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WHAT'S NEXT FOR TELECOMMUNICATIONS DEREGULATION?

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"A year-and-a-half after the President signed a law that replaced a hundred years of monopoly in communications with a commitment to competition, we should ask: is it working? Will Congress and the President see their intentions come true?"[1]

—Reed Hundt, Chairman
Federal Communications Commission

In a recent speech at the American Enterprise Institute, outgoing Federal Communications Commission Chairman Reed Hundt echoed the concerns of countless policymakers when he asked, "is it [the Telecommunications Act of 1996] working?" Policymakers are wondering whether their laborious two-year struggle to deregulate the communications industry will prove to have been worth the effort. Many on Capitol Hill realize that the Telecom Act has not lived up to expectations and, on many counts, has been a failure.

The intent of the Telecommunications Act was to bring competition into a traditionally non-competitive, monopolistic industry by replacing regulatory mandates with free-market policies, especially consumer choice. In reality, however, it has not fulfilled these goals. As Robert W. Crandall, Senior Fellow in Economic Studies at the Brookings Institution, has explained, the Telecom Act "continues and extends a regulatory framework that is a proven failure."[2] Not only has Crandall offered harsh criticism of the Act, but he

1 Reed Hundt, "The Light at the End of the Tunnel vs. The Fog: Deregulation vs. Legal Culture," speech delivered to the American Enterprise Institute, Washington, D.C., August 14, 1997; available on the Internet at *http://www.fcc.gov/Speeches/Hundt/spreh741.html*, p. 1.

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also has proposed its reconsideration, arguing that "Not only has the act extended the shared regulatory authority of the Federal Communications Commission and the states, allowing both sets of regulators to continue their regulatory distortions of telephone rates, but the act has also prescribed a major extension of regulation."[3] As Harvard Law School constitutional law scholar Laurence H. Tribe stated recently in *The Wall Street Journal*, "The only point on which all parties agree is that the law isn't working as intended, and that American consumers are still waiting for free and healthy competition in communications services."[4]

Even though the 104th Congress's attempt to deregulate the communications industry has proved to be ineffective, the desire to implement reforms continues. A new deregulatory effort initiated in the 105th Congress could help to solve many of the problems associated with the Telecom Act. On July 30, 1997, Representatives W. J. (Billy) Tauzin (R–LA), chairman of the House Telecommunications, Trade and Consumer Protection Subcommittee, and Richard A. White (R–WA), chairman of the Internet Caucus on Capitol Hill, along with other members of the House Commerce Committee, introduced H.R. 2372, the Internet Protection Act of 1997, to keep the stifling hand of regulatory micromanagement off the Internet.

The Internet Protection Act (IPA) offers a radical and refreshing break from the old model of regulatory control embodied in both the Communications Act of 1934 and the Telecommunications Act of 1996. Specifically, it would insulate the Internet from the reach of the current failed regulatory regime by amending the 1934 Act to create a new Section 231 on regulation of the Internet and interactive information services. The language of the proposed new Section 231 clearly supports markets over mandates: "In order to support rapid and efficient technological and commercial innovation, deployment, and adoption of Internet information services, it shall be the policy of the United States to rely on private initiative and to avoid, to the maximum extent possible, government restriction or supervision of such services."

To make sure that bureaucrats could not evade Congress's intent, the IPA outlines in meticulous detail the actions which federal and state regulators would be prohibited from taking. For example, public officials would not be allowed to engage in:

- Regulation of "the rates, charges, practices, classifications, facilities, or services for or in connection with the provision of Internet information services to customers";
- Regulation of "technical specifications or standards for the provision of Internet information services"; or
- "[A]ny other regulation of the provision of Internet information services."

If accompanied by other specific statutory reforms, the framework established in the Tauzin–White bill could serve as a new and better model for Congress in dealing with the entire telecommunications industry to ensure that competition and consumer choice in the United States develop more rapidly.

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2 Robert W. Crandall, "Are We Deregulating Telephone Services? THINK AGAIN," Brookings Institution *Brookings Policy Brief* No. 13, March 13, 1997; available on the Internet at *http://www.brook.edu/ES/POLICY/ POLBRF13.HTM*, p. 1.

