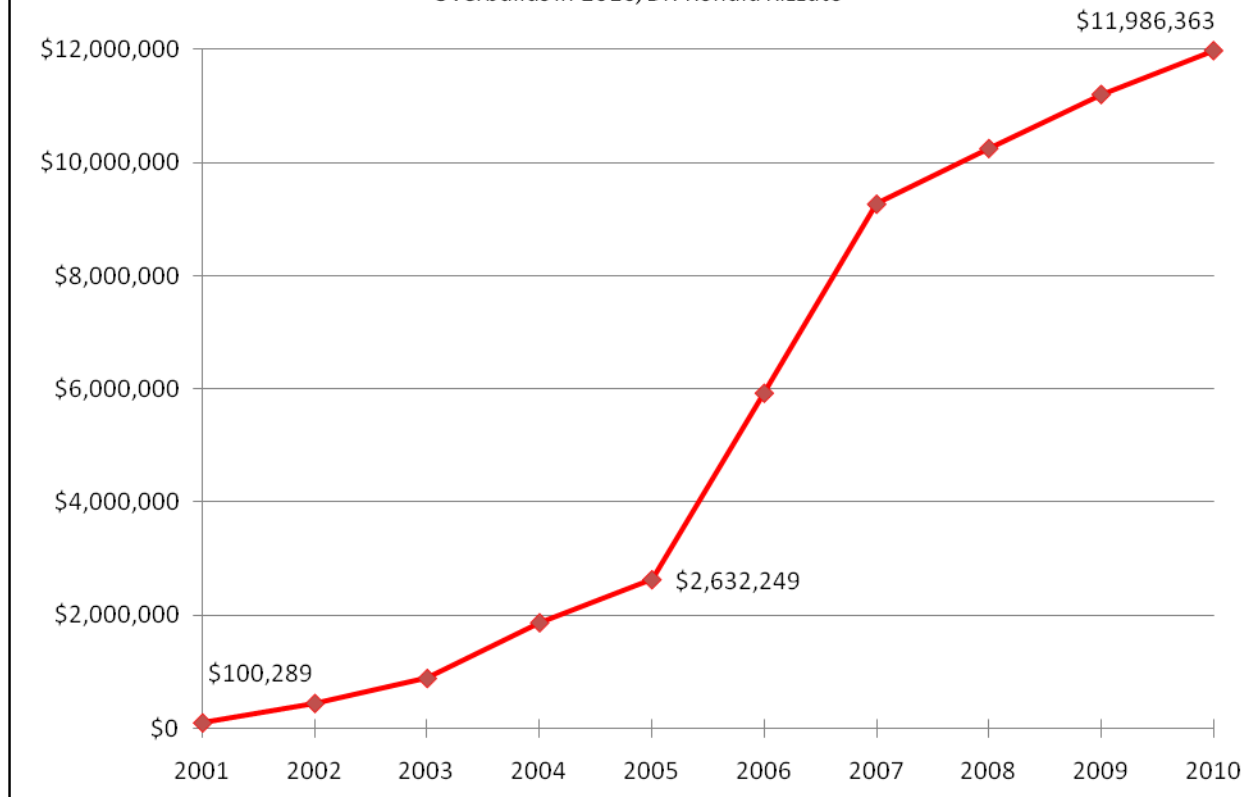
Continuing to use Tennessee as an example, a recent study by University of Denver Professor Ronald Rizzuto sheds some light on the risks faced by Volunteer State taxpayers. His review, entitled "Financial Performance of Tennessee's Municipal Cable and Internet Overbuilds in 2010," takes a deep look at the finances of nine government-owned networks in the state: in Bristol, Chattanooga, Clarksville, Columbia, Fayetteville, Jackson, Morristown, Pulaski, and Tullahoma. The results are not pretty for taxpayers.

Dr. Rizzuto's study shows that annual debt financing costs are significant and rising ominously. Figure 3 charts this alarming trend over the last decade.

