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A POLICY MAKER'S GUIDE TO DEREGULATING TELECOMMUNICATIONS PART 4: WHY TELECOMMUNICATIONS PROTECTIONISM SHOULD BE ENDED

By Adam D. Thierer

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INTRODUCTION

Much of the current debate over telecommunications deregulation is focused on removing barriers to competition within the United States that are limiting the growth of this industry. This country, however, also has constructed barriers to competition from foreign companies that are hurting American consumers, discouraging the introduction of more innovative goods into the U.S. market, and hampering the growth of a more competitive marketplace. As Congress considers telecom legislation, it should remove these restrictions and resist imposing new ones.

The benefits to the United States of an open trading system are enormous and well-documented. From 1986 to 1992 alone, world exports nearly doubled from $1,984 billion to $3,697 billion.[1] Because of more open world borders, U.S. exports as a percentage of gross domestic product jumped from 9 percent in 1960 to 21 percent in 1990,[2] resulting in more jobs, increased consumer options, and lower prices for goods and services. Despite these benefits, the federal government continues to protect a handful of industries from foreign investment, including the telecommunications sector.

For over six decades, the Federal Communications Commission has shielded American telecommunications from competition through strict ownership ceilings on overall foreign investment. Although similar restrictions do not apply to other high-tech industries such as computers or electronics, investment in the telecommunications sector generally is capped at 25 percent of a U.S. company. Despite the rapid evolution of the industry, these rules have remained intact for over six decades.

Changing Justification, Same Results. The justification for the protection of this industry has changed over time. Protectionist measures were imposed in the early decades of this century primarily because of national security concerns. Legislators feared that a potential foreign enemy could gain control of telephone and telegraph networks, severing important communications links during wartime. Now, with the Cold War over and the threat of a foreign takeover of America's telecommunications system less credible,[3] policy makers have found a new justification for protectionist barriers—competitiveness.

1 *Direction of Trade Statistics Yearbook: 1993* (Washington, D.C.: International Monetary Fund, 1993), p. 3.
2 Council of Economic Advisers, *Economic Report to the President* (Washington, D.C.: U.S. Government Printing Office, January 1993), p. 349.
3 Although Communist Bloc countries posed a threat to America's domestic security during the Cold War, it is

Legislators and regulators now reason that America's restrictions must remain as a crowbar to help pry open foreign markets. They argue that if America does not maintain protectionist barriers to foreign investment, and even erect new ones, the U.S. communications sector will suffer at the hands of protected foreign firms. Using this same logic, it might be assumed that other high-tech industries have suffered from foreign imports and investment. Yet the computer industry, for example, currently is not sheltered from foreign interaction, and American firms remain the global leaders in this field. Protectionism has served America no better in telecommunications than it has in any other field. In fact, protecting telecommunications has several adverse effects:

✗ **For the consumer, prices are higher and choices are fewer.** Telecommunications protectionism benefits a small handful of firms by shifting enormous costs to consumers. Free from foreign competition, these firms can charge higher prices for fewer and less innovative services.

✗ **American firms are less competitive.** By learning to depend on protectionism as crutch, American innovation has suffered and rivalry has been discouraged. Protectionist laws encourage domestic firms to use regulations to restrict potential competition instead of innovating to meet such rivalry head-on.

✗ **Jobs are lost.** Protectionism can save a job only by destroying several others, because it raises the cost of protecting jobs to excessive levels. In addition, by restricting foreign investment in the U.S., these barriers have cut off a lucrative flow of capital which could be used to create more jobs.

✗ **Foreign borders are not opened.** Restricting access to the American market has failed to encourage the opening of foreign telecom markets. Instead, legislators should look at the history of other markets where free entry has been allowed. In most cases, this openness has reaped its own reward by spurring rivalry and innovation while lowering consumer prices for an increased selection of goods and services. This is more likely to encourage the opening of foreign markets.

