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A REPORT CARD ON THE PRESSLER TELECOMMUNICATIONS PLAN (S. 652)

INTRODUCTION

The full Senate is poised to vote on legislation to deregulate the telecommunications industry. Unfortunately, the leading bill, while a modest improvement on current law, misses the opportunity to benefit consumers by opening the industry to real competition. If this leading U.S. industry is to live up to its potential, and consumers are to reap the rewards of full competition and innovation, the Senate must make major changes in the bill.

Last year's telecommunications deregulation bill, S. 1822, died in the Senate because of dissatisfaction with the overly regulatory approach produced principally by Senator Ernest Hollings (D-SC). Very late in the legislative session, then Minority Leader Robert Dole (R-KS) began circulating a draft deregulation bill that was a mere 30 pages long—compared to the approximately 200-page Hollings bill. Instead of granting segments of the industry continued protection from competition, as the Hollings bill did, the Dole draft legislation removed almost all barriers to competition immediately.[1] For example, compared with the many pages of regulation in S. 1822 dealing with Title VI of the Communications Act of 1934 (governing cable regulation), the Dole bill simply stated that "Title VI of the Communications Act of 1934 is repealed." This would have deregulated the cable market completely upon implementation had the bill become law.

A choice of paradigms. Thus, when members and key telecommunications staffers on the Senate Commerce Committee began meeting late last year to craft legislation for this session, they had a clear choice of models: S. 1822, which granted certain deregulatory freedoms while still restraining competition in other ways,[2] or the

1 For a detailed review of the Dole draft see Adam D. Thierer, "Senator Dole's Welcome Proposal for Telecommunications Freedom," Heritage Foundation *Backgrounder Update* No. 233, August 24, 1994; Adam D. Thierer, "Don't Settle for Partial Phone Deregulation," *Issues in Science and Technology*, Fall 1994, pp. 55-60.

2 For reviews and critiques of S. 1822, see *ibid.*; Beverly McKittrick, "S. 1822: Regulatory Gridlock on the

Dole draft legislation to deregulate immediately and comprehensively almost all aspects and segments of the telecommunications market. Following the Dole model would mean little to no intervention by bureaucrats and a more rapid transition to complete market liberalization.

Unfortunately, they have tried to craft a hybrid of both models. The result: a bill that fails to create a clear, consistent, and unconstrained environment for America's telecommunications industry. During the early weeks of this year, relatively "clean" legislation was revised many times, with each revision moving further toward the Hollings model by adding more regulatory baggage in an apparent effort to appease various segments of the industry seeking to avoid new entrants into their markets. Not surprisingly, therefore, the first formal draft to emerge publicly from Chairman Larry Pressler's (R-SD) office was, in many ways, already an unsatisfactory compromise.[3]

When the final bill emerged at a Senate Commerce Committee mark-up on March 23, it was even less satisfactory than earlier drafts. Apparently in a last-minute effort to gain the support of several Democratic members of the Commerce Committee, most deregulatory elements of the bill were watered down. Even so, many Democrats continued to express reservations, and several pro-regulatory amendments were added to address their concerns. At the end of mark-up, the bill being sent to the floor comprised close to 150 pages and contained almost 100 new rule-making provisions for the Federal Communications Commission (FCC). The capitulation to the Hollings model was complete.

To be sure, the bill contains some important improvements over current law. For example, the Pressler bill would:

- ✓ **Eliminate** many important barriers to industry-wide competition,
- ✓ **Provide** incentives to open the traditionally uncompetitive local market to competition,
- ✓ **Eliminate** elements of the 1992 Cable Act,
- ✓ **Allow** somewhat increased foreign investment, and
- ✓ **Devise** a system to scale back FCC powers.

Information Superhighway," Citizens for a Sound Economy *Issues and Answers*, September 19, 1994; Adam D. Thierer, "A Guide to Telecommunications Deregulation Legislation," Heritage Foundation *Issue Bulletin* No. 191, June 3, 1994.

3 For a critique of the first formal Pressler draft, see Beverly McKittrick and Adam D. Thierer, *Letter to Honorable Larry Pressler From Citizens for a Sound Economy Foundation and The Heritage Foundation*, February 22, 1995.