3 *Ibid.*

4 Laurence H. Tribe, "The FCC vs. the Constitution," *The Wall Street Journal*, September 9, 1997, p. A18.

What's Needed: A Fresh Approach to Governing the Communications Sector

That the chairman of the FCC should ask whether the Telecommunications Act of 1996 is working while, at the same time, his agency helped cause many of the problems that developed after the Act was passed is not without irony. At nearly every turn, the Federal Communications Commission sought to expand its authority over the telecommunications industry rather than allow market players and industry consumers to make their own decisions. The FCC, as an aide to Representative Tauzin recently remarked, "in recent years has tried to become a Department of Justice, an EEOC (Equal Employment Opportunity Commission), a tax collecting agency, a Department of Education, and right on down the line."[5] As noted by Thomas J. Duesterberg and Kenneth Gordon of the Hudson Institute in their new book, *Competition and Deregulation in Telecommunications: The Case for a New Paradigm*, "the early evidence is that the FCC would prefer to manage the transition to a competitive landscape rather than achieve its goals simply by relying on market mechanisms and removal of legal and economic barriers to entry."[6]

Yet, despite such criticism of the FCC, the real fault for the failings of the Telecom Act lies with Congress. The 104th Congress did not just give the FCC the ability to impose a remarkable number of new rules on the industry; it also failed to prevent the FCC from using rules already on the books to continue to harm the deregulatory cause. In a sense, the 1996 Act allowed the FCC to make an unprecedented power grab and agency bureaucrats to impose their own version of industrial policy on an already overregulated sector.

As a result of shortcomings in the Telecom Act, the increases in service rivalry and customer choice that Congress and the President expected have not developed. Worse still, many industry observers and officials now openly fear that the reach of the Telecom Act's failed regulatory apparatus will spread to newer and more competitive factions of the communications sector, such as the Internet and interactive computer services industry.

Not surprisingly, many policymakers and regulators like Hundt have proposed strengthening FCC authority to deal with these problems rather than relying on real deregulation and consumer choice. In other words, in typical Washington style, one bad law could very well beget many additional bad laws which would make the predicament even worse. Cato Institute Senior Fellow Lawrence Gasman aptly summarizes the current situation: "As has happened so many times in the history of telecommunications, industry is being shaped in Washington and not in the marketplace."[7] *Washington Post* columnist Robert J. Samuelson concurs, noting that "Washington trumpets phone deregulation, but it's still regulating merrily away."[8]

The answer to Hundt's question "is it working?" must be a resounding "No." Congress needs to consider a new framework for governing the interactive computer services industry before more damage is done to this important sector of the American economy.

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5 Quoted in "Showdown May Be Brewing on Telecommunications Act Changes," *The White House Bulletin*, August 18, 1997, p. 2.

6 Thomas J. Duesterberg and Kenneth Gordon, *Competition and Deregulation in Telecommunications: The Case for a New Paradigm* (Washington, D.C.: Hudson Institute, 1997), p. viii.

7 Lawrence Gasman, "Access in Telecommunications: A Little Less Equality, A Little More Entry," *Regulation*, Spring 1997, p. 41.

8 Robert J. Samuelson, "Telephone Straddle," *The Washington Post*, May 1, 1997, p. A21.

The IPA as New Model. The explosive growth of the Internet and the interactive computer services industry has been both rapid and unprecedented. It also has not gone unnoticed by Congress. As the Internet's popularity has grown in the media, in academia, and among Americans generally, Members of Congress have introduced a succession of bills to deal with issues surrounding its use, including Internet taxation policy, copyright protection, content controls, encryption policy, gambling, and privacy concerns. The Internet Protection Act introduced by Representatives Tauzin and White would establish a legal firewall between the new interactive computer services technologies and all other telecommunications technologies which have been heavily regulated in the past. Under H.R. 2372, public officials would have no authority to regulate the rates, facilities, or service standards of either the Internet or companies in the interactive computer industry.