✗ **Speech is restricted, which could be found unconstitutional.** Scholars argue that these protectionist barriers could be found unconstitutional under the First Amendment since they restrict what carriers can say and what consumers can hear. Future court decisions might strike down these laws if Congress fails to act first.

To remedy this situation, Congress must take three important steps:

➊ **Repeal all existing protectionist laws.** Congress should open up the telecommunications market immediately to competition by repealing all remaining barriers. Once communications freedom is established, American consumers and businesses will reap the same benefits free trade brings in other fields. Making this liberalization conditional upon equal access to foreign markets will not help to open those markets; it will only discourage beneficial foreign investment and expanded consumer choice.

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unlikely any of them would have had the ability actually to take over the telephone system or even control a portion of it. The technological capabilities of these countries were so inferior that investments in American firms undoubtedly would have met with failure. In any event, such a hypothetical threat should not have been used to restrict investment by firms from ally countries such as Britain and France. Instead of restricting all foreign investment, the Department of Defense simply could have prohibited threatening investment by perceived enemies. Other investments simply could have been monitored for threatening foreign influence. Such a policy would have invited beneficial foreign investment while discouraging undesirable advances by hostile countries.

❷ **Do not mandate protectionist barriers on newly liberalized telecom firms.** Unfortunately, policy makers not only refuse to scrap old protectionist laws, but recently have considered erecting new barriers in the name of saving jobs and opening foreign markets. Specifically, last year's failed legislative bills included domestic content provisions which would have restricted American firms from manufacturing overseas or purchasing foreign components to manufacture goods. Yet protectionism saves a job only by destroying several others, since the costs associated with protection are so high. In addition, by building new barriers to the American market, legislators will encourage foreign nations to close their markets just as they are beginning the liberalization process.

❸ **Work through GATT mechanisms to ensure further liberalization of foreign telecommunications markets.** The telecommunications revolution will not be complete until all countries have liberalized their communications sector. The greatest hope for the successful fulfillment of this goal is the General Agreement on Tariffs and Trade (GATT), which can accomplish the task without threat of a retaliatory trade war. Congress should instruct trade negotiators to work through the multilateral free trading system to continue the liberalization of this important market across the globe.

By taking these steps, Congress will ensure that America's telecommunications industry remains the pre-eminent global leader in the production of communications goods and services while guaranteeing that consumers will reap the rich rewards of lower prices and increased service and product options.

310(B) AND THE TOOLS OF TELECOMMUNICATIONS PROTECTIONISM

The United States has implemented numerous laws over the past six decades to protect the telecommunications industry from foreign interaction. A recent publication by the Office of Technology Assessment[4] outlined the six main protectionist restrictions on the U.S. telecommunications market:

- Section 310(b) of the Communications Act of 1934;
- The Submarine Cable Landing Act of 1921;
- The Telegraph Act of 1900;
- The Communications Satellite Act of 1962;
- An FCC decision, *International Competitive Carrier* (102 FCC 2d 812), as modified in 1992 in *Regulation of International Common Carrier Services* (CC Docket No. 91-360, FCC 92-463);
- The 1988 Exon-Florio Amendment to the Defense Production Act of 1950.

4 Office of Technology Assessment, *U.S. Telecommunications Services in European Markets* (Washington, D.C.: Government Printing Office, 1993), pp. 4-5.

Although all these laws can be used to restrict investment in the American marketplace, Section 310(b) is the most important protectionist barrier in America. Specifically, Section 310(b) makes it illegal for a foreign investor:

- ✔ **To own fully** a radio license or a common carrier (telephone company) license;
- ✔ **To own more than 20 percent** of the shares of a company holding a radio license;
- ✔ **To own more than 25 percent** of the shares of a company holding a common carrier license;
- ✔ **To sit on the board or become an officer** of either a radio licensee or common carrier licensee.