But these benefits are largely outweighed by provisions that retain or extend suffocating rules. For example:

- ✗ Arbitrary FCC-administered "entry tests" could cause potentially lengthy delays before competition is allowed in certain industry segments.
- ✗ Some elements of the destructive Cable Act will remain in effect, and rules regulating the video industry remain confusing.
- ✗ Foreign ownership rules are relaxed only for a portion of U.S. industry and could be enforced retroactively after repeal.
- ✗ No serious effort is made to eliminate the FCC or specific bureaus of the agency; other rules in the bill could increase its size and power.
- ✗ There is no serious reform of the electromagnetic radio spectrum to encourage increased wireless competition and innovation.
- ✗ The bill maintains and expands telecommunications entitlements that discourage industry competition.

After seeing this final bill, more deregulatory-minded legislators such as Senator John McCain (R-AZ) were left asking, "Why do we need to make a deal if it's a bad deal?"[4] Indeed, it is unclear why concessions were made to industry special interests by the committee. It is likely that a bill modeled on the Dole draft of last year could win passage in both houses of Congress. However, now that one modeled more closely on the Hollings approach has been adopted by the Commerce Committee, the Senate must focus on how to improve S. 652, The Telecommunications Competition and Deregulation Act of 1995. If this legislation becomes law as structured today, consumers will not be able to look forward to serious telecommunications deregulation or competition in the short term.

WHAT IS GOOD AND BAD ABOUT THE PRESSLER PLAN

The Pressler bill essentially is the product of two diametrically opposed models of telecommunications deregulation. Thus, both good and bad elements can be found juxtaposed within the bill. It is important to separate the unneeded regulatory elements from the more sound deregulatory components to consider what needs to be changed in the bill to create a sound deregulatory environment for the industry. One way to do this is to compare the bill with a set of criteria for what could be considered true, free-market-oriented deregulatory reform.

Seven such general principles can be used to judge the deregulatory nature of the bill:

❶ **Creation** of sensible interconnection policy to open the local market to competition;

4 Daniel Pearl, "Panel Clears Telecommunications Bill," *The Wall Street Journal*, March 24, 1995, p. B2.

❷ **Elimination** of regulation and barriers to entry in the telephone market;

❸ **Elimination** of regulation and barriers to entry for the cable and video market;

❹ **Elimination** of protectionist barriers to foreign investment;

❺ **Sharp reduction** of the telecommunications bureaucracy;

❻ **Substantial movement** toward a free market in spectrum; and

❼ **Elimination** of telecommunications entitlements.

Judged against these criteria, the bill earns a very mixed report card.

A REPORT CARD ON THE PRESSLER PLAN FOR TELECOM (S. 652)

Report Card Item	Grade
Creation of Sensible Interconnection Policy	A
Elimination of Regulation and Barriers to Entry (Telephony)	B-
Elimination of Regulation and Barriers to Entry (Cable and Video)	B-
Elimination of Protectionist Barriers	C+
Reduction of Telecommunications Bureaucracy	D-
Movement Toward a Free Market in Spectrum	F
Elimination of Telecommunications Entitlements	F
Overall Grade for S. 652	C-

CRITERION #1: Creation of a Sensible Interconnection Policy

Grade: A

Good Points: A "competitive checklist" provides right incentives to open local market to competition; does not apply policies too broadly.

Bad Points: None.

The Pressler bill creates a sensible interconnection policy to ensure the local telephone market is opened to competition as soon as possible. A 14-point "competitive checklist" is established that allows competitors access to the "Baby Bell's" local telephone network.[5] This framework is based on an "open

5 These policies include: (1) non-discriminatory, unbundled access; (2) capability to exchange customers between carriers; (3) access to poles, ducts, conduits, and rights-of-way; (4) unbundled local loop transmission; (5) unbundled local transport; (6) unbundled local switching; (7) access to emergency, directory assistance, and operator services; (8) access to white pages directory listings; (9) access to telephone numbers for reassignment; (10) access to databases and signaling functions; (11) number portability; (12) local dialing parity; (13) reciprocal compensation arrangements; (14) unbundled network functions.

access" philosophy, which encourages the expansion of rivals to incumbent monopolistic carriers while preserving the ubiquitous nature of the American telephone network.[6]

In addition, these access requirements are focused narrowly on less competitive local markets where firms have traditionally been granted service monopolies. The Pressler bill wisely does not apply such access and interconnection mandates on competitive sectors such as the cellular industry where they would be counter-productive by discouraging the expansion of infrastructure and competition.[7]

CRITERION #2: Elimination of Regulation and Barriers to Entry (Telephony)

Grade: B-

Good Points: Opens local telephone market to competition; allows new rivals a chance to enter market.

Bad Points: Allows for potentially lengthy and arbitrary FCC delays on competition in other segments of the telephone market.

