42. Telecommunications

> ***Congress should***
>
> - allow the free sale and ownership of the broadcast spectrum;
> - repeal 47 U.S.C. sec. 254, which imposes a heavy regulatory tax on consumers and businesses to subsidize universal service;
> - minimize the application of ''unbundling,'' or ''open access,'' rules to new broadband and high-speed data networks; and
> - finally eliminate the Federal Communications Commission.

Decades of experience with telecommunications regulation teach a simple lesson: regulation stifles competition and growth. By contrast, the computer and software industry, largely unfettered by regulation, is one of the most vibrant, competitive, and innovative sectors of the economy. In 1996 Congress tentatively deregulated some aspects of the telecommunications industry. But the work of deregulation is not done.

Recognizing That Regulation Doesn't Work

The rapid pace of change in the telecommunications industry makes regulatory micromanagement harmful for two reasons. First, regulators cannot adapt regulations fast enough to keep up with changes in the industry. Cellular phones were delayed for 10 years by the FCC, at a cost to the economy estimated by National Economic Research Associates at $85 billion. Regulators' attempts to adjust to change create further uncertainty and delay.

Second, regulators are most friendly to familiar technologies and see new competition as an attack on regulatory goals. MCI had been using microwaves to send signals over long distances in competition with AT&T for decades, but competition was held back by the FCC. For years the FCC suppressed cable to protect television broadcasters.

In enacting the Telecommunications Act of 1996, Congress recognized that traditional regulation hurt businesses and consumers. Local and long-distance phone companies were permitted to enter one another's markets and to compete with cable television. Cable operators were freed from rate regulation. The antitrust consent decrees that had brought the business planning of the Bell Companies, AT&T, and GTE under the jurisdiction of the federal courts were terminated. But the act did not go far enough in freeing the industry to manage its own affairs.

While the act did remove some statutory barriers to competition, the FCC retains the authority to impose formidable barriers of its own. The act delegated at least 80 matters to the FCC. A statute that makes it illegal for Company A to compete with Company B is not a good thing. But allowing competition only if Company A spends two years wrestling with regulators and subsidizes Company C is not much better. In particular, the FCC extorts from communications companies trying to merge (with the prior approval of the Department of Justice) agreements to comply with a detailed series of extralegal conditions and rules never contemplated by Congress. The FCC is recreating the regulatory patchwork that Congress attempted to eliminate in the 1996 Telecommunications Act. Such a patchwork is incompatible with free markets and convergence. Regulatory discretion is not the same thing as freedom. Congress should take five steps to move the telecommunications industry toward an efficient market structure.

Privatize the Electromagnetic Spectrum

Once, mainly television and radio broadcasters and a few primitive point-to-point devices used the electromagnetic spectrum. Now, the spectrum is used by satellites sending voice, data, and video communications; cellular phones; personal communications services; pagers; wireless local area networks; and wireless Internet access. The wireless sector of the economy is ready to leap ahead in the 21st century.

But the current regulatory structure for spectrum allocation and assignment holds the industry back. Early in the history of broadcasting, government claimed the electromagnetic broadcast spectrum as public property. The only way to prevent interference, the theory was, is to have the government allocate blocks of spectrum to particular uses and then assign licenses to those frequencies within a certain area to individual users. For example, a certain range of frequencies is set aside for FM radio, and would-be broadcasters apply for licenses to provide FM service to particular regions or cities. In 1993 spectrum licenses began to be distributed by auction, rather than by hearings or lotteries. That reform did not go far enough.

The government, not the marketplace, still decides which "blocks" of spectrum will be used for what services. The slowness of this process costs the economy tens of billions of dollars. A Progress and Freedom Foundation analysis estimates that a six-year delay in bringing personal communication service technology to the market cost the economy $9 billion.

Even if delays could be eliminated (history suggests that they could not), it makes no sense for government to dole out spectrum to some industries and deny it to others. Bureaucrats cannot know better than entrepreneurs how to use spectrum. Consumers should not be forced to pay more for wireless phone service because the government thinks that spectrum that could be used for mobile telephony or wireless Internet access should be used only for advanced television.

Furthermore, the current spectrum allocation system allows licensees to benefit from the use of assigned portions of the spectrum only temporarily. Licenses are not full property rights. As residents of the former Soviet Union learned the hard way, private property rights are central to a thriving economy. Temporary licenses make investment in the industry more risky and less rewarding. David Colton, author of a report prepared for the Reason Foundation, cites estimates that auctioning off full property rights in spectrum could raise from $100 billion to $300 billion in revenues.

Anyone (including foreign investors) should be able to use any part of the spectrum to provide any service, as long as he complies with rules against interference. Rights in spectrum should be full property rights, freely transferable.

Repeal Universal Service Laws

Lawmakers erroneously enshrined an expansive concept of universal service in the Telecommunications Act of 1996 by extending subsidies to cover advanced services for the first time. The universal service provisions are incompatible with competition and should be repealed.