Figure 3

Annual Debt Service Costs for Tennessee Municipal Broadband and Cable Entities

Source: Financial Performance of Tennessee's Municipal Cable and Internet Overbuilds in 2010, Dr. Ronald Rizzuto

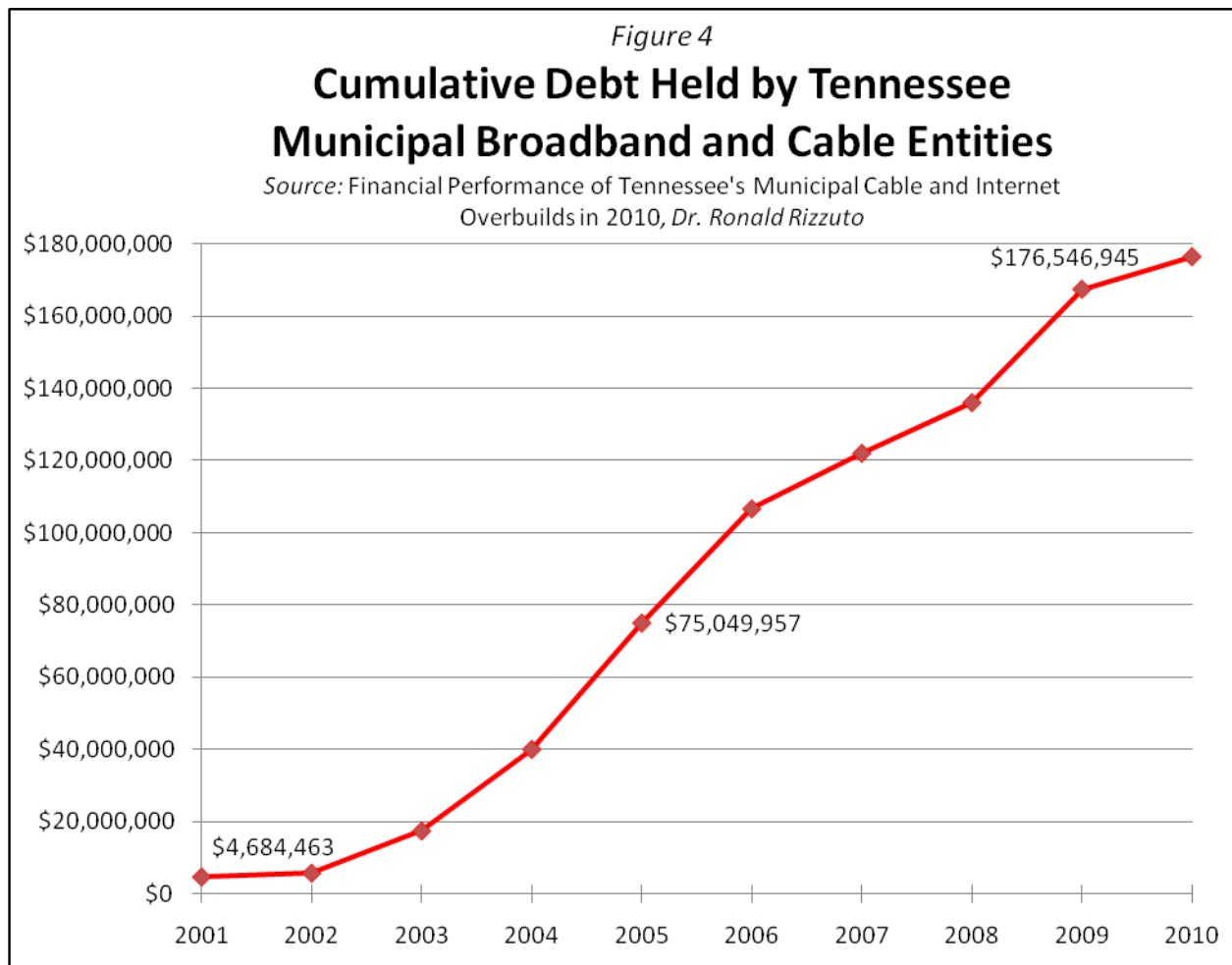


In 2001, the total cost in interest and principal payments was just \$100,289, as only Fayetteville's network had begun operation. By 2005, that amount had jumped to over \$2.6 million with the advent of networks in Columbia, Covington (which was later sold in 2007), Jackson, and Morristown. By 2010, it had skyrocketed to nearly \$12 million as Bristol, Chattanooga, Clarksville, Pulaski, and Tullahoma began operations.

These costs are borne directly by citizens who have signed up for the network's services or are shifted onto consumers of a utility's related services, as in the case of EPB where electric customers subsidize the fiber-optic operation. Given that the population of these nine towns totals less than 490,000 (roughly 110,000 fewer than reside in Nashville and 170,000 fewer than live in Memphis), it's perfectly legitimate to ask whether \$12 million worth of annual "maintenance" for the debt is worth the flashy curb appeal of these government-built structures.

While the annual debt service costs are high and can be difficult to meet, the total debt numbers are likewise daunting. All told, the networks had incurred a combined \$176.5 million

in cumulative debt by 2010, up from just under \$4.7 million in 2001. Figure 4 shows the rapid increase in indebtedness over the last decade.



This \$176 million-plus debt load weighs heavily on the shoulders of taxpayers in more ways than one. If even one of the nine entities fails, future debt service costs for the other eight networks could rise as investors demand higher risk penalties for new issuances. Should those networks somehow avoid borrowing another dime going forward, what would happen to investor (not to mention taxpayer) confidence in the governments associated with these projects?

Taxpayers may not have to guess for long. Just last month the Fitch agency downgraded EPB's credit rating to "AA." One reason: its "reliance on non-electric revenue" coming "from Internet and newly launched cable & video services" to finance part of its smart grid updates. Fitch noted that, "These services entail a higher degree of business risk and operating margins that are less predictable than the EPB's traditional electric operations."¹¹