The Pressler bill encourages greater telephone competition by eliminating all entry barriers to local telephone markets immediately. This means alternative providers, such as utility companies and cable companies, would be allowed to enter the phone market.[8] This will encourage competition from entirely different sectors and also help ensure that service to many rural areas becomes competitive, since these firms already have the needed infrastructure in place.

However, many impediments either remain or are established by the bill for the first time. For example, the Senate should have allowed the Baby Bells to enter the long-distance and equipment manufacturing markets on a specific date or after they had met the "checklist" criteria discussed above. But a last-minute compromise in Committee deliberations eliminated the "date-certain" or

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6 For more information, see Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 1: The Open Access Solution," Heritage Foundation *Talking Points*, December 13, 1994, pp. 5-6.

7 This is because competitive firms no longer will have the incentive to build-out their networks if they can interconnect with each other on demand. Interconnection policies should be used only to ensure firms have access to those markets to which they have not been granted access in the past: local telephone markets. See Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 3: Solving the Local vs. Long-Distance Dilemma," Heritage Foundation *Talking Points*, February 21, 1995, p. 18; "Imposing Requirements Intended for Local Telephone Companies on Wireless Carriers Will Undermine the Growth of a Robust Infrastructure," Cellular Telecommunications Industries Association, *Congressional Issue Paper*, Spring 1994; Michael F. Altschul and Randall S. Coleman, "In the Matter of Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services," *Comments of the Cellular Telecommunications Industry Association*, Before the Federal Communications Commission, CC Docket No. 94-54, September 12, 1994; Robert F. Roche, *Competition and the Wireless Industry*, Cellular Telecommunications Industry Association, 1994.

8 Many utilities have been restricted from entering other markets under the Public Utilities Holding Company Act of 1935.

"checklist-certain" approach and substituted a new "public interest" standard. Thus, after complying successfully with the checklist objectives, the Bells must face an arbitrary review of the benefits of their entry into markets from which they are currently are barred. If, for any reason, FCC regulators feel Bell entry into these markets is not "consistent with the public interest, convenience, and necessity," they can block it.

This is a disturbing and inferior standard upon which to base telephone deregulation. Deregulatory language should establish clear, objective criteria by which firms can understand what must be done to assure access to new markets. Placing a "public interest" test within the bill is an open invitation to anti-competitive special-interest pleading and regulatory abuse, since the standard is largely subjective.[9] In addition, allowing the FCC to interpret what is in the "public interest" introduces a perverse incentive for FCC officials to slow down deregulation: smoothing the way for competition would mean a corresponding decrease in their workload and little continued need for their agency's existence.

The inclusion of this anti-competitive "public interest" test reduces the grade the Pressler bill receives for elimination of barriers to telephone competition, since beneficial Bell entry into new markets will be delayed. According to the WEFA Group, this delay could result in approximately $300 billion in lost economic output and 3.4 million lost jobs over the next ten years.[10] With such economic costs, it makes little sense to include language in the bill delaying entry, especially since Baby Bell power in local markets is dwindling.[11]

In addition, although the Pressler bill makes a half-hearted attempt to eliminate the constraints placed on the seven Baby Bell companies under the Modification of Final Judgment consent decree of 1982, no attempt is made to supersede the consent decree that continues to restrain the GTE Corporation. Under a 1984 decree struck with the Department of Justice, GTE is discouraged from entering many of the same lines of businesses the Baby Bells are via structural safeguards and specific regulatory restraints.[12] Thus, the Bells could be granted operating freedoms much sooner than GTE under the Pressler bill, resulting in an uneven playing field.

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9 Although many rules and regulations are crafted under the "public interest" standard, it has never been defined formally by Congress or the FCC.

10 The WEFA Group, *Economic Impact of Deregulating U.S. Communications Industries* (Burlington, Mass.: The WEFA Group, February 1995) p. 3.

11 For more information on the decline of Baby Bell power in the local market, see Daniel F. Spulber, "Deregulating Telecommunications," *Yale Journal of Regulation*, Vol. 12, No. 1 (Winter 1995), pp. 25-67; Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 3: Solving the Local vs. Long-Distance Dilemma," Heritage Foundation *Talking Points*, February 21, 1995, pp. 10-16; Martyn F. Roetter, "The Future of the RBOC's Part I: The Collapse of the Cocoon," Decision Resources *Spectrum*, June 16, 1994; Philip J. Sirlin, *Bellopoly—The End of the Game*, Wertheim Schroder & Co., March 22, 1994.

