

## **The Case for Affirmative Action – From Conscience to Coffers**

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The Federal Communications Commission's auction of wireless communication licenses last fall has been criticized as a huge Government giveaway because of the substantial bidding preferences granted to women and minorities. In March, Federal court action delayed the FCC's June auction until August to consider the legality of similar preferences.

But far from being a giveaway, affirmative action actually increased the total amount paid to the Government by about \$15 million.

Women and minority bidders were granted a 40 percent bidding credit on certain licenses and the right to pay the Government in installments over 10 years at a favorable rate. The combined effect was that these favored bidders only had to pay the Government 50 percent of any winning bid. So how could such subsidies have raised the total auction revenue? The answer is that giving preferences to relatively weak bidders can induce strong bidders to bid higher. The extra revenue the Government gets from the strong bidders can more than offset the subsidy to the weaker bidders.

Consider four bidders competing for two similar communication licenses. Each bidder desires a single license. Two of the bidders (who are strong) are willing to pay up to \$100 million for either license; and two of the bidders (who are weak) are only willing to pay up to \$50 million.

Without any preferential treatment, each of the strong companies would only need to bid slightly more than \$50 million to outbid the weaker rivals for each license. The Government collects \$100 million.

But if the FCC gave preference by setting aside one license for the weaker bidders, the two strong bidders competing for a single license would bid close to \$100 million. And the weaker bidders would bid close to \$50 million for the set-aside license. Far from reducing the Government revenue, the set-aside lifts the Government's expected revenue by 50 percent, to \$150 million.

Likewise, auction revenues could be increased by giving bidder subsidies to women and minorities. A strong bidder might be willing to bid more because it must now compete with higher subsidized bids.

This happened last fall when licenses for narrow bands of the radio spectrum were awarded for advanced paging services networks. Subsidized bids by a minority-controlled company substantially increased the price a concern paid.

Early in the auction which lasted 104 rounds, bidding among companies had ended with PageMart Inc. holding high bids totaling \$76 million for five licenses. In the bidding for minority licenses, prices got so high that one minority-controlled bidder, PCS Development LP, decided to bid against PageMart on the licenses. PageMart still won the licenses, but only by paying \$93 million. The additional competition from the minority-controlled company increased the Government's revenue by \$17 million.

Why weren't firms willing to bid further, consequently pushing PageMart's bid above \$76 million? We must remember that these licenses are going to be used for emerging technologies, like pagers that can respond to as well as get messages. It should not be surprising that capital markets shied away from financing companies that did not already have big personal communication experience. But, as this example makes clear, if enough licenses were being auctioned to meet the needs of experienced companies, then auction competition among those well-financed companies might allow them to pay less than they think the licenses are worth.

In the narrow band auctions, the bidding subsidies trimmed the Government's revenue on a particular license when women or minorities prevailed. And with these substantial subsidies, it is not surprising that the preferred bidders won 11 of the 30 licenses at auction. But the additional revenues extracted from the nonpreferred bidders more than off-set the subsidies.

The net revenue (accounting for the installment and bid subsidies) was 5 percent, or \$15 million, higher in the fall auction than in an earlier summer auction at which similar licenses were sold with much smaller bidding preferences.

As the White House searches to identify affirmative auction programs that work, the FCC's success fostering diversity and reducing the deficit should count in favor of continuing this practice. But the court action on the legality of similar affirmative action preferences threatens to undo what may be – at least measured by its impact on the Treasury – one of the most successful affirmative auction programs.

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