The Telecommunications Act of 1996

Lawrence Gasman

Future historians of the Clinton administration undoubtedly will regard the passage of the Telecommunications Act of 1996 as one of its greatest achievements. While the Telecommunications Act of 1934 has undergone many important changes, the 1996 revision is the first attempt to reform the *whole* of telecommunications law, not just one specific aspect of it. Of course the act was more than due for an overhaul. In 1934 there was no television, telephones were scarce, and technological wonders such as the World Wide Web had not been dreamed of by even the most speculative science fiction writers.

Efforts to rewrite telecommunications legislation have received strong bipartisan support for many years. The Democrat-controlled 103rd Congress tried to pass a telecommunications bill, but ran out of time discussing the details. The 1996 act passed by the Republican-controlled 104th Congress was surprisingly similar to the earlier bill, and was enthusiastically signed into law February 1996 by President Clinton with the stroke of an electronic pen. Even though the Clinton administration began its tenure by issuing a series of papers emphasizing its enthusiasm and support for information technology, it remained relatively silent during the writing of the telecommunications bill—with one exception. Vice President Gore, who has always been interested in such matters, is said to have exerted considerable influence on the bill through his lifelong friend Reed Hundt, chairman of the Federal Communications Commission (FCC).

Lawrence Gasman is director of telecommunications and technology studies at the Cato Institute.

Hype and Glory

Whatever the actual legislative history of the bill may be, the relatively strong consensus for it has enabled both parties to take credit for its passage and to present it as radical deregulation under which the country will move toward a brave new world of telemedicine, distance learning, and movies-on-demand. According to the hype, such wonders will be created by the competitive forces that have been set free by the new act.

But the truth is that the Telecommunications Act of 1996 is a timid piece of legislation that barely acknowledges the competition that was emerging as the result of new communications technology. And rather than diminishing the government's role in directing the telecommunications industry, the bill has increased it.

Consider, for example, how the act deregulates the cable television industry. This industry had severe price controls placed on it by the Cable Television Consumer Protection and Competition Act of 1992. This act was passed despite President Bush's veto, and was clearly a triumph of politics over economic sense. Price controls, in addition to being ineffective, usually have been applied to commodities considered vital to life.

Presumably, cable television has yet to meet this standard. Furthermore, price controls tend to reduce the quality and quantity of supply. In this regard, it is interesting to note the work of Professor Thomas Hazlett of the University of California at Davis whose research indicates that price controls emanating from the 1992 act have indeed affected the quality of television produced by the cable industry.

It could be argued that cable television enjoyed a quasi-monopolistic status—cable operators held local government franchises. However, in some areas there has long been competition for services that distribute some or all of the same programming available locally through terrestrial microwave technology. Satellite technology has brought similar programming to rural and suburban neighborhoods, and major urban areas have been so well served by terrestrial broadcast channels that cable television has not seemed a worthwhile investment to many consumers.

What has completely changed the competitive environment for cable television, however, is the arrival of direct broadcasting satellites (DBS). Direct broadcasting satellites offer programming to consumers through dishes small enough to be used in urban settings and inexpensive enough to be afforded by most Americans. Moreover, the DBS service DirecTV/USSB typically offers more channels than most cable systems, and higher-quality video and audio—the latter because DBS uses digital technology rather than the analog technology that dominates most cable systems. Currently DirecTV/USSB services about two million subscribers, and other digital DBS services such as Primestar and EchoStar are growing.

The cable television industry therefore is an industry which enjoys substantial competition from new technology and, as it happens, is maturing rapidly. Approximately 70 percent of homes in the United States receive television service from their local television companies and, excluding rural areas where cables will never be installed, there are few new subscribers left for the cable industry.

Given all this, one might expect that price regulation would have been abandoned as part of the "radical" reform ideas underlying the Telecommunications Act of 1996. Instead many areas will not see price controls removed until March 1999. And in a definitional approach that defies common sense, the bill explicitly excludes DBS from consideration as a technology that provides effective competition in cable services.

