

THE TELMARC GROUP, NOTES NO 42  
**POLICY AND PLANS, WHO WILL THE  
BROADBAND CZAR BE.**<sup>1</sup>  
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There has been a growing demand for a national broadband policy and even some has asked for a national broadband plan. It is not clear that anyone involved in this process has a consistent definition of what they are talking about. In this White Paper we examine some of the issue related to this question and look at the alternative of just allowing the market to continue. There is even talk about taking a few hundred billion that the current administration is throwing around and apply it to implementing this plan, policy, strategy or whatever the supporters are calling it today.

The general logic used by the promoters of this effort is as follows:

1. The United States is seriously lagging the deployment of true broadband.
2. Broadband is a "right" akin to public education or national healthcare.
3. The current providers are failing in their duty to provide true "broadband" and they are doing so out of some set of malevolent or greedy interests.
4. To this group, "broadband" is defined as something in excess of 100 Mbps per second per user, with a price which is usage independent, provided at the highest reliability, and accessible by anyone, anywhere, in the United States, independent of any underlying economic feasibility.
5. Since this is a "right" to every person in the United States and that the current providers are lacking then it is incumbent upon the Federal Government to develop a Plan, establish Policies, and implement Strategies using tax dollars to affect this overall goal of universal access to unencumbered broadband ad a de minimis cost to the end user.

The above is an attempt to articulate what many of the proponents have been proposing. The elements of any discussing related to broadband seem to revolve around the following issues:

1. **Speed:** The proponents want as fast as possible and they are always benchmarking against other countries. Verizon FIOS has recently said they will provide 100 Mbps local access. The key question here is speed at what point and from where to where. Local access speed may be high but limited speeds connecting to the backbone or in

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the backbone create problems. Bottlenecks can and do appear across Internet networks. This speed as a requirement needs careful definition which none of the proponents has faced in detail.

2. **Accessibility:** Access anywhere I am is the ultimate mantra. If I chose to live on Mt. McKinley then I suppose they want to be certain that anyone who so decides has access. There is total disregard for the marginal cost of such customers, if the Government provides the Government pays.

3. **Price:** The price must be low. Cable modem access has been creeping up again. This and the cable network management problems as evidenced by the ongoing Comcast harassment of their customers have driven the price issue. The proponents seek some form of universal service pricing which most likely is subsidized. They seem to forget that subsidies are taxes and taxes are taken from the pockets of the taxpayers.

4. **Interconnection/Content Control:** This is the Net neutrality. The proponents want no management, control, delimitation, oversight, or whatever on the packets sent.

5. **Capacity:** The proponents want no control over the capacity used. If they want 24 by 7 HDTV down loads, so be it. In that case the capacity must be there and the price should not change.

The proposal is for a centralized Plan for national universal affordable broadband implemented and oversees by the United States Federal Government. In many ways it is akin to the central planning done under the old Soviet regime. It assumes a market failure, and in the minds of many of the proponents of the Plan a deliberate market failure. This is the second step in the Net Neutrality battle.

The question that comes forth as a result of what the proposers of a Government or National Policy, Plan or Strategy are seeking is; what part does the market play here and what part does the Government play? Investors go where they seek a rate of return. This is generally true of large corporations as well as entrepreneurs. Moreover the entrepreneur is even more sensitive since he has less money to expend on ventures where the return is highly uncertain. A large corporation could invest its funds in large ventures under the rubric of it being "strategic" but just for so long.

A simple case study would be the Verizon FIOS build-out. To date they have announced the following:

*""The results of this study underscore that FIOS delivers a home-entertainment experience that the competition can't match," said Marilyn O'Connell, Verizon's chief marketing officer."Only Verizon delivers all-digital TV over the nation's leading all-fiber network, all the way to customers' doors. For customers, this means stunning picture-and-sound quality, more and more HD and video-on-demand choices, and innovative interactive features that go beyond the ordinary."*

*FIOS TV continues to grow throughout the country. In the third quarter of 2008, 233,000 more consumers chose FIOS TV. In areas where the service is available, nearly*

*one out of five customers chose FIOS TV, a penetration rate of 19.7 percent. FIOS TV is now available to more than 8.2 million homes and growing. By the end of 2010, Verizon expects to be offering FIOS services to 18 million homes and businesses."*<sup>2</sup>

This means that Verizon has about 1.6 million customers and a 20% uptake rate on homes passed. Remembering the Cable business in the late 70s and early 80s the 20% take rate was acceptable and grew over the next ten years to over 70% in most markets. Thus given the general hatred for cable companies the Verizon FIOS offerings represent a significant upside.