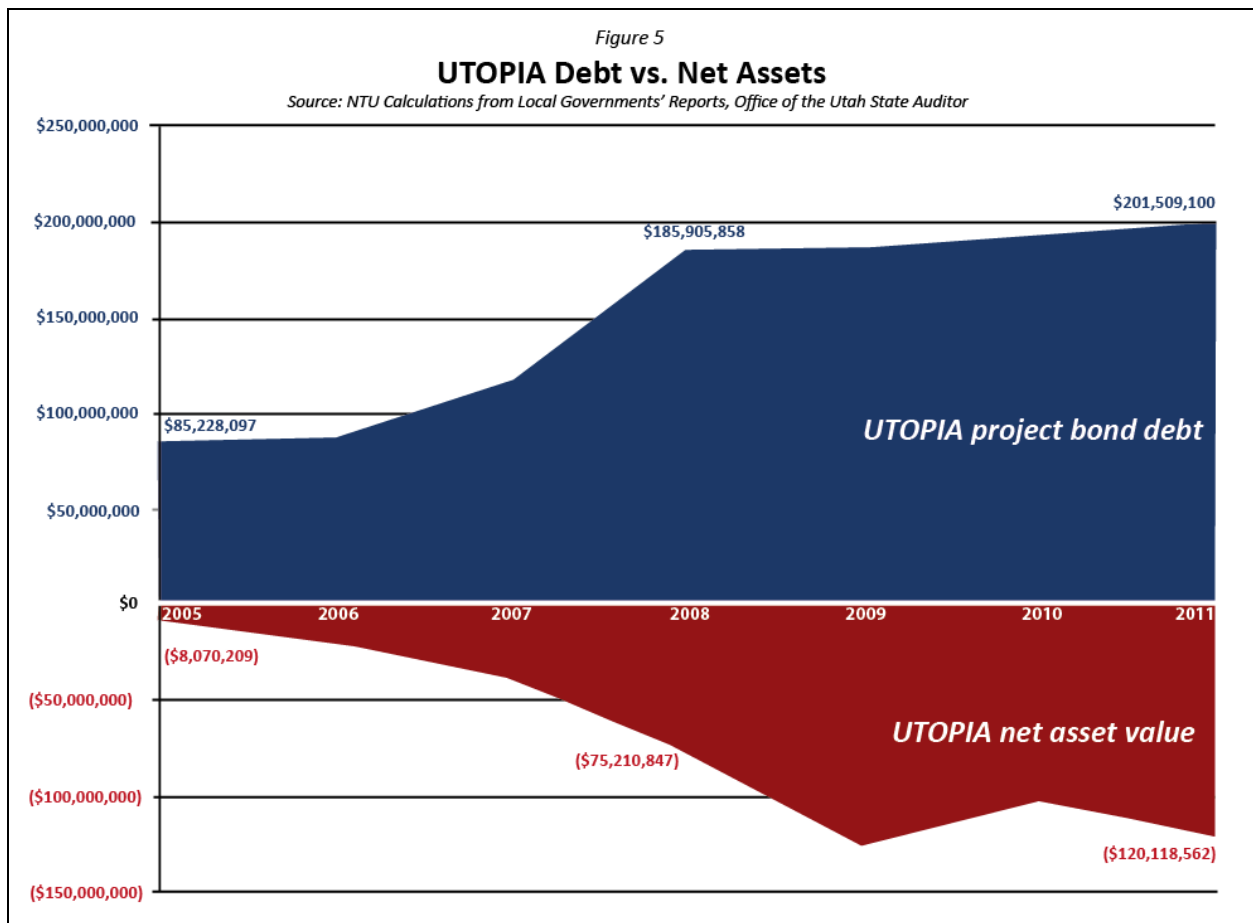
Municipal Broadband Failures

It may not be apparent in the ribbon-cutting ceremonies or self-congratulatory press releases, but cold, hard evidence suggests that municipal broadband businesses are prone to failure. Several such ventures across the country which were announced with much fanfare and back-patting ended in disaster, sticking taxpayers with millions in unpaid bills and revealing much about the incompetence of municipal officials when tasked with running a high-stakes business.