12 See Michael K. Kellogg, John Thorne, and Peter W. Huber, "The GTE Decree," *Federal Telecommunications Law* (Boston, Mass.: Little, Brown & Co., 1992), pp. 401-421.

Finally, the Pressler bill does little to remove more traditional regulatory barriers to telephone competition. Elements of the original Communications Act of 1934, such as licensing, tariffing, and other operating requirements, have always been a burden on the industry. For example, Section 214 gives the Commission the power to approve or deny the extension of phone lines and services to consumers. In addition, the Commission requires that telephone firms file schedules of their rates, or "tariffs," with the agency for public inspection. Although it makes little sense for the Commission to be determining whether a company should be extending services and requiring firms to reveal their rates to competitors, the Pressler bill does not eliminate these uncompetitive and costly regulations.[13]

CRITERION # 3: Elimination of Regulation and Barriers to Entry (Cable and Video)

Grade: B-

Good Points: Eliminates cable-telco cross-ownership restrictions.

Bad Points: Does not repeal Cable Act outright; maintains asymmetrical regulatory standard for video delivery.

Recognizing that the Cable Act of 1992 has been a failure, early drafts of the Pressler bill contained language calling for the repeal of the Act and prohibiting any future cable rate regulation. Unfortunately, a series of last-minute compromises resulted in retention of the Cable Act, albeit with important modifications. In essence, cable rates under the Pressler bill will be regulated if they "substantially exceed the national rate for comparable cable programming services." However, if a telephone company provides video services in a cable operator's territory, rate regulation will not apply.

In addition, instead of eliminating all regulations governing the delivery of video programming, the bill mandates continuation of a confusing twofold standard—one for video signals carried by telephone wires and one for video signals carried over cable systems. In essence, this means that an asymmetrical regulatory standard for the delivery of video programming will continue to exist.

13 Tariffing requirements can discourage uncompetitive pricing strategies since competitors are able to see rivals' prices before they take effect. This could encourage them to mimic their actions and potentially to begin pricing their services in tandem. Thus, tariffing requirements often encourage cartelistic markets by discouraging firms from initiating surprise price wars that would benefit consumers, but hurt their own profit margins.

CRITERION #4: Elimination of Protectionist Barriers

Grade: C +

Good Points: Potentially allows increased foreign investment and competition in the common carrier market.

Bad Points: Retroactive protectionist provisions could be enforced; ignores radio licenses.

The Pressler bill undertakes a long-needed reform of rules restricting foreign ownership of American telecommunications companies. Since 1934, foreign entities have been effectively prohibited from owning more than 20 percent of the shares of a company holding a radio license or more than 25 percent of the shares of a company holding a common carrier telephone license. Foreigners also are not allowed to sit on the board or become an officer of a radio licensee or a common carrier licensee.[14]

The Pressler bill aims to eliminate the 25 percent cap on common carrier ownership for any country that has opened its markets to American goods. But it does nothing about the 20 percent radio ownership ceiling. Furthermore, the bill contains a potentially retroactive "snapback" provision that allows U.S. regulators to re-impose protectionist barriers on countries that fail to provide continued market access to U.S. firms.

While the Pressler bill is superior to current law on foreign ownership, it still falls short of compete reform. Exempting radio licenses from the liberalization makes little sense, and the retroactive snapback clause will likely be used by less-efficient U.S. firms to close the American market when foreign competition becomes intense.

CRITERION #5: Reduction of Telecommunications Bureaucracy

Grade: D-

Good Points: Eliminates some tasks over time and devises a process to review regulations.

Bad Points: Requires increased telecom spending and bureaucracy in short term; no end in sight for the FCC.

The Pressler bill will eliminate some of the telecommunications bureaucracy simply by eliminating the regulations it enforces. In addition, beginning in 1997, it requires a biennial review of regulations by the FCC to determine which rules are no longer in the "public interest." Likewise, the FCC does not have to enforce any regulations it feels are not in the public interest.[15]

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14 For an overview of the current telecommunications protectionist restrictions, see Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 4: Why Telecommunications Protectionism Should Be Ended," Heritage Foundation *Talking Points*, March 2, 1995.

However, the bill does not contain any serious discussion of the future of the Federal Communications Commission. Policymakers appear unconcerned with the role the agency plays in the deregulatory process and apparently do not realize it is part of the problem they hope to correct. Congress should follow the model established by congressional Democrats and the Carter Administration in the late 1970s when they led the battle to deregulate the airlines. From the start, the future of the Civil Aeronautics Board (CAB), which regulated the airline industry, was on the table. It was well understood by most in Congress that deregulating the airlines would mean eliminating the CAB. A few years later, the CAB was abolished.