Verizon's major problem seems to be the slowness of its deployment. They deploy at the rate of about 1 million homes passed per quarter, say 350,000 per month all having a 20% take rate. The problem is that the cost per household is about \$2,500 to \$3,000, so that they are burning about \$100 million per month just in CAPEX. As we had stated in a previous White Paper they can obtain this capital from selling off old copper based central offices, however, with the real estate down-turn this financing strategy has stalled, thus the stall in total system deployment.

Cable companies have been providing broadband as well but as we have also noted in a previous White Paper they are setting up for massive rate increases even though their current rates are near extortionary.

In 2002 we wrote a paper on Municipal Broadband and at that time we felt that towns should have the right to construct their own networks. We continue to feel that way. However as has been observed as towns have done so, they have not produced successful economic entities. Many if not most of the municipal broadband projects have been less than successful. In one of our prior White Papers we showed how we were dealt with in Hanover NH, local politicians playing gods and trying to make they look like heroes at the expense of the residents. We were not willing to play their game, thus to the detriment of the residents.

Thus, in today's world we have three broadband players: cable, telco fiber, and municipal. Cable dominates because their plant is just there. Telco is delayed in build out resulting from the economy. Municipal is a very weak third, showing what all the weaknesses of any government effect plan and deployment are. We now will look at the proposed changes coming from Washington. If implemented the effect on our economy can be chilling.

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<sup>2</sup> See <http://www.marketwatch.com/news/story/Verizons-FIOS-TV-Ranks-Highest/story.aspx?guid=%7B6F668284-AB54-474E-9D58-70B9AC47D41E%7D>

## CURRENT PLANS, POLICIES AND STRATEGIES

The Municipal Broadband advocate and attorney, Jim Baller, has for the past year or so sent out his daily emails with the headlining items called<sup>3</sup> : "NATIONAL BROADBAND STRATEGY CALL TO ACTION". In these newsletters he follows the efforts by many to develop a national broadband plan, policy or strategy. The focus of Beller seems to be to evoke a centralized US Government Plan, and then have industry follow the plan. Baller is one of hundreds if not thousands of self proclaimed promoters of universal broadband, defined somewhat as providing everybody with as high a data access rate as technically achievable at a de minimis price. Baller has been a strong advocate of municipal broadband apparently since this also accounts for his firm's client base.

In one of his recent announcements he introduced the intent by the French Government to unveil its Plan, called "Digital France 2012" which is focused on getting the exiting French entities, with Government help and direction to have a fully digital and broadband France by 2012. This is in many ways a prototypical French act, and one must remember that France, totally unlike the United States, sands its best and brightest into Government, the Ecole Polytechnic being the feeder for the best and brightest in technology. In the US, MIT and Stanford undergraduates would look at employment in the US Government as an admission of total failure in life.

The New America Foundation, a left wing think tank in Washington, is holding session on a National Broadband Strategy in December in the Senate Office Building<sup>4</sup>. The President of the Foundation, Stephen Coll, is well known as the author of the best seller the Deal of the Century, undoubtedly the best book describing the breakup of AT&T, and recently writing excellent books on the Taliban and Ben Laden, and the Chairman is Eric Schmidt, the CEO of Google, and a strong Clinton and Obama supporter. Thus one could assume that this group is both well informed and has a significant political agenda. The intent of the group is to provide the Obama Administration with a Broadband Strategy.