The Bells Win Their Freedom

Perhaps the most central feature of the 1996 act is the ending of restrictions on the Bell companies with regard to entry in the long-distance, manufacturing, and entertainment-video distribution businesses. This new permission is largely predicated on the emergence of true competition in the local loop; otherwise, the Bells could use monopoly profits to subsidize their other efforts in manufacturing and long-distance services.

How likely is it that competition will develop? The fact of the matter is that there are hundreds of nontelephone companies straining at the bit to get into the telephone companies' traditional business. Already about 10 to 15 percent of cable television systems are using hybrid-fiber coax (HFC) technology that can provide voice services, Internet access, and traditional cable television services. In addition, the FCC recently auctioned off billions of dollars worth of spectrum licenses for personal communications services (PCS). Personal communications services will be used by preexisting and start-up companies to provide voice services using digital microcellular technology at prices that are comparable to those of regular telephone services, and less expensive than analog cellular technology.

The business of local telecommunications has as much to do with state authority as it does with federal, and some states already had opened up local telephone markets to competition prior to the 1996 act. Indeed, states and local authorities have been permitting limited competition for business services since the 1980s when companies such as MFS and Teleport (now TCG) first began building fiber optic loops. Originally such companies only sold capacity on the dark fiber they installed, but they have developed gradually to a point where they now sell a wide range of high-end business telecommunications services.

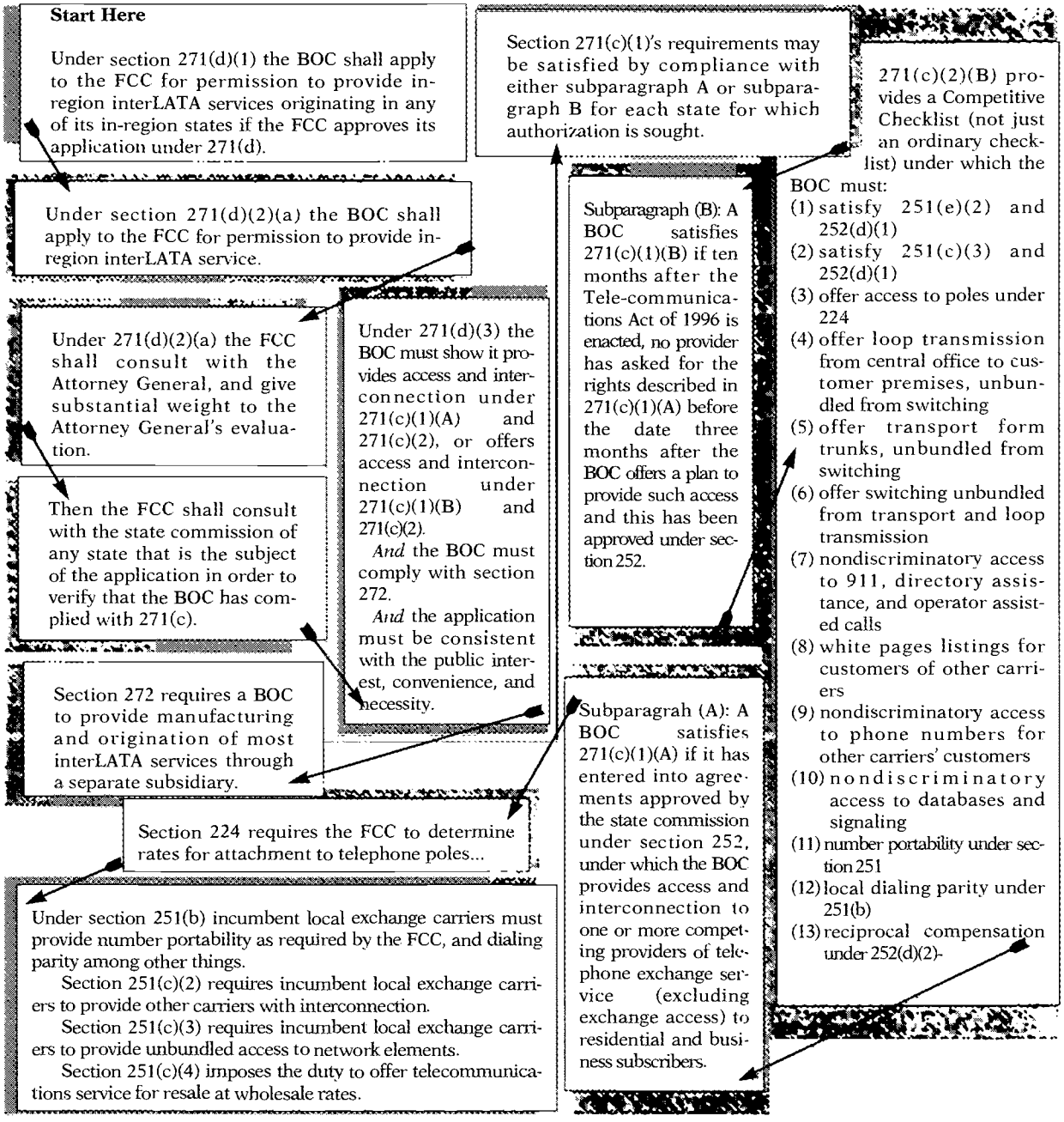
These facts suggest that local telephone competition exists already and is likely to intensify considerably in the next twelve to eighteen months. It is true that given the power the Bells inherited as former-monopolistic government franchises, gentle pressure may be needed to get them to interconnect with emerging local service providers. But the thinking behind the 1996 act is clearly that the Bells are still in some way a danger to the public.