For six decades, the FCC has used this provision to deny foreigners access to the American communications market. But, as noted by J. Gregory Sidak, resident scholar at the American Enterprise Institute, Section 310(b) has been misinterpreted by federal regulators: "[T]he FCC has misinterpreted this provision to be an absolute bar against more than 25% ownership—unless the foreign investor can prove that a large stake wouldn't harm the public interest, in which case a waiver can be issued. No court has addressed this amazing misreading of the statute. But if one does, it should not (as often happens in administrative law) defer to the agency's interpretation."[5]

Sidak correctly points out that Congress never intended Section 310(b) to be a ceiling on foreign investment. Rather, it was supposed to be a trigger for careful FCC scrutiny of potentially harmful effects once foreign ownership reached the 25 percent threshold. It is unclear when the agency began treating this threshold as an absolute limitation on foreign investment, but it has become an accepted truth that this is its proper role.

Regardless of this gross misreading, federal regulators continue to use the law as an absolute ceiling on foreign investment. For example, Section 310(b) was used in 1986 to deny license renewal to 13 television stations which were partially owned by a Mexican media firm. Commenting on why renewal was denied, John H. Conlin of the FCC noted that "the groundwork has been laid for an enterprise that would be receptive to, and indeed dependent on, influence and direction from non-U.S. citizens and foreign corporations under their control."[6] Despite this sinister-sounding rhetoric, no substantive explanation was given as to how investments by the Mexican firm would harm American interests or consumer welfare.

Currently, Section 310(b) is being used against foreign firms whose markets supposedly are not as open as America's. For example, the U.S. has considered delaying $4.2 billion investment in Sprint Corp. by France Telecom and Deutsche Bundespost Telekom since their markets are less open than the U.S.[7] Despite the fact Sprint could lose the chance to enter both those markets immediately, the deal could be held up by federal regulators. Thus, Section 310(b) is used primarily as a retaliatory weapon, even though that clearly was not its legislative intent.

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5 J. Gregory Sidak, "Don't Stifle Global Merger Mania," *The Wall Street Journal*, July 6, 1994, p. A18.

6 Quoted in "FCC Official Orders Denial of 13 TV Licenses," *The Wall Street Journal*, January 9, 1986. Also see Penny Pagano, "KMEX, 12 Other TV Stations Lose Licenses," *The Los Angeles Times*, January 9, 1986, p. 1; "FCC Contests TV Stations' Licenses," *Atlanta Journal and Constitution*, January 9, 1986, p. A22.

7 See Catherine Arnst and Gail Edmondson, "The Global Free-For-All: As Huge New Telecom Markets Open, Carriers Aim to Carve Up the World," *Business Week*, September 26, 1994, p. 121.

Other Laws That Protect the Telecommunications Sector

The Submarine Cable Landing Act of 1921. The Submarine Cable Landing Act requires that foreign firms wishing to land cables on American shores first seek permission from the FCC. As the OTA notes, "One of the purposes of this act was to give the United States leverage in getting U.S. cables landed in other countries."[8] Hence, the law is yet another retaliatory tool the government uses instead of working toward multilateral liberalization of world telecom markets, although it is not enforced as vigorously as 310(b).

The Telegraph Act of 1900. This law prohibits a foreign carrier from landing telegraph lines or cables in Alaska. It was promulgated at the turn of the century and is now largely irrelevant.

The Communications Satellite Act of 1962. The Communications Satellite Act created a private satellite corporation, COMSAT, and gave it sole authority to participate in INTELSAT (an international communications satellite consortium that provides global satellite connections for a broad range of wireless services) and INMARSAT (a similar organization that provides global maritime satellite communication services). Since COMSAT is the exclusive provider of such services to America through these organizations, foreign carriers have limited access to the American market.