In this sense, introduction of the IPA represents an admission by federal policymakers that the old regulatory model, created under the auspices of the Communications Act of 1934 and extended in the Telecommunications Act of 1996, is an ineffective and potentially destructive way to regulate dynamic technologies like the Internet. Donald McClellan, Jr., Senior Fellow for Communications Legal Policy Issues at the Progress and Freedom Foundation, appropriately labels the IPA "a containment policy for protecting the Internet from regulation."[9]

Such a firewall is essential; it would be disastrous if the confusing and convoluted regulatory apparatus currently governing other sectors of the industry broadened its reach to encompass an increasing number of Internet services and technologies. An important new study by the MCI Communications Corporation acknowledges that this would be the case:

> [W]hile the Internet is intrinsically a global system, many policies have been formulated and laws passed that seem to reflect only the most parochial of perspectives. And while seamless infrastructure is, and will continue to be, the Internet's most essential element, public policy has often appeared anything but seamless—producing patchworks of conflicting laws and policies.[10]

Furthermore, the Clinton Administration recently released a surprisingly free-market-oriented document, *The Framework for Global Electronic Commerce*, which argues for a "predictable, minimalist, consistent and simple legal environment for [electronic] commerce."[11] As the Administration document correctly notes, "Existing laws that may hinder electronic commerce should be reviewed and revised or eliminated to reflect the needs of the new electronic age."[12] During the press conference announcing release of the *Framework*, President Bill Clinton argued that the Internet "should be a global free trade zone...with minimal regulations and no new discriminatory taxes. It should be a place where government makes every effort first...not to stand in the way—to do no harm."[13] The Internet Protection Act would facilitate the development of such a "global free trade

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9 Donald McClellan, Jr., "A Containment Policy for Protecting the Internet from Regulation," Progress and Freedom Foundation *Progress On Point*, Release 4.5, August 1, 1997, p. 1.

10 MCI Communications Corporation, *Internet Policy Vision: A Global View*, 1997, p. 5; available on the Internet at *http://www.mci.com/aboutus/company/news/internetpolicy/index.shtml.*

11 Interagency Working Group on Electronic Commerce 1, *The Framework for Global Electronic Commerce*, The White House, July 1, 1997; available on the Internet at *http://www.whitehouse.gov/WH/New/Commerce.*

12 *Ibid.*

zone" for the Internet by providing such a "minimalist, consistent and simple legal environment."

Improving the Internet Protection Act. The sweeping prohibition of regulatory activity in the Internet Protection Act clearly is the most market-oriented telecommunications policy advanced by Congress in recent years, but it can and should be made even stronger. To strengthen the impact of the IPA, Congress should consider three minor modifications:

1. **Exempt the Internet from the FCC's universal service proposals.** Congress must state clearly that Internet-based and interactive service technologies will be exempt from universal service proposals and proceedings underway at the FCC. Currently, FCC regulators are exploring alternative methods of subsidizing new industries and technologies; the risk is becoming great that Internet and interactive services technologies could be regulated directly or indirectly in the future as these new subsidy programs are created. Congress should prohibit the spread of such subsidization schemes to Internet-based technologies, since they will be accompanied by new regulations as well.

2. **Narrowly define encryption regulation.** The IPA contains a clause that would allow the FCC to ignore the Act's prohibitions when "necessary to protect national security or network reliability, or assist law enforcement...." Although this policy may sound sensible in theory, it would open the door for the FCC to impose extensive and intrusive regulatory burdens on Internet communications through encryption regulation or other types of technology controls. Policymakers would be wise to craft such exemptions as narrowly as possible so that their applicability is limited to threats that are both strictly defined and realistic.

3. **Reverse the burden of proof.** The IPA includes an excellent section which demands that the FCC refrain from regulating telecommunications providers who eventually enter the interactive services business. However, the bill's language would allow the FCC too much leeway in determining whether forbearance is warranted. Instead of giving the FCC open-ended authority to grant forbearance on any timetable and in any manner it might choose, Congress should reverse the burden of proof and demand mandatory forbearance once a firm enters the interactive services business. The FCC then would have to make a case for *not* granting the firm such freedoms under the IPA.

If these specific weaknesses were resolved, the Internet Protection Act could serve as an effective shield against intrusive and unneeded federal regulatory micromanagement of the Internet and interactive services.