Yet, not only does the Pressler bill fail to mention the future of the FCC, but many provisions discussed above or found elsewhere in the bill actually will increase the size of the telecommunications bureaucracy. For example, new universal service provisions, "public access" requirements,[16] content controls,[17] and separate subsidiary safeguards undoubtedly will require additional FCC enforcement and staff. Likewise, "public interest" tests and continued licensing and tariffing requirements probably will require stable or increasing FCC bureaucracy.

Although Section 3 of the Pressler bill is titled "An End to Regulation," there is no end in sight to the telecommunications bureaucracy. Congress could address FCC staffing and funding issues during the appropriations process, but it is unwise to rely on Appropriations or Budget Committee members to carry out a task that should be handled within the bill itself.

CRITERION #6: Movement Toward a Free Market in Spectrum

Grade: F

Good Points: None.

Bad Points: No serious reform of the radio spectrum.

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15 Although the "public interest" is never defined in the bill, it is unlikely the Commission will refrain from enforcing rules voluntarily since it is not in its best interest to do so.

16 "Public access" requirements, such as the "Snowe-Rockefeller" amendment to the bill, allow public, educational, and government institutions to obtain telecommunications services from carriers at a lower cost than other organizations. In addition, under the Pressler bill, health care providers in rural areas would be able to receive service upon request at prices comparable to those charged in urban areas, regardless of the actual costs of servicing them. Besides requiring increased FCC enforcement, by mandating what specific groups pay for certain services, these provisions distort price signals and discourage competition.

17 Section 402 of the Pressler bill, known as the "Exon Amendment," would impose two-year jail terms and fines up to $100,000 on anyone who transmits "obscene, lewd, lascivious, filthy, or indecent" material over telecommunications networks. Besides requiring increased federal bureaucracy to enforce such rules, the amendment is potentially unconstitutional since it opens the door to censorship of on-line services and therefore would violate the First Amendment.

The opportunities presented by complete liberalization and privatization of the radio spectrum are enormous. Billions of dollars in revenue could be raised through the expansion of spectrum auctions. More important, if spectrum was freed for new or alternative uses, consumers would benefit from more competitive markets, more innovative goods and services, and falling prices.

Sadly, the Pressler bill does not make a serious effort to exploit these opportunities. It contains moderate relaxation of national ownership restrictions on broadcasters, but this falls short of the position, held even by the FCC, that the rule should be repealed outright. Furthermore, many other ownership restrictions remain in the bill which restrict the ability of broadcasters to operate freely.[18]

Worse yet, the bill makes no attempt to end the nearly seven-decade-old socialistic spectrum management policies of the FCC. Spectrum remains treated as a nationalized public resource to be regulated in the "public interest"—meaning, in reality, as the Commission sees fit. Hence, spectrum holders will continue to be denied flexible use of their current spectrum allocation,[19] while no move is made to vest them with property rights in their allocation. In addition, although the Pressler bill hopes to create more efficient spectrum use by instituting a system of fees for particular uses, the Commerce Committee missed the chance to move to a superior, efficiency-enhancing system of complete privatization. This would have ensured that spectrum was auctioned off to the highest bidder and owned by the firm that valued it most highly. It also would have generated billions of dollars for the federal government. Moreover, broadcasters will continue to be regulated under a "public interest model" under the bill, with only limited First Amendment protections. Remarkably, the Pressler bill makes no mention of the First Amendment.

As with the scaling back of telecommunications bureaucracy, spectrum reform technically could take place later in a separate bill. But the opportunity for more comprehensive and immediate spectrum deregulation is missed in the Pressler bill.

CRITERION #7: Elimination of Telecommunications Entitlements

Grade: F

Good Points: None.

Bad Points: Expands telecom subsidies; gives FCC larger role; potentially regulates computer industry.

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18 For a review of many of these unnecessary broadcast regulations, see "Review of The Commission's Regulations Governing Television Broadcasting," Federal Communications Commission *Notice of Proposed Rulemaking*, MM Docket No. 91-221, June 12, 1992.

19 Currently spectrum holders can use their allocation only for purposes defined by the FCC. For example, the holder of a television station spectrum license could not convert that station into a cellular telephone system even if it would be more efficient and profitable to do so.