***International Competitive Carrier* (102 FCC and 812), as modified in 1992 in *Regulation of International Common Carrier Services* (CC Docket No. 91-360, FCC 92-463).** This 1992 FCC regulatory decision requires that "foreign-owned" U.S. firms be considered a "dominant carrier" of communications services. Dominant carriers face stricter regulations than other carriers in that they must file "tariffs"(pricing plans and schedules) with the FCC before offering service to the public.

Remarkably, this decision arbitrarily defines a "foreign-owned" firm as "any U.S. carrier that is over 15 percent directly or indirectly owned by a foreign telecommunications entity or on whose board of directors a representative of a foreign telecommunications entity sits."[9] This discourages foreign investment, since such a firm would face more rigid regulatory requirements and delays for price and service approval. As the OTA report notes, "Some foreign telecommunications operators complain that the FCC has delayed action on applications for over a year."[10]

The Exon-Florio Amendment to the Defense Production Act of 1950. The Exon-Florio Amendment, implemented in 1988 over President Ronald Reagan's veto, allows the President to block any proposed alliance or takeover involving an American company that supposedly could threaten national security. In reality, the provision is a tool to restrict foreign investments that legislators dislike.[11] Although the amendment has not yet been used to prevent foreign investment in the

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8 Office of Technology Assessment, *op. cit.*, p. 4.

9 *Regulation of International Common Carrier Services* (CC Docket No. 91-360, FCC 92-463), p. 7342.

10 Office of Technology Assessment, *op. cit.*, p. 5.

11 See Susan W. Liebeler and William H. Lash III, "Exon-Florio: Harbinger of Economic Nationalism," *Regulation*, Winter 1993, pp. 44-51. Liebeler and Lash note, "Exon-Florio appears destined to serve as a harbinger of economic nationalism; it is a convenient carrier for various schemes designed to widen the criteria for screening foreign acquisitions. Absent executive restraint and in an atmosphere of industrial policy, Exon-Florio could be transformed from a shield into a strategic weapon in the hands of competitors, target managers, special interests, and the lawyers and lobbyists who serve them."

U.S. telecommunications industry, it could be if other protectionist barriers were removed and this provision remained.

THE ADVERSE EFFECTS OF TELECOM PROTECTIONISM

Although no comprehensive study has been conducted to document the effects of these protectionist barriers, anecdotal evidence and studies of other protected industries help illustrate the damaging impact of these laws on the U.S. economy, the telecommunications industry, and consumers. The evidence shows that telecom protectionism:

✗ **Results in higher consumer prices and less consumer choice.** The most obvious drawback to telecommunications protectionism is that it directly restricts the ability of foreign companies to offer American consumers additional communications, information, and entertainment choices. This limiting of competition in the domestic market in turn drives up the price of the services offered to consumers. In addition, as with any protected industry, the quality of these services declines.

If protectionist barriers were removed, this situation would be reversed. For example, investments such as British Telecommunications' $4.3 billion purchase of 20 percent of MCI Communications Corp. would proliferate, providing American firms with added capital resources and expertise to deliver more advanced, low-cost services to consumers.

In the U.K., where no foreign investment barriers exist, American firms such as NYNEX, US West, and Tele-Communications, Inc. (TCI) have been doing just that. NYNEX is the second largest cable operator in the U.K., with over $540 million invested already and $3 billion more planned by 1998.[12] TeleWest, a joint venture between NYNEX and TCI, is the largest provider of combined cable-television and telephone services in the world. Because, unlike the U.S., the U.K. has no restrictions on the delivery of telephone service through cable systems, TeleWest is able to provide telephone service over 182,000 lines as well as cable service to 252,000 subscribers.[13] As Erik R. Olbeter and Lawrence

WHO IS FREER?