THE BENEFITS OF BROADENING THE SCOPE OF THE IPA

The policies embodied in the Internet Protection Act could benefit all communications technologies, across the board. Congress would be wise to consider that broadening the Act's application could revolutionize how the American telecommunications industry operates. The three improvements outlined above would strengthen prohibitions against

13 "Remarks by the President in Announcement of Electronic Commerce Initiative," The White House, Office of the Press Secretary, July 1, 1997; available on the Internet at *http://www.whitehouse.gov/WH/New/Commerce/remarks.html.*

micromanagement, but Congress also should explore ways to broaden the IPA's scope to include related industry sectors that remain trapped under the old regulatory regime.

If Congress fails to do this, some of the older, more heavily regulated companies—such as those involved in wireline telephony, cellular telecommunications, cable, and broadcasting—at the very least might claim that Congress is targeting the Internet and interactive technologies for special treatment under the IPA. Conceivably, traditional telecommunications sectors might demand that any new industry segments and technologies be subjected to the same failed regulatory apparatus under which they themselves have been trapped for the past six decades. There are at least two important reasons why this would be a mistake.

First, adopting the Internet Protection Act would serve the old sectors as well as the new interactive service sectors. It would allow the older firms to deploy the new broadband services and technologies which would be exempt from traditional types of price and service regulation.

Second, adopting the IPA could open the door for broader, industry-wide regulatory forbearance and deregulation.

Therefore, instead of opposing the Internet Protection Act, the well-established and overregulated companies should encourage Congress to expand its policies and grant all telecommunications companies the same freedoms it currently offers, or proposes to offer, Internet providers and users.

By successfully incorporating older technologies, services, and companies under the IPA's umbrella of regulatory protection in this manner, Congress would establish a policy that upholds the importance of the telecommunications sector to the future of America. In effect, it would send out the message that a "most favored" status should apply to important sectors of the U.S. economy as well as to foreign nations. In the field of trade policy, most favored nation (MFN) status is granted to countries involved in global free-trade agreements to ensure nondiscriminatory treatment for their exports. MFN does not mean that one country (or, in this case, one telecommunications sector) is more favored than another. It simply means that everyone is operating on the same legal footing or level playing field.

Policies that work well within the international system of commerce will work as well for U.S. telecommunications policy. Placing everyone on the same level playing field should be at the heart of all telecommunications policy to ensure nondiscriminatory regulatory treatment of competing providers and technologies. If a carrier seeks to offer a new service, it should be regulated no more stringently than its least regulated competitor. Such an approach would ensure that regulatory parity exists within the telecommunications market as the lines between existing technologies blur.

A 14-Point Checklist of Reforms to Improve the Telecommunications Act of 1996

Regardless of whether it broadens the Internet Protection Act's forbearance language in this manner, Congress should seek to eliminate many of the specific statutes and regulations currently on the books. The Telecommunications Act of 1996 includes a much-heralded "14-point checklist" of interconnection and open-access requirements to foster competition, but the following 14 reforms would do much more to usher in the age of competition for all segments of the communications industry. To improve and safeguard the telecommunications industry, Congress should:

1. **Require** expanded regulatory forbearance and complete merger and acquisition freedom;
2. **Initiate** comprehensive reform of the FCC;
3. **Sunset** all interconnection and open-access provisions according to a strict timetable and constrain their short-term effects;
4. **End** telecommunications "welfare as we know it";
5. **Allow** complete pricing freedom and reject calls for price controls;
6. **Disallow** FCC standard-setting authority;
7. **Prohibit** Internet taxation;
8. **Protect** the Internet from regulation;
9. **Allow** spectrum flexibility and move toward spectrum property rights;
10. **Eliminate** remaining broadcast media ownership restrictions;
11. **Eliminate** foreign protectionist rules;
12. **Eliminate** all "public interest" requirements;
13. **Guarantee** First Amendment parity for all media; and
14. **Prohibit** government-mandated encryption standards and controls.

These fundamental reforms do not include all those that are needed, but they do represent the minimum that is required if policymakers hope to complete the efforts begun during the 104th Congress to deregulate the telecommunications industry.

Forbearance and FCC Reform

To create a less intrusive, more flexible legal environment, Congress should:

- **Require expanded regulatory forbearance and complete merger and acquisition freedom.** The forbearance language in H.R. 2372 could be strengthened and broadened to apply to both existing and potential technologies and all businesses that develop over time. However, it may be necessary for Congress to take additional steps to promote regulatory forbearance at the FCC, because the agency undoubtedly will be reluctant to grant such freedoms without a fight.