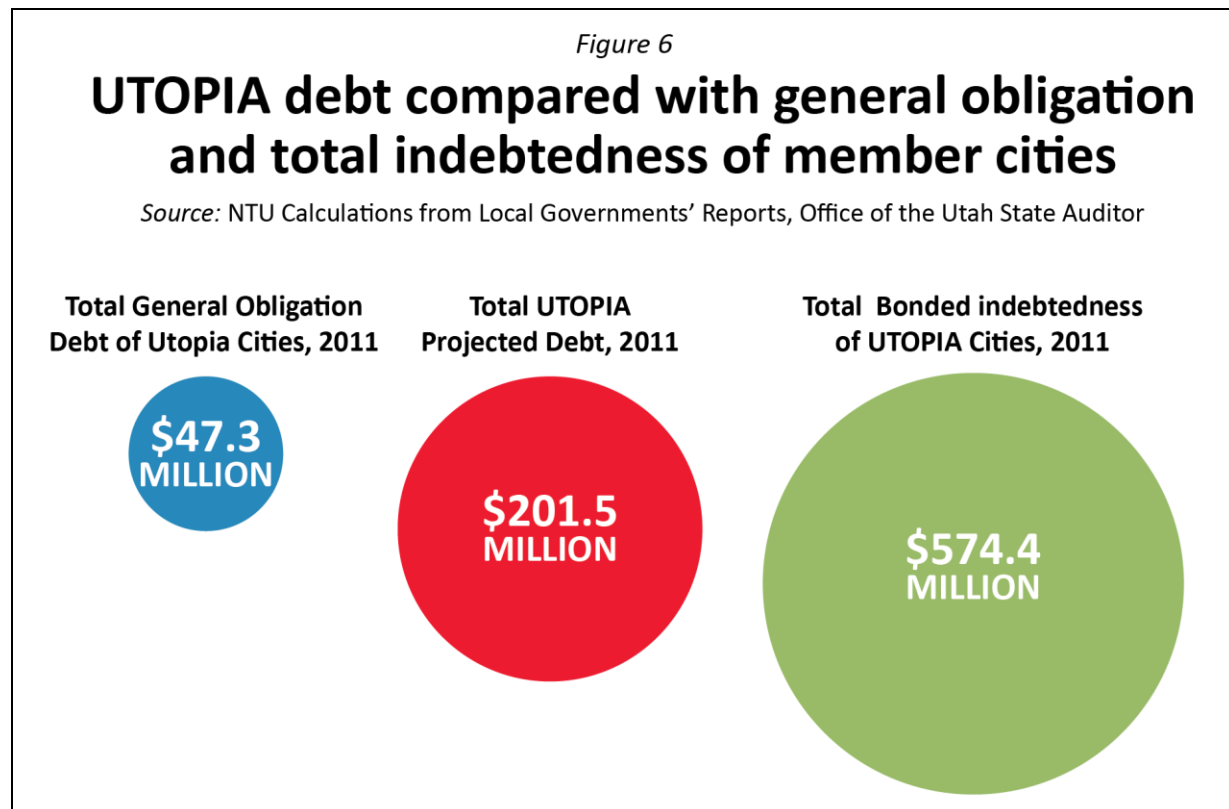
UTOPIA

In an award-worthy effort of Orwellian acronym development, the Utah Telecommunication Open Infrastructure Agency, known as UTOPIA, is a consortium of 11 cities and towns that have pledged hundreds of millions of dollars in taxpayer financing to construct a broadband network.

Figure 5 shows how debt associated with the UTOPIA project compares with the net asset value of the business that's been created. The result is a stark depiction of fiscal decline. UTOPIA project debt has continued to rise precipitously, all while the actual value of the business is less than nothing and continuing to drop.



Meanwhile, Figure 6 shows in dramatic fashion just how large the UTOPIA project's debt is when compared with other metrics. The bubbles are represented in scale to help visualize how big the UTOPIA debt load is.



Debt associated with UTOPIA totaled a staggering \$201.5 million last year, up from just \$85 million in 2005. Meanwhile, the 11 partner cities had a combined general obligation debt of just \$47.3 million. Thus for every dollar in debt associated with much of their infrastructure operations, there are four dollars of UTOPIA-related debt.¹² In addition, while it is technically held separately, the visual depiction above shows that UTOPIA debt alone is more than one-third as large as the partner cities' total bonded indebtedness of just over \$574 million.

This financial deterioration has manifested itself in many ways. According to its 2011 financial audit, if UTOPIA were forced to liquidate its assets tomorrow the consortium would owe creditors \$120 million.¹³ Its net asset value dropped \$19 million between 2010 and 2011 and, during that same period, the network incurred a \$6.1 million operating loss.

It is a very peculiar state of affairs when the burden of a failing business venture like UTOPIA vastly outweighs that of the consortium's general obligation debt and is one-third of the size of its overall debt. Unfortunately, there does not seem to be an end in sight for the massive government subsidies. Despite its voluminous losses to date, partner cities have pledged an additional \$500 million in taxpayer funds over the next 30 years toward UTOPIA – even though to date only 8,572 households out of a possible 56,000 have signed up for service.