Government Restrictions on...	U.S.	United Kingdom
Foreigners Holding a Radio or Common Carrier License	*Prohibited*	*No restrictions*
Partial Ownership in a Domestic Firm that Owns a Radio License	20%	*No restrictions*
Partial Ownership of a Domestic Telephone "Common Carrier"	25%	*No restrictions*
Propes Foreign Acquisitions that Supposedly Pose a "National Security" Threat	*Potential nullification*[1]	*No restrictions*

Note: Although there are no government barriers to common carrier investment, the Articles of Association of Britain's two leading telephone service providers, British Telecommunications and Cable & Wireless, both contain 15% foreign ownership restrictions and the requirement that the Chairman of the company be a British citizen.
1. Via Exon-Florio Amendment to the Defense Production Act of 1950. Since the Amendment's enactment in 1988, no telecommunications mergers or alliances have been nullified.
Source: "U.S. and U.K. Telecom Regulations Compared," Transnational Data and Communications Report, Transnational Data Reporting Services, Inc., 1993, p. 44-54.

12 Julia Flynn, "The Sparring Match Being Fought in Britain," *Business Week*, September 26, 1994, p. 124.
13 "TeleWest: Combined Cable-TV," US West *Investors Report*, September 1994, p. 2.

Chimerine of the Economic Strategy Institute note, "Local service in the United Kingdom has been completely liberalized and currently more than 20 North American firms (mostly U.S. firms) operate as both cable television and local telephony providers."[14]

This surge in foreign investment has helped the U.K. become the low-cost service leader in Europe.[15] Likewise, New Zealand recently abolished nearly all telecommunications regulations, allowing Ameritech, Bell Atlantic, and Bell South all to make major investments in the market.[16]

✗ **Encourages firms to rely on protectionism as a strategic business tool.** Many American firms have become dependent upon Section 310(b) as a shield against foreign competition. Instead of innovating to meet this competition head-on, many firms prefer to use protectionist laws to keep new products and services from being offered to consumers in the first place.

For example, several firms have tried to invoke Section 310(b) against the Fox television network since its owner, Rupert Murdoch, was once a foreign resident. Even though Mr. Murdoch eventually became an American citizen (in part to avoid such discriminatory restrictions), NBC recently asked the FCC to investigate Fox's expansionary efforts to see if they are being fueled by money from foreign sources.[17] NBC's intent is clear—it is easier to use laws to restrict competition than it is to innovate and face such challenges in a competitive marketplace. Unfortunately, this means consumers lose the opportunity to choose from new entertainment and information sources.

✗ **Makes American firms less competitive in general.** Contrary to popular belief, protectionism does not make American firms more competitive by shielding them from foreign competition. In fact, the opposite is the case. Increased openness to foreign competition makes the American economy more productive than other economies.

Harvard Business School Professor Michael Porter documented this phenomenon in his acclaimed book *The Competitive Advantage of Nations*. Porter notes that "Companies and economies flourish because of pressures, challenges, and new opportunities, not a docile environment or outside 'help' that eliminates the need to improve."[18] Management consultant Peter F. Drucker also argues that "The evidence of the past four decades does show convincingly that participation in the world economy has become the controlling factor in the domestic economic performance of developed countries. . . . [P]rotection does not protect. In fact, the evidence shows quite clearly that protection hastens decline. The counter-argument has always been that it protects jobs, but it does not even do that."[19]

As *The Economist* also recently noted, "The great renewing forces in American business have been its ability to create small firms and the country's openness not only to competition but also to

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14 Erik R. Olbeter and Lawrence Chimerine, *Crossed Wires: How Foreign Regulations and U.S. Policies Are Holding Back the U.S. Telecommunications Services Industry* (Washington, D.C.: Economic Strategy Institute, December 1994), p. 49.

15 See Andrew Adonis, "UK Telecoms 'Less Expensive'," *The Financial Times*, May 13, 1994, p. 9.

16 John Crook, *Preparing for Privatization: The Story of Telecom New Zealand*, Presentation at the Symposium on Telecommunications Privatization Experience Held in Bangkok, December 8-9, 1993.