Consider what a Bell must do to enter the long-distance market. For example, in *How Deregulation Works*, my colleague Solveig Bernstein of the Cato Institute shows that under the supposedly deregulatory act of 1996, the Bells must undergo regulatory scrutiny that would embarrass even the most hardened New Dealer (See below).

How Deregulation Works

Solveig Bernstein is assistant director of telecommunications and technology studies at the Cato Institute.

The Telecommunications Act of 1996 is supposed to allow Bell Operating Companies (BOCs) to cast aside the shackles of the antitrust decree that has bound them since the breakup of AT&T in 1984. This flow chart illustrates the operation of just one of the act's forty-eight sections, section 271, that allows a BOC to offer long-distance phone service for calls originating in states within the region that the BOC has traditionally served.



Universal Service

Of course the 1996 act is not really a piece of deregulatory legislation at all. By most accounts it adds more than eighty new items to the FCC's "to do" list. Most importantly, it opens the door to a massive new federal entitlement program in the form of enhanced universal service.

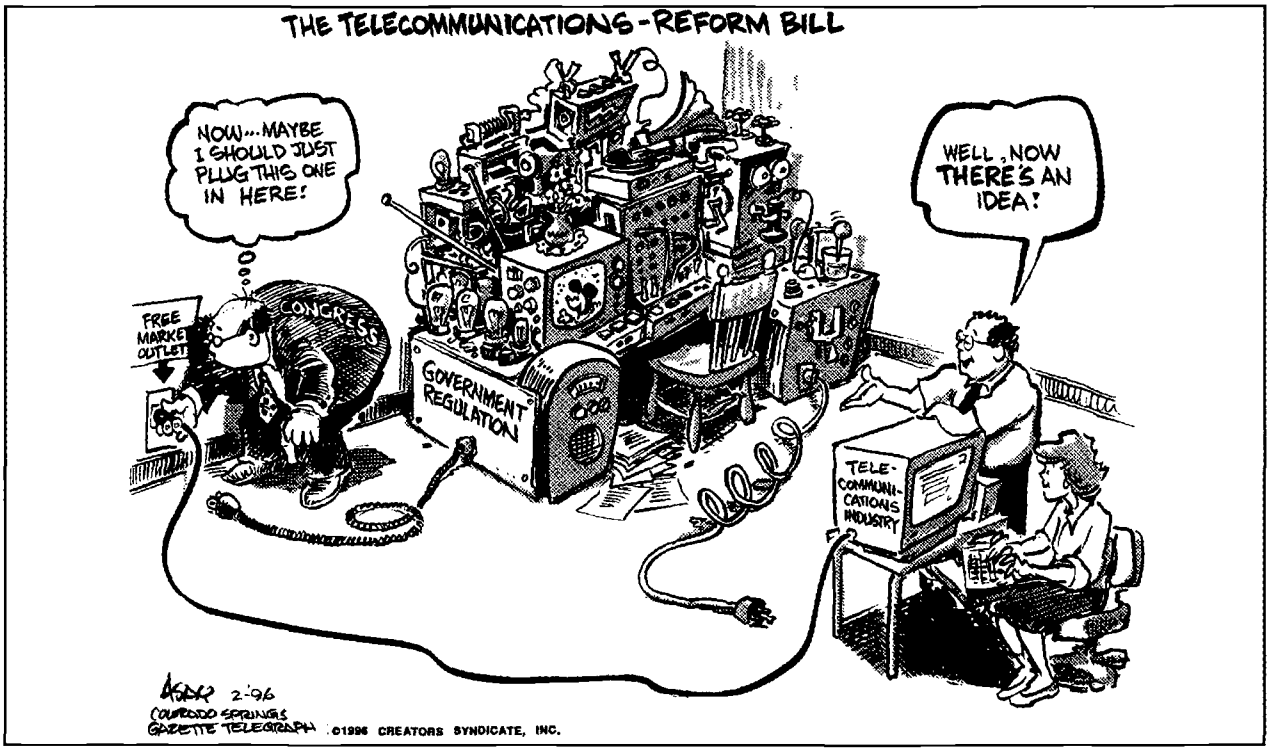
For decades some policymakers believed that the benefits of electronic communications could be brought to the masses *only* by regulation. This view, embodied in the universal service doctrine, has been a central philosophy of U.S. telephone industry regulation at the state and federal levels. The universal service doctrine supports a system of subsidies where some customers subsidize others—thus, rural telephone service has been subsidized by urban telephone service, and local service by long-distance service.