The most disastrous elements of the Pressler bill are the sections dealing with universal telecommunications service. Current telephone subsidy policies redistribute wealth in a highly inefficient manner to provide cheap local telephone service. Subsidies generally flow from long-distance users to local users, business users to residential users, and urban users to rural users. These overlapping cross-subsidies have destroyed industry competition by discouraging market entry, since few potential competitors have the capital necessary to take on the subsidized firms.[20] By artificially elevating prices in the long-distance market, these subsidies also have cost society between $1.5 billion to $10 billion per year in higher prices.[21]

Instead of attempting to reform or eliminate this destructive subsidy system, the Pressler bill actually expands its scope. For example, the bill:

- ✓ **Maintains current price controls** by requiring that services be provided at "just, reasonable, and affordable rates," and does not define what these highly subjective terms mean.
- ✓ **Continues inefficient rate averaging,** which requires that rates in rural areas be roughly the same as those in urban areas, regardless of cost.
- ✓ **Expands telecommunications entitlements** by mandating that, "At a minimum, universal service shall include access to telecommunications services that the Commission determines have, through the operation of market choices by consumers, been subscribed to by a majority of residential consumers."

The continuation of the failed subsidy policies of the past, combined with the expanding definition of universal service mandated under the bill, places at risk almost everything else the bill hopes to accomplish. Once personal computers, on-line services, set-top boxes, and other future technologies become part of a package of mandated benefits to which every American must have access, it is

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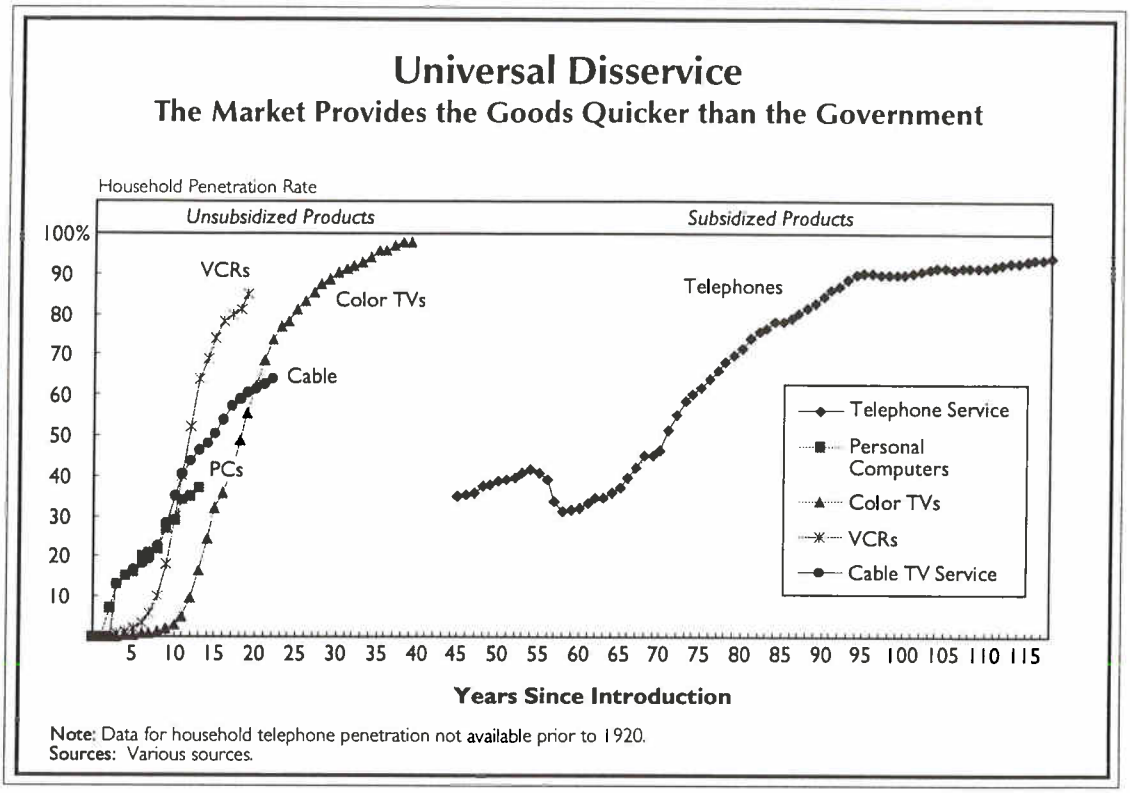
20 For more information, see John Browning, "Universal Service: An Idea Whose Time Is Past," *Wired*, September 1994, pp. 102-105, 152-154; David L. Kaserman and John W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation*, Vol. 11 (Winter 1994), pp. 119-146; David L. Kaserman, John W. Mayo, and Joseph E. Flynn, "Cross-subsidization in Telecommunications: Beyond the Universal Service Fairy Tale," *Journal of Regulatory Economics*, Vol. 2, (1990), pp. 231-249; Peter Pitsch, "Disconnect the Universal Subsidy," *The Wall Street Journal*, April 4, 1994, p. A12; MFS Communications Company, Inc., "In the Matter of Inquiry Into Policies and Programs to Assure Universal Telephone Service in a Competitive Market," *Petition of MFS Communications Company, Inc. for a Notice of Inquiry and En Banc Hearing*, Before the Federal Communications Commission, November 1, 1993; Bridger M. Mitchell and Ingo Vogelsang, *Telecommunications Pricing: Theory and Practice* (Cambridge, U.K.: Cambridge University Press, 1991); MCI Communications Corporation, *Defining and Funding Basic Universal Service: A Proposal of MCI Communications Corporation*, July 1994.