Baller has stated:<sup>5</sup>

*"Realistically, however, no proposed national solution can succeed in the foreseeable future without the enthusiastic participation of all major stakeholders, including the incumbents. That can happen only if all concerned perceive substantial benefits from participating, significant harm from not participating, or a combination of the two. Unfortunately, neither Congress nor the Federal Communications Commission has had much success in forging widespread consensus on a national broadband policy.*

*Congress has been unable to pass new federal telecommunications laws, much less with the vast majorities in both houses that passed the Telecommunications Act of*

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<sup>3</sup> See [http://www.baller.com/national\\_broadband.html](http://www.baller.com/national_broadband.html)

<sup>4</sup> See [http://www.newamerica.net/events/2008/national\\_broadband\\_strategy\\_call\\_action](http://www.newamerica.net/events/2008/national_broadband_strategy_call_action)

<sup>5</sup> See [http://www.baller.com/pdfs/Baller-Lide\\_AmericaNeedsNatIBBPlanNow\\_10-06.pdf](http://www.baller.com/pdfs/Baller-Lide_AmericaNeedsNatIBBPlanNow_10-06.pdf)

1996. The Commission has, if anything, exacerbated America's declining world standing by adopting inadequate definitions of broadband and utilizing misleading data gathering approaches that have retarded our recognition of the urgency of the challenge.<sup>28</sup> The best solution, we submit, is for the President, with the advice and consent of Congress, to appoint an independent, non-partisan, blue-ribbon commission to study, report on, and build consensus on a national broadband policy. The commission should include representatives of the Federal Communications Commission, the states, local governments, the incumbents, other industry groups (particularly the high-tech sector), the educational community, consumer groups, and all other major stakeholders. "

Obama has stated:<sup>6</sup>

**"Deploy Next-Generation Broadband:** Barack Obama believes that America should lead the world in broadband penetration and Internet access. As a country, we have ensured that every American has access to telephone service and electricity, regardless of economic status, and Obama will do likewise for broadband Internet access. Obama and Biden believe we can get true broadband to every community in America through a combination of reform of the Universal Service Fund, better use of the nation's wireless spectrum, promotion of next-generation facilities, technologies and applications, and new tax and loan incentives. "

In a Wall Street Journal article in May of this year it states about Obama:<sup>7</sup>

"He (Obama) laid out his plan during a speech at Google Inc.'s headquarters. He voiced his support for "net neutrality" -- shorthand for preventing Internet service providers, such as cable companies, from selectively slowing traffic from certain sites, such as those that enable video downloads. He called for greater availability of government data online. He proposed appointing a national chief technology officer, who would focus on tech and government-transparency issues.

"If you look at Obama's [tech] wish list, it looks like our wish list. He talks our talk extremely well," said Brian Peters, a director of government relations at the Information Technology Industry Council, an association for several high-tech companies, including Apple Inc., Dell Inc. and Cisco Systems Inc."

In this quote there are three key observations. First is the Google nexus and Schmidt's closeness and support of the campaign, second the fact that support comes from the entrenched players, namely the Industrial State as Galbraith would call them, and third the call for a Technology Czar.

The new Administration is proposing an Auto Czar and there is talk about a Broadband Czar as well. One assumes that the Auto Czar would oversee the US Auto bailout, if such occurred before their bankruptcy, and that the Broadband Czar would control the

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<sup>6</sup> See <http://www.barackobama.com/issues/technology/#modern-communications>

<sup>7</sup> See : [http://online.wsj.com/article/SB121185125362921643.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB121185125362921643.html?mod=googlenews_wsj)

build out of broadband where the Czar determines it is inadequate. We have a Banking Czar now in Treasury and by the time the current Administration and the next Administration get finished we will have eliminated any unemployment by having Czars and their natural staffs and outside support for every sector and segment of the US economy. And these Czars will all be political appointees who naturally have no business experience and in turn have no understanding of the markets, technologies, and will manage to kill any entrepreneurial creative destruction in the classic Schumpeter sense.