The FCC first formalized a universal service policy in 1970. (It is a myth that the 1934 Telecommunications Act created universal service subsidies.) Revenues from artificially high prices on long-distance phone service subsidized artificially low prices for local phone service. That meant that the FCC could not allow competition—competition would force long-distance prices down. There would be no money left to subsidize local services.

Even when the FCC could hold back competition no longer, business users and intrastate long-distance customers paid more, so local service could cost less. As competition grew between providers of local business phone service, the monies that had been siphoned from business users to residential users began to dry up.

The answer in the Telecommunications Act of 1996 was to make all telecommunications service providers pay something toward the universal service subsidy. But competition will force all service providers to move prices toward costs. No business will be able to charge extra. Businesses with the least healthy balance sheets will be hit the hardest.

It's unfair to ask some telephone customers to pay more so that other customers can have lower bills. Subsidizing service to rural areas is particularly unjust. Many rural telephone customers are wealthy. And people live in rural areas by choice. Some things cost more in urban areas (housing), and some cost more in rural areas (transportation). People should bear the consequences of their decisions to live where they do.

History suggests that competition will work better than subsidies to bring services to the poor and to rural areas. By 1920, after a period of competition between independent telephone companies, rural households in the United States had the *highest*, not the lowest, levels of telephone service. In Ohio, Indiana, Illinois, and Kansas, subscription levels ranged from 60 to 70 percent. More recently, intense competition in the computer industry has illustrated how quickly prices come down when free markets are unleashed. Competition, not subsidies, will make even advanced services accessible to the poor.

Finally, subsidizing "high-cost" areas sets up a self-fulfilling prophecy that investments in rural and mountainous areas will be unprofitable. Satellite communications and innovations like rural switching centers mean that companies *can* provide affordable service to those areas at a profit. But holding prices below market rates means that no one will invest in those innovations or try to compete against the subsidized incumbents.

Universal service subsidies impose a massive tax on telephone consumers. The universal service provisions of the Telecommunications Act of 1996 should be repealed.

Reexamine New Interconnection Regulations

The interconnection obligations imposed on telephone companies by the Telecommunications Act of 1996 were drafted with the best of intentions.

Unfortunately, good intentions do not necessarily make good law. Legislators should begin rolling back interconnection regulations.

Ordinarily, no one gets to use his competitor's facilities to help him compete. A moving company is not obligated to carry other companies' shipments on its own trucks. But that is precisely what interconnection requires. In comparison with the obligations imposed on almost any other industry, interconnection obligations are an extraordinary remedy.

Requiring one company to connect with its competitor violates the first company's property rights and provides a subsidy to the second company. Even if an invasion on property rights can sometimes be justified to prevent monopoly (which was argued in the case of the companies that once formed the old Bell system), lawmakers should move carefully to make the invasion as limited as possible.

Instead of proceeding with caution, the Telecommunications Act of 1996 imposes interconnection obligations broadly on *all* telephone companies, regardless of whether the companies threaten to monopolize anything. Interconnection was assumed to be a cure-all for sick markets, all benefit and no cost, and the drawbacks of interconnection were never explored.

First, the interconnection obligations contained in the act embroil telecommunications companies in an enormously complex and political regulatory apparatus, embodied in the FCC's 700-page interconnection order. Connecting two communications networks requires businesspeople to wrestle with difficult issues of engineering, pricing, and billing. The act makes already uncertain negotiations less likely to proceed smoothly by giving the parties to the negotiations the option of playing political games in the federal or state regulatory arena.

Second, the act gives interconnecting companies almost complete parity with the incumbent service provider. That gives interconnecting companies little incentive to develop their own networks. They can be parasites on the incumbent networks indefinitely. Incumbents are less likely to undertake the expense of building new networks, knowing that those networks will be used by competitors. Too generous interconnection could diminish the chances of facilities-based competition. Expansion of unbundling requirements to new data networks—as the FCC has recently proposed in response to several Bell companies' petitions to build new high-bandwidth backbone and carry interstate data traffic—will be particularly devastating.

Third, mandated interconnection is a form of subsidy; property is taken from one company to be used by another. The more generous the interconnection rights, the greater the subsidy. Expansive interconnection brings into existence a plethora of feeble competitors, all dependent on others' networks. Thus, expansive interconnection will lead to weak competitors who must use the political process to survive.

Because the costs of the interconnection regulatory apparatus probably outweigh the benefits, Congress should consider repealing the interconnection obligations entirely. Congress might also consider second-best alternatives. First, reform the interconnection laws so that companies that never had government help in maintaining monopoly power need not allow their networks to be used by competitors. Second, give companies that benefit from interconnection incentives to build their own networks, and make it harder for parasitic competitors to survive. Start by

- removing the FCC's authority to require unbundling of new data networks, including those built by telephone and cable companies;
- amending the interconnection provisions to sunset on a clear, certain date;
- reforming the law so that companies need not offer complete parity in interconnection agreements; and
- discouraging companies entering interconnection negotiations from manipulating the regulatory process.