Specifically, until various regulations and statutes can be eliminated, Congress should demand that certain classes of advanced telecommunications services remain free of regulation. For example, there is no need for the FCC to regulate such technologies as facsimile, voice mail, Caller ID, data services, video telephony, Internet telephony, cellular telephony, new broadcast services, cable television rates or services, direct broadcast satellite television rates or services, or computer-based or interactive services. The firewall proposed in the IPA should be extended to protect these and other services from FCC regulation.[14]

Finally, the FCC should allow complete merger and acquisition freedom. Mergers, acquisitions, and other forms of joint ventures are being used more and more by communications companies in an attempt to increase their customer base and name recognition, expand their product lines and services, enhance their operational efficiency, and lower their prices. For example, the recently announced attempts by WorldCom Inc. and GTE Corporation to take over long-distance giant MCI Communications Corp. will serve the best interests of consumers no matter who eventually prevails and purchases MCI. The FCC is in no position to judge the business merits of such deals and therefore should be prohibited from restricting them or modifying them in any fashion.

- **Initiate comprehensive reform of the FCC.** Although many scholars have argued for a plan to dismantle the FCC completely during the next few years, it is politically unlikely that Congress will be able to do so. However, this does not mean that comprehensive reform should not be undertaken.[15] Furthermore, legislators should not shy away from using the appropriations process to defund the FCC; the agency should not be given additional resources with which to do still more harm. Congress could seek, for example, a 10 percent to 20 percent reduction in funding for each of the next three to five years to reduce the FCC's size and power.

Wireline/Interconnection Issues

To facilitate competition in the wireline sector of the telecommunications industry, Congress should:

- **Sunset all interconnection and open-access provisions according to a strict timetable and constrain their short-term effects.** At the heart of the Telecommunications Act of 1996 was a congressional effort to open local telephone markets to competitive rivalry. To accomplish this, the authors of the bill imposed a series of interconnection and open-access requirements that local telephone exchange carriers must meet before they can enter the long-distance market. Essentially, these rules require local carriers to give competitors access to their local wireline infrastructure by reselling network elements at a "just" and "reasonable" cost.[16]

  Although these rules could facilitate the development of local telephone competition, they also could be used by regulators to discourage actual facilities-based

14 See Lawrence Gasman and Solveig Bernstein, "A 'Firewall' to Protect Telecom," *The Wall Street Journal*, March 27, 1997.

15 In 1995, the Progress and Freedom Foundation assembled a group of leading telecommunications experts to establish a blueprint for gradual dismantling of the FCC that still serves as a model today. See *The Telecom Revolution: An American Opportunity* (Washington, D.C.: Progress and Freedom Foundation, May 1995).

16 However, these terms were not strictly defined in the Act.

investment in infrastructure which would allow a company to compete for existing customers. If regulators priced open-access entry to local networks so low that any rival could purchase existing network elements well below their actual costs, companies would be less likely to invest in their own facilities to compete with incumbent providers. Rivals simply would purchase below-cost network access at the regulator-approved discount rate.

This process would encourage a fair amount of entry into the local market by new competitors, but it also would discourage much-needed upgrades in local telecommunications infrastructure. Moreover, enforcing such entry would require laborious and perpetual regulatory micromanagement, and incumbent local providers could wind up being forced to foot the entire bill for carrying the additional traffic over their existing networks.

Such micromanagement is exactly what the FCC proposed when it released its remarkably lengthy and complex interconnection order on August 8, 1996. In an arrogant attempt to implement its own version of deregulatory industrial policy, the FCC ignored the Telecommunications Act's requirement that interconnection and pricing arrangements be negotiated voluntarily by private companies, with state policymakers offering arbitration assistance if necessary. Instead, the FCC simply decided to mandate, in disturbing detail, the pricing policies to be used by companies and states in subsequent interconnection proceedings.

The stunning and needless complexity of the FCC's interconnection pricing proposal is summarized aptly in a Prudential Securities *Telecommunications Regulatory Update* headline: "If The Devil's in the Details, Then We Must Be in Hell."[17] Indeed, the FCC's proposed rules quickly created a heated legal debate in the courts as companies invested their time and money in lawsuits to oppose or promote them. In other words, the only real beneficiaries of the Telecommunications Act continue to be lawyers, economists, and consultants. These court proceedings obviously must go forward, but Congress still needs to consider amending the 1996 Telecom Act to make it clear that problems caused by the FCC's interconnection and open-access fiasco are not allowed to do any further damage.