McCraw, in his paper on Schumpeter, recounts the following about centralized planning in the sixteenth and seventeenth century<sup>8</sup>:

*"Entrenched interests fought tenaciously against mechanization and the factory system. Unlike the Prussian inventor of a ribbon-weaving loom who was put to death in 1579 by order of the Danzig municipal authority, "entrepreneurs were not necessarily strangled" but "they were not infrequently in danger of their lives". Craft guilds in England invoked medieval methods. They petitioned for regulations outlawing factories and particular mechanical devices."*

McCraw also states:

*"The failure of both classical economists and Karl Marx "to visualize clearly entrepreneurial activity as a distinct function sui generis, a distinction Schumpeter always understood, was a crucial flaw in their analysis of capitalism."*

The entrepreneur, outside of any central plan, policy, strategy, and in fact despite these elements, finds new paths and new ways. The entrepreneur is the catalyst of the creative destruction that is essential to growth and change that Schumpeter talks about. What seems to be missing from Schumpeter's analysis and is a key element of classic Marxism, is that Marx views the dialectic as deterministic and inevitable, one process or system conflicts with an opposing and the result is the inevitable communistic state. In reality, the missing element is Darwinism in a stochastic sense, there is no determinism, at best there is a bounded set of changes wherein the changes are essentially undeterminable since they are generated by random events.

Finally there is the call for using the \$700 billion for broadband. It appears as if this \$700 billion will be used many times over, not just for investing in banks for improving liquidity. The National Governors Association in a letter dated 27 October 2008 sent to Reid and McConnell in the Senate is seeking Federal money for broadband. The TIA, the Telecommunications Industry Association, also sent a letter to Senate and House leaders on 30 October 2008 requesting also incentives for increased broadband implementation. TIA wants these incentives as part of the new economic stimulus package. Every possible entrenched player has their hand out to increase their piece of the Government pie.

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<sup>8</sup> See McCraw, Thomas, Schumpeter's Business Cycles as Business History, Harvard Business School, Business History Review, Vol 80, pp 231-261, 2006.

But what exactly is being asked for in these many requests. Some call it a Plan, some a Policy, some a Strategy, and some just plain want money, the reason being vague. The distilled view is that they want the Government, through some gold plated panel or board, to create a plan, and in turn pronounce a policy and issue a strategy for its implementation, including the creation of some Government Czar and resulting staff to hand out money to entities, directly or through tax incentives, to deploy more broadband. The fear is that we the United State will fall behind if we do not do this now. The approach is akin to what the famous socialist economist John Galbraith promulgated in his 1967 book about the *New Industrial State*.

## GALBRAITH REDUX

Why go back and look at Galbraith? The reason is becoming clear, Galbraith was a classic Keynesian and a Liberal in the best tradition of the mid twentieth century, namely as close to being a socialist as one can be without outright stating as such. What did Galbraith stand for; high taxes, Government central planning and control, strong regulation and oversight by various Government institutions, income redistribution, and being wary of large corporations. What did Galbraith totally ignore, the entrepreneur and the humble engineer in particular. Also one must go back and look at Galbraith since his views were, unlike Schumpeter, which were based on enormous volumes of facts as in his famous Business Cycle book, Galbraith was a polemicist, who shunned data and followed the limelight.

In 1967 John Galbraith published his book, *The New Industrial State*. He states as follows<sup>9</sup>:

*"We come to the second conclusion which is that the enemy of the market is not ideology but the engineer. In the Soviet Union and Soviet type economies prices are extensively managed by the state. Production is not in response to market demand but given by the overall plan. In western economies markets are dominated by great firms. These establish prices and seek to insure a demand for what they have to sell. The enemies of the market are thus to be seen, although rarely in social matters has there been such a case of mistaken identity. It is not socialists. It is elevated technology and the specialization of men and process that this requires and the resulting commitment of time and capital. These make the market work badly when the need is for a greatly enhance reliability, when planning is essential."<sup>10</sup>*

Galbraith also spends a great deal of time opining on the telephone industry. Specifically he states:

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<sup>9</sup> One should look at the book on Galbraith by Richard Parker, the founder of Mother Jones and now on the faculty of Harvard's Kennedy School. Parker clearly is a dedicated disciple of Galbraith and the book is slanted so well leftward that it is often difficult to gather useful tidbits amongst the praise for Galbraith and the left and the outright hostility and distortions of the right. For example p. 635 he outright accuses Gingrich for the McVeigh bombing!

<sup>10</sup> See Galbraith, p. 44.