This system of subsidies was established for economic rather than social reasons. There has been widespread support for the view that the penetration of telephones would never have been as high as it is now without a commitment to the universal service doctrine. This is a historically dubious proposition that in recent years has been coupled with the belief that access to advanced information technology will be essential to personal and business success in the future. This has created a mandate for policymakers to extend the universal service doctrine in two ways. First, it is said that universal service should now include more than telephone service, so that the entire "information infrastructure" can benefit from universal service requirements in a manner similar to that in which the telephone service purportedly benefited in earlier years. Secondly, since "info-have nots" will be at a significant disadvantage compared to "info-haves" over the coming decades, the *economic* doctrine of universal service needs to be expanded to a *social* doctrine that uses universal service mechanisms to provide information technology resources to politically favored groups.

These ideas are explicitly contained in the 1996 act which establishes a "joint board" to advise the FCC on what should be included in the new definition of universal service. This board, which will report to the FCC in November 1996, is made up of representatives of the FCC, the state utility commissions, and one "consumer advocate." There are no industry representatives which just about ensures that any definition of universal service that emerges will be very broad. Among the suggestions they have received for inclusion under the new universal service doctrine is the call by Secretary of Education Richard Riley for a commitment by the telephone companies to supply *gratis* advanced telecommunications services to schools and libraries. Meanwhile the FCC's staff itself has discussed subsidized pagers for the homeless—presumably to enable prospective employers to contact these unfortunates—while the Rand Institute is recommending government-subsidized electronic mail. In a similar vein, the National Telecommunications and Information Administration (NTIA), which is part of the Department of Commerce, has urged the FCC to set national telephone subscriber goals for the year 2000.