Congress should demand the sunsetting of all interconnection and open-access rules according to a strict timetable. If these rules have not accomplished their intended purpose within the next three to five years, it is doubtful they ever will do so. The timetable could be triggered after each local exchange carrier has met the minimal interconnection requirements outlined in the Telecommunications Act or after the local incumbent company has lost a certain percentage of market share, as Solveig Bernstein of the Cato Institute has suggested.[18] This would give a fair number of potential rivals the chance to enter the local market and build name recognition with new customers. A cutoff date for the rules would place new rivals on notice that preferential treatment eventually will end, and they will need to deploy their own facilities and technologies to compete directly with incumbent carriers.

17 Susan A. Lynner, "FCC Opts for Federal Framework over State Discretion in Local Competition Proposal," Prudential Securities *Telecommunications Regulatory Update*, April 25, 1996, p. 3.

18 See Solveig Bernstein, "Mandatory Interconnection: The Leap of Faith," paper presented at a Cato Institute conference, Beyond the Telecommunications Act of 1996: The Future of Deregulation, September 12, 1997.

Finally, Congress should not allow regulators to apply the current interconnection, unbundling, and resale rules to newly deployed advanced network technologies or elements. Requiring that new network technologies be instantly available to competitors would discourage firms from deploying them. Once again, the rules themselves could serve as impediments to the deployment of competitive broadband infrastructure.[19]

Universal Service

To eliminate unneeded and uncompetitive subsidies, Congress should:

- **End telecommunications "welfare as we know it."** The most disastrous sections of the Telecommunications Act of 1996 dealt with the expansion of the federal telecommunications welfare state. Not only did policymakers fail either to eliminate or to effect radical reform in universal service subsidization mechanisms, but Congress also gave the FCC *more* power that it could use to wreak havoc in the telecom market in the name of social justice. Current telephone subsidization policies redistribute wealth in a highly inefficient manner to provide cheap local telephone service. Subsidies generally flow from long-distance users to local users, from business users to residential users, and from 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 compete with subsidized firms.[20] By artificially elevating prices in the long-distance market, such subsidies have cost Americans billions of dollars per year in higher prices.[21]

  Instead of reforming or eliminating this system of telecommunications welfare, the 1996 Act preserved its essential elements, including price controls through geographic rate averaging. Even worse, it encouraged the FCC to expand the subsidized telecommunications grab bag. The FCC's radical and remarkably expensive expansion of telecom welfare could cost Americans over $13 billion.[22]

  Such actions pose a more serious threat to the future development of communications competition than any other factor policymakers will deliberate. By their nature, these subsidization mechanisms radically distort market prices and send skewed signals to industry officials and investors who ponder moving into new markets. The more heavily subsidized certain segments of the telecom market become,

19 See Henry Geller, "Encouraging Infrastructure Investment: A Comparative Study," paper presented at a Cato Institute conference, Beyond the Telecommunications Act of 1996: The Future of Deregulation, September 12, 1997.

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; Bridger M. Mitchell and Ingo Vogelsang, *Telecommunications Pricing: Theory and Practice* (Cambridge, U.K.: Cambridge University Press, 1991); and 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.

22 Donald W. McClellan, Jr., "The FCC's $13 Billion Tax Hike," Progress and Freedom Foundation, available on the Internet at *http://www.pff.org/pff/FCCtaxhike.html*. See also Americans for Tax Reform, Cato Institute, Citizens for a Sound Economy, and Progress and Freedom Foundation, "Joint Statement on the New FCC $5 Billion Tax and Entitlement Program," 1997.

the less likely it is that competition will spread to these segments to improve costs and service to the consumer.

The telecommunications welfare state must be scrapped, and prices must be allowed to adjust accordingly. Any future subsidies that are deemed necessary should be means-tested and delivered through such competitively neutral mechanisms as vouchers. Even more important, these vouchers should be given directly to individual consumers, not to corporations as another form of corporate welfare. These subsidies should be kept to a minimum. They should restricted to basic, essential phone services and not used for luxury goods or services such as the Internet.