17 See Adam D. Thierer, "NBC, Fox, and Witless Regulations," *The Washington Times*, October 25, 1994, p. A17; Bill Carter, "Fox-NBC Fight May Reach Congress," *The New York Times*, December 5, 1994, p. D7.

18 Michael E. Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990), p. 735.

19 Peter F. Drucker, "Trade Lessons From the World Economy," *Foreign Affairs*, Volume 73, Number 1 (January/February 1994), pp. 105, 108. Drucker notes that those sectors of the American agricultural industry that are least protected—soybeans, fruit, beef, and poultry—are the most competitive in world markets. Products such as corn, wheat, and cotton, which receive more protection and subsidization, are much less competitive internationally.

people from overseas."[20] These sentiments are reinforced by recent empirical evidence from a study by the McKenzie Global Institute, an international economic research organization, that in nine major manufacturing industries, America still is more competitive than Japanese and German rivals.[21] The study also found that the key determinant of this superior performance lies in America's openness to foreign direct investment and competition.

The lesson of the past four decades for the telecommunications industry is clear. Just as openness to foreign competition has made other sectors of the U.S. economy more productive and competitive, it will strengthen the position of American telecommunications firms in global markets. Continued protectionism will encourage less innovation from American firms, making it less likely they can remain technological leaders in this field.[22]

✗ **Restricts job-creating opportunities.** Trade protectionism can save a job only by destroying several others. When a country imposes trade and investment barriers to protect a certain class of workers, it usually raises prices on goods and services well above their natural level. Therefore, though a few jobs in the protected industry may be saved, many more job opportunities are lost because of the costs associated with the trade barriers.

For example, a recent study by the International Trade Commission (ITC) found that protecting the U.S. sugar industry from foreign competition raised aggregate sugar prices by $657 million annually. The ITC determined that 2,040 sugar industry jobs were saved through trade barriers at a cost of $322,059 per job. Given that the annual average wage for an industry employee is $27,716, this means roughly $294,343 is being wasted per job saved.[23] This is money that could be used to employ several more workers in many different industries. Hence, telecommunications protectionism is costing Americans jobs.

✗ **Discourages liberalization of foreign markets.** Many legislators believe that continued or even expanded protectionism can be used effectively in negotiations to open up foreign telecom markets. But by fighting fire with fire, everyone gets burned. In addition to the undesirable effects listed above, such protectionism does not help to open foreign markets. In fact, it may do the exact opposite. As U.S. Trade Representative Mickey Kantor pointed out last year in a letter to Congress concerning new protectionist requirements then under consideration, such measures would violate both the General Agreement on Tariffs and Trade and the North American Free Trade Agreement and also would "seriously jeopardize ongoing telecommunications negotiations with the European Union."[24]

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20 "Ready to Take on The World," *The Economist*, January 15, 1994, p. 66.

21 McKenzie Global Institute, *Manufacturing Productivity* (Washington, D.C.: McKinsey & Company, Inc., October 1993).

22 In addition, if greater competitive pressures were put on domestic producers by foreign competitors, it would likely encourage more rapid liberalization and deregulation within this market, just as it has in the European market. As a 1993 International Trade Administration Market Research Report noted, "Mention must be made of the influence that U.S. service and equipment providers have had on liberalization...in the European Union. Participation in the European telecom market by AT&T, MCI, Sprint, and the Baby Bells, has brought competitive pressures to the European marketplace that have led to and encouraged its increased liberalization. While market share may still be limited...their impact has nonetheless been significant, both as contributors to legislative initiative and as competitors to European service and equipment providers." See "European Community—Telecommunications Liberalization," International Trade Administration *Market Research Reports*, IT Market 111096421, December 20, 1993.