Leave New Broadband Networks Free of Open-Access Regulation

In the 1996 Telecommunications Act, Congress authorized the FCC to oversee the creation of something called "Open Video Services" (OVS). OVS was the successor to the FCC's experiments with video dial tone. The idea of OVS was to allow communications companies to build new video delivery networks and to sell the capacity of those networks to other content providers—all under FCC regulation.

What happened next? Did investors rush excitedly to embrace the OVS opportunity? No. There are a few OVS applicants and small ventures around, but for the most part it was a flop. Why? Because business models designed by regulators—especially with rate regulation built in—don't offer nearly as good a return to investors as do models designed by the market, where entrepreneurs can control their own business partners and risks and experiment with their own pricing models.

The mixture of misplaced idealism and self-interest driving the push for open access threatens to turn promising new broadband networks being built by cable and telephone companies into failing OVS systems. Mandatory open-access regimes will result in

- the need for rate regulation, stifling returns on investment;
- increased risk because networks will lose control of who their "partners" are;
- increased risk because networks will lose control of their architecture;
- flight of investment capital to less-regulated ventures;
- creation of a cycle of perpetual dependence on monopoly networks; and
- degradation of network due to loss of investment incentives.

New high-speed networks built by cable companies, telephone companies, or any other company should remain free of this type of regulation. What about monopoly power? The worst way to fight monopoly is to erode incentives to build new networks. Facilities-based competition, including that from wireless or satellite ventures, is the better way.

Take the First Step toward Eliminating the FCC: Eliminate or Cut Back Its Merger Review Authority

Before the Telecommunications Act of 1996 was passed, there was much talk of downsizing or eliminating the FCC. Many leading telecommunications analysts had recognized that the FCC was an extraordinary institutional impediment to free markets in telecommunications. The rapid pace of innovation meant that markets changed too fast for commissions of experts to follow—let alone try to lead. Central planning for the "public interest" died with the Soviet Union. Telecommunications markets should be governed by the same general laws that govern every other industry. As it has in Silicon Valley, true freedom for telecommunications could be expected to bring an explosion of innovation.

Talk of abolishing the FCC has died since the 1996 act was passed. The idea behind the act was that the FCC must continue to grow now, so that competition could be born, and then perhaps the FCC could be phased out or restructured later. The act was not truly deregulatory and thus left the FCC intact to perform an enormous number of tasks. Staffing levels continued to grow. Planned cutbacks were never implemented. The fundamental fallacy here is that the FCC and continued regulation are good for competition. The view that competition will arrive only if the FCC is there to create it is a myth.

The long-term goal must be to *eliminate* the FCC, as the ultimate step in freeing telecommunications.

The logical first step toward eliminating the FCC is to substantially reduce or eliminate the FCC's authority to review mergers. 47 U.S.C.

310(d) stipulates that the transfer of a communications license may go forward only "upon finding by the Commission that the public interest, convenience, and necessity will be served thereby." For mergers, the FCC's inquiry ranges from cursory to exhaustive.

The FCC might review competition issues, which the Department of Justice also considers. The FCC might decide how existing rules apply to a merged entity (say, if one is under price caps and the other is not). As a condition of approving the merger, the FCC might require the merged entity to comply with new rules beyond those required by statute. The level of scrutiny varies widely; the "public interest" varies depending on whether the transfer is the sale of a single license, the merger of two railroad companies, or the merger of two telecommunications companies.

The FCC's merger authority should be eliminated or sharply curtailed, first, to prevent duplication of the DOJ's inquiries. Second, elimination of the FCC's merger review would end the uncertainty of a broader public interest review. Investors cannot predict what the public interest will entail, or which mergers will bring lobbying and delays on a massive scale. Third, the FCC's power to impose conditions on mergers divorces communications governance from congressional intent.

The Telecommunications Act of 1996 freed companies from a patchwork of decrees and special rules. A series of conditioned mergers will recreate the patchwork, vastly complicating statutory issues such as section 271 applications. Another grave problem is that the FCC's discretionary power over mergers (and other matters) often "chills" companies from pressing arguments that would displease the FCC—arguments needed to enrich the public debate.

Reforms short of eliminating the FCC's authority entirely might include

- setting a time limit; under the Hart-Scott-Rodino Act, the DOJ must complete its review of some mergers within 30 to 50 days;
- revising 47 U.S.C. § 310(d) to permit license transfers without review or placing the burden of proof on opponents of the merger (that is, presume that mergers are in the public interest, a natural step away from the rule that that which is not expressly permitted is forbidden); and
- removing 47 U.S.C. § 310(d)'s reference to section 308 to clarify that the FCC should not consider competition issues or create new rules for merging companies; for the time being, the FCC might retain some role in deciding how existing laws apply to the merged entity.

Conclusion

The regulatory strictures on the telecommunications industry were created with good intentions. But this regulatory regime and the litigation that goes along with it have severe consequences: the market works less efficiently; the uncertainty of the regulatory system deters investment; the regulatory system is used to impede and delay competition. Telecommunications entrepreneurs should be freed to develop a communications infrastructure for the new century.

Suggested Readings

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