Memphis Network

In June of 1999, with an initial taxpayer investment of \$28.6 million, a municipal broadband company was created by Memphis Light, Gas, and Water (MLGW). Initially called Memphis Broadband, LLC, it was later spun off to become Memphis Network. Between 1999 and 2006, a total of \$32 million was committed to construct 250 miles of fiber networks throughout the city.¹⁴

Unlike EPB in Chattanooga and other ventures which deliver services directly to businesses and consumers (just as Comcast or satellite providers do), Memphis Network leased its “dark fiber” lines to other entities. Theoretically, a “wholesale” model like this should pose fewer competitive concerns since it subsidizes the building of the network infrastructure but does not engage in the “retail” side of the business in delivering services to consumers. Unfortunately for taxpayers, even this downsized attempt at broadband subsidies managed to end in a debacle.

Though Memphis Network had a revenue stream of \$5 million in 2006, it *never once* turned a profit. In 2005, due to its poor financial state, officials asked the City of Memphis for a \$6 million cash infusion. The City Council refused, forcing MLGW to further dilute its stake in the network. Eventually even that position became untenable and the entire network was sold in 2007 for a net of less than \$1 million, a loss of more than \$27 million from the city’s initial investment.¹⁵ Adding insult to injury, in 2009 the city sued Memphis Network, charging that it failed to pay franchise fees as required under the terms of a 2001 agreement.

Burlington Telecom (BT)

Burlington, Vermont is a quiet town of 50,000 people and happens to have been the scene of one of the worst broadband disasters in recent years.

In 2001, Burlington Telecom (BT) was hatched under the wing of the local government. BT structured its financing in such a way that, despite being publicly-owned, it used private funds to build its fiber network and then paid a lease on those lines. Due to repeated mismanagement, the network is now over \$50 million in debt and is embroiled in both state and federal investigations. CitiCapital sued BT for \$33.5 million and is seeking repossession of all leased equipment, and in 2009 BT acknowledged to the Vermont Public Service Board that it had failed to repay \$17 million in city funds, in violation of its charter.

Burlington taxpayers, whether they signed up for broadband service or not, are now paying for the project. As Christopher Mitchell, a well-known municipal broadband proponent, noted, there is very little chance of the public ever receiving an honest accounting of BT’s financial malfeasance:

Twenty six months after having cash in the bank from the Citi financing in the summer of 2007, BT was indebted to the City’s cash pool by some \$17 million and was far below subscriber targets. Of this total, less than \$3.5 million was paid to Citi for interest. The

capital to connect approximately 2,500 [subscribers] over this period should not have exceeded \$4 million....

The network pass (the wires up and down streets that can then be connected to homes and businesses) was largely finished when [Burlington Telecom Director Tim] Nulty left, leaving the bulk of the \$17 million debt unexplained. Though the FBI joined the investigation of BT in November 2010, nothing seems to have resulted. **We do not know, and may never know, exactly how the \$17 million was spent.**¹⁶ (emphasis added)

FiberNET

In the mid-1990s Marietta, Georgia's public utility, the Marietta Board of Lights and Water, created FiberNET. Local officials envisioned FiberNET as an extension of the Board's services, one that would provide expanded Internet access to local businesses. From 1996-2004, FiberNET built over 400 miles of cable for a mere 180 customers.¹⁷

The *Atlanta Journal-Constitution* proved prescient in 1999 to the ensuing decade of debate by noting politicians were acting as "entrepreneurs and pretend risk-takers with somebody else's money."¹⁸ Ultimately, those "pretend risk-takers" – bureaucrats in Marietta – created quite real adversities for citizens. FiberNET failed to turn a profit during any year of operation and was eventually sold at a loss of \$25 million to the taxpayers in 2005.