23 U.S. International Trade Commission, Investigation No. 332-325 (November 1993) and Heritage Foundation calculations.

24 Michael Kantor, letter to Representatives John D. Dingell and Edward J. Markey, February 28, 1994.

The best way to encourage foreign governments to open markets is to liberalize the American domestic market immediately. This will spur market growth, product innovation, and job creation by making the U.S. a more attractive investment environment. Such openness also will place American firms in the forefront of global competition as they grow stronger through intense market rivalry, forcing foreign nations to eliminate their remaining investment barriers if they hope to modernize their communications sectors.

✗ **Restricts free speech and probably is unconstitutional.** Although no court has heard a case concerning the constitutionality of Section 310(b), it is quite likely a case could be built on First Amendment grounds. Notes Sidak, Section 310(b), "runs into First Amendment problems, since it limits the rights of foreigners to express their views and limits the right of Americans to hear foreigners' views. This seems to be at odds with the FCC's own policies in other areas, which are designed to promote 'diversity of ownership' and 'diversity of expression' through the electronic media. If 'diversity' is an important government objective...then why are the diverse views of foreigners not welcome?"[25]

Telecommunications protectionism has these drawbacks precisely because all protectionism has these drawbacks. Policy makers must understand that what sounds good in theory, has failed in practice. Continuing to use such protectionist measures only threatens the competitiveness of American firms while forcing consumers to bear the burden in the form of higher prices and restricted choice.

RECOMMENDATIONS

Congress should heed the lessons of protectionism's failures and take concrete steps during the upcoming debate over telecom deregulation to remove domestic and international barriers. To ensure that free trade in telecommunications services and products becomes a reality, Congress should:

❶ **Repeal all existing protectionist laws without exception.** Congress should open up the telecommunications market to foreign competition immediately by repealing these protectionist measures.[26] In the House, Representative Mike Oxley (R-OH) has introduced H.R. 514, which would begin this process by repealing Section 310(b) unconditionally. In the Senate, a comprehensive telecommunications deregulation "discussion draft" released by Republicans on the Commerce Committee also calls for the abolition of 310(b), but only on a reciprocal basis. Reciprocity clauses would allow investment in the American marketplace only by firms whose home governments provide equal access to American firms. While this sounds good, it is disastrous in practice. Reciprocity clauses encourage bilateral trade wars that rarely achieve their intended goals. In addition, by restricting beneficial foreign investment from such countries, Congress would be denying consumers the right to choose among more and lower-priced goods and services.

❷ **Do not mandate protectionist barriers on newly liberalized telecom firms.** More important, Congress should refrain from imposing new protectionist rules while tearing down old barriers. Unfortunately, recent congressional attempts to reform the telecommunications industry have included provisions that would have forced the Regional Bell Operating Companies (or "Baby

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25 Sidak, *op. cit.*

26 This means INTELSAT will have to be privatized for liberalization to be complete. Such a privatization plan has recently been put forward by COMSAT President Bruce Crockett. See Doug Abrahms, "Long an Untouchable, Intelsat's Turf in Danger as Foes Seek Piece of Action," *The Washington Post*, July 29, 1994, p. B8.

Bells," as they are commonly known) to manufacture all their equipment within the United States once they were allowed to enter the industry.[27] In addition, the bills would have forced them to purchase all their manufacturing inputs and components domestically unless they received a special waiver from the federal government to use foreign parts.

Such new protectionist requirements are counterproductive. Legislators who fear the Baby Bells will leave the country to take advantage of cheaper labor fail to take into account other factors important to the industry. Most manufacturers likely will remain in the domestic market to take advantage of the greater technological advantages provided by the highly skilled workforce, adjoining industries, and various other educational or engineering institutions. In addition, transportation costs will be higher and delivery times longer if firms establish factories overseas, providing an incentive to remain at home. In reality, the most important factor that would drive firms overseas is the more open regulatory environment to be found in such nations as the United Kingdom and New Zealand. This should provide Congress with an even greater incentive to deregulate the entire market.