It has been said that social security is the third rail of U.S. social policy—touch it, and die! By the same token one might argue that the universal service doctrine is the third rail of U.S. telecommunications policy. Certainly there has been a reluctance to discuss a future without universal service. During the debates that preceded passage of the Telecommunications Act of 1996, there was little discussion of the merits of universal service. This is easy to understand politically. Democrats and liberals genuinely believe the universal service doctrine helps the poor and worthy organizations like schools and libraries. For them, the universal service doctrine is especially attractive because it represents an opportunity to pass social welfare legislation as part of a broadly supported law at a time when the era of big government is supposedly over and large scale social welfare programs, such as socialized medicine, are difficult to pass. Meanwhile, Republicans and conservatives who might have been expected to oppose universal service in both its social and economic forms have not done so because universal service provides subsidies for telephone service in rural areas—a strong political base of the right.

But even if one accepts that the universal service doctrine was the key factor that led to the widespread deployment of telephones in the United States, the cost of trying to use a similar process to extend the deployment of so-called advanced services would be enormous. Suppose, for example, that a goal was established to provide subsidized Internet access to all American homes—something that is certainly on the wish list of many cyberspace activists. There are



By permission of Chuck Asay and Creators Syndicate.

approximately 100 million homes in the United States and the current market value of a 28.8 kbps connection to the Internet is about $200 per year, putting the full cost of providing this service at $20 billion. Even a 10 percent subsidy would be valued at $2 billion. And of course subsidized Internet access may be just a small part of the new universal service.

Will the FCC Ever Go Away?

The new universal service provisions in many ways are what is truly radical about the 1996 act. As Professor Milton Mueller of Rutgers University has pointed out; the old version of universal service was a broadly accepted policy, not a legal mandate. By contrast, the new universal service doctrine will be a fundamental part of U.S. communications law, which will thus embody the notion that free markets cannot adequately spread the benefits of information technology without a little help from the FCC. Since the act also requires the FCC to update the definition of universal service as technology develops, the universal service agenda gives the FCC a reason to exist in perpetuity.

In my book *Telecompetition*, I was perhaps the first commentator to suggest that the American public would be the net beneficiary of the abolition of the FCC. Last year a group of Washington think tanks, led by the Progress and Freedom Foundation but not including the Cato Institute, added flesh to the bone of my original proposal and delivered some suggestions as to how the FCC could be phased out and replaced—perhaps with a severely scaled back agency.

It should be clear, however, that the 1996 act makes it extremely unlikely that the FCC will disappear in the immediate, or even the midterm future. In view of this, the best way forward seems to lie in the provisions of the act that allow the FCC to "forbear from applying any regulation or any provision of this act . . . if the commission determines that enforcement of such regulation or provision is not necessary to ensure that charges, practices, classifications, or regulations are just and reasonable [or] is not necessary for the protection of consumers."

This approach has shown some promise in the past. In the 1980s, under Chairman Mark Fowler, the FCC was highly restrained from using its power which helped make the 1980s a decade of growth for the electronic communications business. Later-Chairman Alfred Sikes used his position at the FCC to promote an idea that he had while at the Department of Commerce—video

dial tone. Video dial tone was essentially a form of regulatory forbearance since it provided a way around the rigorous, antiquated restrictions placed on telephone company activity in the video entertainment market.

Video dial tone ultimately failed commercially, but it might have done better if the FCC had further loosened the rules that bound the large telephone companies. Unfortunately, a further evolution of the rules would have required congressional action, and considering the environment of the time—Congress was in the process of reregulating the cable industry—this was very unlikely. Nevertheless, the video dial tone concept did produce some useful experiments in interactive television whose results will be carried over into exciting innovations in telephone and cable companies.