LompocNET

In 2000, Lompoc, California spent \$3 million to construct a city-wide wireless broadband network for its 42,000 residents. By 2007, the network had only attracted a few hundred subscribers. Spotty coverage and poor overall service, combined with competitive private-sector options, prevented the network from ever reaching its estimated break-even point of 4,000 subscribers.¹⁹

Lompoc's network still operates with 1,450 customers, stranding the city with annual operating obligations of about \$800,000 while private service providers such as Comcast have rolled out more advanced networks in the area. The city is now left with an expensive and outdated network few people actually use.²⁰

Iowa Communications Network

Although Iowa's ambitious plan to provide distance learning capacity over the Internet has not gone broke, experts say it has not lived up to fiscal expectations. According to research from the Public Interest Institute (PII), the taxpayer-funded Iowa Communications Network (ICN), authorized some 20 years ago, "has spent millions and millions of dollars to create and maintain a network whose usage is falling and that is fast being made obsolete by web-based distance-learning courses." That conclusion appeared in a 2005 publication written by PII President Donald P. Racheter, who noted that ICN's tentacles were flexing, in hopes of

spreading elsewhere. The very same company that lobbied for ICN began pressuring local governments to build supposedly public-purposed fiber optic networks of their own. According to Dr. Racheter:

One city where this is being pushed, Dubuque, conducted a feasibility study which found the proposal ‘prohibitively costly.’ Muscatine, which has already gone down this road to municipal telecommunications, has continuously raised rates and still not produced the savings promised. The claim was that since the city would not be ‘taking a profit’ for the owners of the company or shareholders, the same service could be provided for less and the savings transferred to the customers. The fact that the promised savings have not materialized is no surprise to anyone who has studied the provision of services by monopoly suppliers versus suppliers in a competitive marketplace.²¹

In fact, Muscatine’s publicly-owned utility took a \$1.5 million loss on its communications operations alone in 2011.²² Thankfully for taxpayers some Iowa policymakers have begun exploring how to sell off ICN and get government out of the competitive telecommunications business, but they have met with resistance.

The Threat of Bankruptcy

As cities continue to eye taxpayer resources for funding municipal broadband projects, the fiscal threat goes beyond the “mere” loss of millions of dollars. Since 1982, 259 local governments of some sort have declared bankruptcy, the vast majority of which were cities or municipal utilities. Interestingly, these are the two types of public entities most commonly involved in creating broadband networks. Yet, other kinds of mismanaged multi-million dollar infrastructure projects have brought down cities in recent years, and should prove a powerful cautionary tale to over-exuberant officials intent on gambling taxpayer money for government-driven Internet programs.

Jefferson County, Alabama is home to the state’s largest city, Birmingham. It is also home to the largest municipal bankruptcy case in United States history. The city made its condition official late last year, claiming that it owed more than \$3.1 billion on a sewer project gone wrong.²³ Its experience serves as a warning of how complicated and impenetrable the financing of core government functions has become (setting aside the complexities of non-essential services like broadband networks).

Harrisburg, Pennsylvania, with fewer than 50,000 residents, has experienced one of the messiest roads to bankruptcy in recent memory. The city is currently in receivership and has only been spared from defaulting on its general obligation bonds by state aid and other emergency measures. On March 15th of this year, it failed to make more than \$5 million in debt payments and is currently embroiled in legal wrangling over a Chapter 9 bankruptcy filing, all due to a bungled incinerator project.

The incinerator opened in 1972 with the hope that it would take what was otherwise an expense – municipal waste – and offset the cost by burning it to provide electricity. By 2003, a series of regulatory changes, management failures, and bad decisions had left the city with an inoperable facility on which it still owed \$104 million.²⁴ But rather than shut the incinerator down and eat the costs, city officials decided to double down and float \$120 million in new debt to retrofit it to meet modern emissions standards. Construction delays and cost growth quickly ballooned to more than \$280 million, leaving the city utterly incapable of its annual debt service requirements.