*""Had local telephone service been provided by one or more companies in each city, town or hamlet; had all these rates been subject to local regulation and influence; had long distance service been supplied by numerous separate companies, only loosely coordinated with the local service; had there been little or no research or technical development anywhere in the system; had the local units been strongly dependent on external authority-municipal governments or local banks-for capital; and had been no planned provision for labor supply or substitute technology, it seems unlikely that telephone communications could have survived in any very useful form. That they flourished, none can doubt, is owing not to a mindless response to a free market but to the subordination of the market at all points to comprehensive planning.""<sup>11</sup>*

Looking back now over forty years one sees that this statement is total nonsense. Yet it did make sense even in 1967 when it was written. In 1967 I was at Bell Labs, and saw firsthand what the planning did. It made it illegal for any entrepreneur to enter the business, it created a massive bureaucracy to inhibit innovation, it promoted the Carterfone prohibition, and it delayed any introduction of digital transmission or switching. Despite the words of the apologists for Bell Labs and the Bell System, what was working in 1967 under the leadership of the Chairman Fred Kappel was a massive bureaucratic entity devoid of any creativity; the phone was black so get used to it.

Galbraith was a strong believer of the large corporation in the sense that only Government could be a countervailing power against it. He saw no purpose of the market and more importantly no purpose of the entrepreneur. He saw that Government was the only entity to protect the people from the evils of the large companies who were composed of brilliant industrialists. He never understood the Schumpeter model of creative destruction and the role of the entrepreneur. One now looks at the promoters of the Broadband Plan and they are Galbraithian. They look solely to the Federal Government and its role as market controller, as a police officer to control the basically evil industrialists. This world view is frequently seen in many of the groups that oppose open international markets; they assume that Government should look out for the worker and control the evil industrialists. In a strange manner this plays directly into the hands of the incumbents. The net result of a Galbraithian world is one where entrepreneurs are totally suppressed as a result of the oppressive Governmental controls.

However one need look no farther back than the 1996 Telecom Act and see that the Act was in effect a Government Policy and Plan. The Government used the rewritten Act to restructure the economy, and as Joseph Stiglitz, the Chairman of the Council of Economic Advisors to President Clinton has noted<sup>12</sup>:

*"The FCC's landmark "interconnection" order was essentially a playbook for implementing the 1996 Telecom Act...In their lawsuits the established phone companies argued that the new rules forced them to give competitors access to their networks at prohibitively low prices...The Baby Bells knew that they had far more*

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<sup>11</sup> See Galbraith *New Industrial State* p. 365.

<sup>12</sup> See Stiglitz, *The Roaring Nineties*, p. 188.

*influence over state regulators....But our most serious misjudgment involved the degree, in each of the markets we were deregulating of the intensity of the drive for domination."*

In effect, Stiglitz describes what a Government Planning process is truly for Telecommunications. The FCC was but one of the implementers, the DC Federal Courts was the ultimate implementer. In effect, by handing the new law over to the FCC to implement, and the FCC being sued on every decision is made by the incumbents, and by the long term animosity between the Federal D District Court and the FCC, the players with the deepest pockets and the best lawyers created policy, and that policy became law. It became a true sustainable competitive barrier benefitting the incumbents.

If this is an example of the law of unintended consequences or just a Brer Rabbit move, since the incumbents were "born in the briar patch" of law suits and regulation, the 1996 Act, Plan, Policy, Strategy, or whatever one wants to call it was a total and complete failure. Finally it was the prime cause of the 2001 Telecom meltdown which resulted in \$2 trillion of losses, this time from shareholders, banks, vendors, and individuals. There was no Government bailout here; it was the Government and its regulatory stupidity that caused this.

Galbraith shows total a gross lack of knowledge of the entrepreneur; he is the antithesis of Schumpeter, who had been a colleague at Harvard. He argues, unlike Schumpeter in Business Cycles, not from data, but with polemic. Planning is a panacea, because Galbraith says it, not because it works, and the free market is just too unruly.

In fact we would not have had the Internet if the Bell System had its way, or even if IBM had its way, one need remember no more that SNA, System Network Architecture, the IBM protocol stacks, and the many attempts by the late great AT&T to develop data protocols, ATM being one of the last.

## OBSERVATIONS AND RECOMMENDATIONS

Based upon the above observations we can make several recommendations.