21 Kaserman and Mayo, "Cross-Subsidies in Telecommunications," p. 121. Kaserman and Mayo argue these estimates are likely to be too low since "they do not consider the incalculable losses resulting from the distortion of dynamic market incentives to create and adopt technological advances that make more efficient use of the long-distance network."



likely these technologies will be regulated, and thus made less competitive. Although the bill does not specifically require that these goods and services be included in a package of mandated technological benefits, the Pressler draft has provided the FCC with the incentive to do so by requiring that universal service be considered an "evolving level of telecommunications service." It is likely this will encourage the agency to adopt traditional subsidization and regulatory measures to extend these technologies to more Americans once they are included in the evolving definition.

If this occurs and these markets become less competitive, consumers will have less choice, higher prices, and perhaps even less access to these technologies. As the above chart illustrates, it is significant that unsubsidized and unregulated technologies have been made available to American consumers much faster than subsidized and regulated technologies, such as telephone technology.

In addition, it will be more difficult to make the local telephone market competitive, as the bill aspires to do. This is because real price competition will not be allowed to develop freely if subsidies remain in place. Further, it is unclear just how expensive it will be to carry out these new provisions. And although these mandates may not be considered technically a tax increase, since the subsidies flow within the industry and not from a general revenue fund, they will

have the effect of a redistributionist tax and likely will require an increase in the size of the FCC.[22]

How to Improve the Pressler Bill

If the Senate wishes to correct the flaws in the Pressler bill, several changes must be made before the bill is passed. Specifically, to create real competition in the telecommunications industry, Congress should:

✓ **Strip out all unnecessary bureaucratic impediments to immediate deregulation, such as the "public interest" test, licensing and tariffing requirements, delays in equipment manufacturing liberalization, separate subsidiary requirements, and all rate regulation provisions.**

There is little need to delay the onset of complete deregulation and competition. For six decades, consumers and entrepreneurial firms have been forced to sit on the sidelines and watch bureaucrats conduct a regulatory experiment that has ended in failure. Immediate deregulation will ensure that telecommunications companies face a much more ruthless regulator—the American consumer. Policymakers cannot create competition with waiting periods and bureaucratic entry tests.

✓ **Strip out retroactive foreign ownership provisions and eliminate telecommunications protectionism.**

Instead of continuing to deny American consumers the benefits of increased rivalry, competition, and service quality, as the Pressler bill would, Congress should repeal these protectionist provisions in current law. It makes little sense to continue restrictions on foreign ownership of American firms when so many diverse media and communication outlets exist. Some countries like the United Kingdom and New Zealand have liberalized completely their telecommunications markets and enjoy the benefits of increased capital investment and entrepreneurial foreign competition.

To help pry open foreign markets, the White House should pursue a multilateral trade agreement in this area. This would be less likely to fuel the fires of protectionism and avert the chance of a trade war that would threaten U.S. investment abroad. Instead, the Pressler bill attempts to keep one foot in the protectionist camp while slowly stretching the other toward the free market. Unconditionally opening the American telecommunications sector to foreign investment and competition will lower prices, produce more innovative products, and create new jobs. Continuing current restrictions on foreign access to the American marketplace will hurt U.S. consumers more than any foreign firm conceivably might.

22 See Beverly McKittrick and Adam D. Thierer, *Letter to Honorable June O'Neill From Citizens for a Sound Economy Foundation and The Heritage Foundation*, April 17, 1995.