Regulatory forbearance therefore seems to be a winner. It is also a bargain. Not applying rules costs nothing, and scouting for regulations and provisions of the communications acts that need not be applied should provide full-time work for no more than a few FCC staffers. Certainly, no extra staffing should be required, and it seems likely that an FCC faced with budget restrictions will be more likely to forbear and less likely to interfere in the workings of the electronic communications marketplace. For this and many other reasons Congress should resist temptation to increase the FCC's budgets and, if possible, should consider reducing these budgets as part of a sunshine provision for the FCC as a whole.

In the meantime, there have been some excellent suggestions about where in particular the FCC might use its powers to forbear. Wayne Leighton of Citizens for a Sound Economy has proposed the following nine areas in which forbearance could lead to positive results.

- The use of pure price caps for markets in which the FCC must continue to regulate prices.
- No price regulation on the Bell companies in long-distance markets.
- Elimination of all required rate filings for long-distance companies.
- Elimination of separate regulatory accounting rules and use of the Federal Accounting Standards Board requirements.
- Elimination of all quarterly and semiannual filing requirements.
- Reduction of the total number of reports required.
- Removal of FCC approval requirements for new construction as imposed under the 1934 act.
- Self-certification for electronic equipment manufacturers with regard to the radio frequency interference characteristics of their products.
- Elimination of unnecessary licensing rules for broadcasters.

All of these are sensible steps that are likely to appeal to the FCC under Chairman Reed Hundt. Indeed, the idea of detariffing the long-distance companies has already been suggested in the FCC and may occur before the end of 1996.

However, this is a long way from the kind of deregulation that Congress mandated for airlines or trucking in the past. And as we have noted, the deregulatory aspects of the 1996 act must be balanced against the enhanced universal service that it mandates.

With much of the responsibility for deregulation now shouldered by an FCC that will not die, the future of telecommunications deregulation in the United States depends on the ideological complexion of the FCC commissioners, and perhaps the FCC staff. In this sense the FCC has become a little like the Supreme Court with the 1996 act playing the role of the Constitution. The analogy does not hold up completely—one can lobby the FCC.

But like the Supreme Court it seems reasonable to expect mixed decisions from the FCC. The FCC currently seems likely to endorse an expansive version of universal service and it may also be willing to play with First Amendment rights of broadcasters in calls for more children's programming. This is just one step away from calls by activists that certain programming should be carried by cable systems "in the public interest." On the other hand, the current FCC has shown some inclination to forbear on administrative matters and Chairman Hundt is on record as doubting the wisdom of government-mandated advanced television standards.

This paper has dealt only with the core regulatory issues raised by the 1996 act. In the future the FCC may have to deal with an entirely new slate of issues that have not been discussed here. Prominent among these are decency issues for on-line services, and the Internet and radio spectrum allocation issues. These areas are currently being dealt with outside of the FCC. Since the Communications Decency Act that formed part of the 1996 act was judged unconstitutional, the on-line decency issue is likely to move through

the Supreme Court before it comes under the FCC's control. Congress continues to debate the spectrum issue and is unlikely to resolve it until 1997.

Until Congress decides to abolish the FCC, the FCC will be governed either by a philosophy of regulatory expansionism or a philosophy of regulatory forbearance. The choice will be that of the five FCC commissioners, especially those selected under the next administration.

Selected Readings

Gasman, Lawrence D. *Telecompetition: The Free Market Road to the Information Highway*. Washington, D.C.: Cato Institute, 1994.

Leighton, Wayne. "A Nine Point Checklist for FCC Reform." CSE Foundation Issues Analysis, July 1996.

Mueller, Milton L. *Universal Service: Interconnection, Competition and Monopoly in the Making of American Telecommunications*. Cambridge, Mass.: MIT Press, 1996.