**First, there really does not seem to be a broadband crisis.** There are providers in many locales, and in some multiple suppliers, and the number is growing continuously. The US is criticized for being far behind in deployment of broadband but one must understand the nature and coverage of the countries that are alleged to outpace the US. Having build broadband in Central and Eastern Europe from 1996 through 2004, the distinct disadvantage of experience lets me say that the difference are more reflective of cultures and locations of populations density. The US is not Korea or Japan, where there is tremendous population density. The most densely populated state in the US is New Jersey, and there are many parts of New Jersey where shooting a cannon ball will not hit any man made structure. Thus we are not Tokyo, we are not Finland, and we are a dispersed country with a growing infrastructure. There may very well be no problem; I suspect that to be the case.

**Second, Government Czars and Plans have never worked.** There have been many such approaches the most famous were those in the Roosevelt administration in the 1930s and early 1940s. Galbraith was part of the price fixing organization which set and controlled prices during World War II until he got the bounce because of are abrasiveness and arrogance. There have been Drug Czars, Inflation Czars, and the like all to no avail. A Czar managing broadband is totally absurd, even a Government Plan or Policy fly in the face of any free markets and any entrepreneurial spirit. The problem is most likely that the Government regulates for the benefit of the incumbent and in so doing has already over burdened any new entrepreneur.

**Third, the entrepreneur has been the lifeblood of the American economy and replacing the entrepreneur with a Government employee is gross insanity.** Planned and regulated economies as we see in classic European Socialist countries, like Germany, are best suited to sustaining the continuing growth of the imbedded long term players such as Siemens and others. The Planned structure is naturally abhorrent to an entrepreneur. Our future is dependent upon that entrepreneur and the effect of creating a Czar and of implementing a Plan would be its death knell.

**Fourth, the Galbraithian constructs of Government and large industrial planning systems fly in the face of value creation via entrepreneurial spirits.** The Galbraith world of the liberal Democrats is one where it is assumed that there is a supreme form of business and market intelligence which resides in some part of the Federal Government and this benevolent hand can control the market by orchestrating the incumbent players through means of Federal Government persuasion using the tools made available to that entity. Two of the tools are direct financing and administrative law making.

The following Table presents a summary of what the Plan Proponents are attempting to obtain under the new Administration and our suggestions for each area.

<i>Plan Proponents</i>	<i>Factor</i>	<i>Recommendation</i>
A minimum of 100 Mbps or more	Speed	Market speeds
Universal access and access upon demand	Accessibility	Based solely upon economic viability with redress to a regulatory body.
Nominal pricing	Price	Market based pricing in presence of strong competition and regulatory cost and rate of return based pricing in a non competitive market. This requires tight controls on the capital base costs as well.
Net Neutrality	Interconnection/Content Control	Net Neutrality
Unlimited at the same price	Capacity	Fixed and variable based pricing.
Not addressed	Quality Control	Reporting and regulatory redress with fines if standards are not met.
Federal Government and the Plan managers	Arbiter	FCC or similar entity.

We now make several more specific and targeted recommendations:

1. **Tax Incentives will not work.** Tax incentives will not make Verizon go faster. They need capital and the capital can be generated from the market, which is dead for the current time, or from selling real estate which is also dormant.

2. **Regulation has benefits in markets where there is a dominant player with market power.** In markets dominated by a single player there is need for regulation. The cable companies charge confiscatory prices and the consumer has no recourse. The FCC under Martin has unregulated everything to the extreme. This must be carefully undone. Regulation has a role in controlling markets where the buyer has no choice and what is being bought is akin to food and water.

3. **Common Carriage Requirements should be reinstated: Common Carriage has substantial value to both the carrier and the user.** It provides transparency and

consistency and also provides clarity as to what is being sold. We strongly recommend that common carriage be reinstated for the broadband providers.

4. **Local regulations and state regulations impeding competition should be eliminated.** The Franchise is a barrier to entry as if the State regulatory authorities. Neither entity has the competence, capability, or resources to effect rapid market expansion. Broadband should be regulated at the Federal level only.

5. **Net Neutrality rules should be instituted:** This we have argued before in various White Papers.

6. **Federal Government Plans and any form of Federal direction or control should be avoided and entrepreneurial activities should be incentivized using tax policy.** We have argued this in detail above.