As traditional print technologies (such as newspapers and magazines) converge with modern electronic technologies (such as the Internet), it will become increasingly difficult to determine how to separate the different print and electronic standards. For example, will the *New York Times* be regulated under a different interpretation of the First Amendment once it can be delivered to most Americans via computer or cable system? Existing regulatory distinctions distort the true meaning and intent of the First Amendment: "The First Amendment, after all, does not distinguish one 'press' from another."[28]

✓ Include a timetable for closing down the FCC.

A failure to reduce the size of the bureaucracy that governs the telecommunications sector is a failure to deregulate this industry. As long as regulators have jobs, they will regulate. If there is to be full deregulation of this industry, Congress must devise a detailed and workable plan for the eventual closure of the Federal Communications Commission. Unfortunately, with so many provisions in the Pressler bill expanding the federal regulatory workload, this goal cannot be achieved unless the bill is amended significantly.

Lawmakers should eliminate the bill's expansionary language and substitute a plan to close down the FCC.[29] Congress should begin by reducing current FCC appropriations and including procedural reforms in the bill to end destructive regulatory activities. For example, all licensing and tariffing restrictions could be repealed immediately, resulting in substantial cutbacks in bureaucracy. Likewise, entire FCC bureaus, such as the Cable Services Bureau, could be eliminated as the rules they enforce are repealed.

✓ Substitute a more pro-competition alternative for the current universal service sections of the bill.

If policymakers fail to eliminate the language in the Pressler bill that would expand subsidies and entitlements, telecommunications competition could be stifled and current technologies could be made less competitive. Instead of adopting the failed model of the past, Congress should craft policies in this field that fit the new thinking on entitlement reform on Capitol Hill.

Just as some other entitlements are being limited and then devolved to the states, universal telecommunications service policies can be transferred to lower levels of government. States and localities can determine better what their residents need. Ideally, state or local lawmakers could create a voucher plan that would deliver a subsidy directly to a qualified individual, not a company, based on perceived need.[30]

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28 John Thorne, Peter W. Huber, and Michael K. Kellogg, *Federal Broadband Law*, Little, Brown & Co., 1995, p. 21 (forthcoming).

29 See Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 5: Is the FCC Worth Its Cost," Heritage Foundation *Talking Points*, March 22, 1995; Adam D. Thierer, "Congress Should Let FCC R.I.P: Federal Communications Commission Hurts Consumers, Inhibits Innovation," *Human Events*, March 17, 1995, pp.10-11, 17; Peter Huber, "Abolish the FCC," *Forbes*, February 13, 1995, p. 184.

30 See Adam D. Thierer, "Universal Service: The Fairy Tale Continues," *The Wall Street Journal*, January 20, 1994, p. A12; Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications Part 1: The

The subsidy would be narrowly drawn, means-tested, and more friendly to competition—unlike policies today that artificially price service in rural areas below costs. By transferring all authority for the universal service system back to the states, Congress could eliminate the federal bureaucracy that oversees the universal service system.

CONCLUSION

Although it would be unfortunate if telecommunications deregulation legislation died this year, as it did last year, it would not be the proverbial end of the world. For one thing, technologies and the courts are undermining or dismantling many of the barriers now in place. With each passing year, technological innovation circumvents outdated regulatory distinctions, and court decisions are eliminating many regulatory barriers outright. These trends are likely to continue. Another reason to reject flawed legislation is that the Pressler bill actually would make some things worse. In particular, the universal service elements place at risk everything else the bill hopes to accomplish by mandating the continuation and expansion of failed subsidy policies.

Still, supporters of the bill will argue correctly that allowing the perfect to be the enemy of the good can destroy any chance of freeing the industry from many statutory constraints on competition and innovation. They will cite the length and heavy cost of court-based deregulation and the economic losses associated with continuing restrictions for longer than necessary. However, if supporters feel this passionately about the need for immediate deregulation, they will act to eliminate the overly regulatory baggage of the bill and insert more deregulatory, pro-competitive alternatives in its place. Without such changes, S. 652 as currently written is not the landmark telecommunications deregulation bill its sponsors claim, since it continues to rely more on regulators than consumers to decide which firms and technologies prevail in the marketplace.

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Open Access Solution," Heritage Foundation Talking Points, December 13, 1994, p. 2; Senator John McCain, "As We Debate Telecommunications Reform, We Must Ask: Who's Paying for What Here?" *Roll Call*, March 13, 1995, p. 27.