There are many subtler but equally worrisome reminders of how government projects undertaken in the name of “economic development” can go awry, by leaving taxpayers to clean up after white elephants. As NTU has long documented, states and localities’ increasing penchant for publicly-funded sports facilities has often meant significant financial pain for little economic gain.²⁵ Even projects with a muscular connection to transportation can go awry. For nearly 15 years, the St. Louis MidAmerica Airport has struggled to find a private much less a public purpose, in the process receiving millions of county-level dollars in the process. One of the more spectacular aspects involved public monies spent to subsidize flights for an air carrier specializing in flower delivery from South America. In February of this year, county officials overseeing the airport approved a \$550 million “conduit” bond issue to attract cargo operations at the facility.²⁶

Jefferson County and Harrisburg are not necessarily typical examples, but they show very vividly the potential costs associated with inexperienced bureaucrats operating businesses or complicated finance deals about which they know very little. Add in a difficult economic environment and plenty of political bickering, and the result is a disaster that will shred the wallets of hard-working taxpayers while undermining the municipalities’ financial viability.

Protecting Taxpayers

Municipal broadband networks are not a public good – they can only compete when flush with taxpayer money, and in some cases threaten to actually reduce the number of service options for consumers. Given the numerous failures of such businesses across the country and the potential for creating larger fiscal woes for municipalities that are struggling in today’s uneven economic recovery, the time has come for a dose of sanity. Instead of launching into complicated and expensive municipal broadband ventures, local government officials should focus on streamlining and easing tax burdens, reforming regulatory and business climates, and reducing their exposure to the \$4 trillion worth of municipal bonds already in existence (a number nearly one-third as large as our entire national economic output).²⁷

Beyond the policy equivalent of preaching abstinence, however, some states have taken positive steps to enact taxpayer protections against municipal broadband excesses. Twenty states have acted to impose sensible limits on localities pursuing these projects. A standout among these prudent states is North Carolina, which last year passed a sweeping law requiring that any municipal broadband aspirant remit an amount equal to what a private entity would

pay in taxes, confine its scope to within the city limits, and ensure that its service would be fully-funded by subscriber revenue rather than taxpayer funds.²⁸

In Georgia, State Senator Chip Rogers (R-Woodstock) recently introduced Senate Bill 313, which builds upon North Carolina-style protections by also requiring municipalities to solicit proposals from private providers, perform a three-year cost-benefit calculation, conduct public hearings, and secure voter approval before launching a broadband service. These kinds of common-sense pieces of legislation will ensure that if a government does decide to proceed with building a network, it will not burden taxpayers with its existence and will compete on a level playing field.

Nor can taxpayers afford to ignore federal-level cheerleading on behalf of subsidized broadband. As noted earlier in this paper, the Federal Communications Commission's 2010 National Broadband Plan sets ambitious coverage and service targets which, if carried out, could lead to billions in additional expenditures.

The march of broadband Internet service has been steady and growing without government subsidies, and there's little reason to believe it will slow without more infusions of cash from taxpayers or the creation of whole businesses from scratch with taxpayer backing. Indeed, this is a march whose pace and direction should be led not by governments, but by consumers – with private providers responding to the drumbeat.

About the Authors

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Notes

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³ <http://www.broadbandforamerica.com/blog/broadband-investment-trade-groups-tops-250-billion>

⁴ <http://www.bbpmag.com/search.php>

⁵ <http://tennessee.watchdog.org/2011/12/21/chattanooga-residents-get-Internet-courtesy-of-taxpayers/>

⁶ <http://www.downsizinggovernment.org/transportation/airports-atc>

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¹⁰ <http://www.ntu.org/news-and-issues/telecom/yes-on-hr-1343.html>

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- ¹⁷ http://www.pacificresearch.org/docLib/20070227_Wifi_Waste.pdf, page 21-22
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- ²⁴ <http://www.governing.com/topics/transportation-infrastructure/Harrisburgs-failed-infrastructure-project.html>
- ²⁵ See, for example, <http://www.ntu.org/ntuf/stadiums-and-subsidies-strike-out-for-taxpayers.html>; and, <http://www.ntu.org/news-and-issues/state-issues/stadiums--subsidies/economists-letter-new-york-football-stadium.html>
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- ²⁷ <http://www.nytimes.com/2012/02/19/business/jefferson-county-ala-falls-off-the-bankruptcy-cliff.html>
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