More important, trade deficit reduction cannot be accomplished by forcing firms to produce or procure all, or even most, of their equipment and parts domestically. Instead, it often will discourage use of the most cost-effective and innovative products, thereby forcing up prices and decreasing overall quality of service. Attempts to promote domestic manufacturing in one sector through protectionism will require the movement of workers and resources away from sectors where American firms currently hold competitive advantages over rivals. Firms will allocate their resources inefficiently and could lose export advantages they now hold in high-tech telecom products. For example, domestic production and purchasing requirements might encourage some providers to refocus their efforts on producing low-value-added or low-technology products, such as telephone receivers or fax machines, to satisfy the new (but artificially created) market demand. Yet, as Thomas J. Duesterberg of the Indianapolis-based Hudson Institute points out, American producers currently enjoy exporting advantages in high-tech, high-value-added telecom equipment such as satellite, cellular, and microwave systems.[28] Therefore, they might gain some short-term profits by switching to low-tech industry segments but could be foregoing efforts in more important and more profitable high-tech sectors where they currently hold an exporting advantage.

Finally, as mentioned above, U.S. Trade Representative Mickey Kantor pointed out to Congress last summer that these requirements violate trade agreements America has signed. In addition, the U.S. has a long-running effort to break down foreign barriers that bar America's high-tech telecom exports. Establishing domestic barriers when many countries, such as the United Kingdom and New Zealand, are tearing down their own discourages further gains and actually invites retaliation.

❸ **Work through GATT mechanisms to ensure further liberalization of foreign telecommunications markets.** Liberalizing the global telecommunications market would have enormous benefits for consumers and businesses in all countries. America is likely to gain more than others, though, since the U.S. has more firms poised to offer global consumers advanced communications services and products.

Policy makers rightly argue that foreign governments should open up their markets but unfortunately believe that a retaliatory trade war is the best way to do so. For example, as Senator Daniel

27 Under the Modification of Final Judgment (MFJ), the court decree the broke up the telephone system in 1982, the Baby Bells are prohibited from manufacturing communications equipment.

28 See Thomas J. Duesterberg, "Don't Protect Telecommunications," *The Wall Street Journal*, March 17, 1994, p. A16.

K. Inouye (D-HI) said last August during a Senate Commerce Committee debate on the merits of protectionism, "It's about time we stood up and did a little protection on our side."[29] For all the reasons stated above, however, this approach will not yield the results Senator Inouye and many of his colleagues desire. As *The Journal of Commerce* aptly noted when Congress was considering the inclusion of such protectionist measures in deregulatory legislation this summer, "[I]t send[s] the message that competition is fine on the information superhighway but not in America's foreign trade lanes."[30]

Instead of attempting to open up foreign markets by closing this country's markets, Congress should encourage the United State Trade Representative to push for a comprehensive multilateral agreement through General Agreement on Tariffs and Trade (GATT) mechanisms. Although recent GATT rounds have failed to reach a consensus on the liberalization of global markets, the newly formed World Trade Organization (WTO) has signaled its intention to continue to work toward an international agreement. Liberalizing trade in this multilateral fashion means benefits accrue equally to all participating countries across the globe. Attempting to negotiate on a bilateral, or country-by-country, basis will take too long and is less likely to yield beneficial results in the near term.

CONCLUSION

Telecommunications protectionism has not benefited America. Instead of following the prudent path of free trade in goods and services that has paid off so well for other sectors, policy makers unwisely decided to restrict consumer choice. The results should prove conclusively that such interference is no longer warranted and should immediately be ended. Consumers, not regulators, are in the best position to decide who best serves their telecommunication needs.

Unconditionally opening the American telecommunications sector to foreign investment and competition will lower prices, produce more innovative products, and create new jobs. If Congress continues to micromanage foreign trade and investment in this industry, America's competitive advantage in this important sector will suffer while U.S. consumers are forced to pay the price.

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29 Quoted in editorial, "Telecom Protectionism," *The Journal of Commerce*, August 23, 1994, p. 6A.
30 *Ibid.*