Finally, vouchers should be designed by state or local officials who can better target those truly in need. As Duesterberg and Gordon argue, "A national solution to what may be a nonexistent problem is clearly unwise. Leaving the initiative to the states would allow targeted solutions to specific problems without the economic and bureaucratic burden of a national program."[23]

Pricing and Standards Issues

In considering rates and standards, Congress should:

- **Allow complete pricing freedom and reject calls for price controls.** If the telecommunications market is ever to be truly unencumbered by meddlesome regulation, all price controls on various services will need to be eliminated. This is especially desirable with respect to wireline rural communications services, the prices of which have been kept low for decades at the expense of artificially high urban and business rates. Competitive rivalry will bring down all prices over time, but such competition will never develop if rate regulation and cross-subsidization are allowed to continue. In addition, as the IPA wisely provides, any efforts to regulate the price of new and emerging communications technologies should be prohibited.
- **Disallow FCC standard-setting authority.** Whether it concerns standards for high definition television, set-top boxes, cellular communications, satellite transmissions, the Internet, or any other communications industry technology, policymakers should take a firm stand against regulatory efforts that are aimed at boxing this dynamic industry into a single standard. The Internet Protection Act takes such a strong stand against standard-setting for the Internet and interactive technologies, but there is no reason why this prohibition should not be broadened to cover the entire industry.

Internet Issues

To ensure the unrestrained development of the Internet and the interactive computer services industry, Congress should:

- **Prohibit Internet taxation.** Congress must oppose destructive efforts to tax the wonderful new medium of the Internet. H.R. 1054, the Internet Tax Freedom Act recently introduced by Representative Christopher Cox (R–CA), and S. 442, a similar bill introduced by Senator Ron Wyden (D–OR), offer excellent opportunities to

23 Duesterberg and Gordon, *Competition and Deregulation in Telecommunications*, p. 70.

do just that by placing a moratorium on any efforts by the 30,000 different taxing jurisdictions within the United States to impose unneeded and potentially unconstitutional taxes on the Internet.[24]

- **Protect the Internet from regulation.** Reforms of the sort contemplated by the Internet Protection Act should be an essential part of any reform effort Congress undertakes. They would leave state and federal regulators with no choice but to allow this new medium to develop free of unnecessary constraint.

Spectrum/Broadcast Issues

To encourage wireless innovation and entrepreneurship, Congress should:

- **Allow spectrum flexibility and move toward spectrum property rights.** It is essential that policymakers create a truly free market for wireless spectrum use by freeing the electromagnetic radio spectrum from seven decades of regulatory constraint. To do so, they must first allow absolute spectrum flexibility so that owners of spectrum licenses for any type of wireless service (such as cellular, broadcast, or satellite licenses) can use that spectrum for whatever purpose the market demands. Currently, spectrum licenses require that the spectrum be used only for the singular purposes outlined on the license itself.[25]

  Simultaneously, all incumbent holders of spectrum should be granted irrevocable perpetual property rights in their wireless holdings. Like all other property, spectrum property could be used for whatever purposes the owner sees fit, subject to common law standards governing trespass and interference. More important, the FCC should be directed to auction off all competing claims for unused spectrum. Finally, to encourage the government to disgorge as much of its current spectrum as possible, federal agencies would be given a certain percentage of the revenues from the sale of their spectrum. This would ensure an incentive for government spectrum users voluntarily to place some of their vast spectrum holdings on the auction block so that those holdings could be used more efficiently. This plan, advanced originally in a study by the Progress and Freedom Foundation,[26] would guarantee more efficient deployment and use of wireless communications technologies.[27]

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24 See Adam D. Thierer, "Why Congress Must Save the Internet from State and Local Taxation," Heritage Foundation *Executive Memorandum* No. 488, June 23, 1997; Adam D. Thierer, "Spare Internet from Taxation?", *The Washington Times*, July 11, 1997, p. A18; Kent Lassman, "Cox-Wyden Putting Internet Taxation on Hold," Citizens for a Sound Economy *Capitol Comment*, May 22, 1997; and Grover G. Norquist, President, Americans for Tax Reform, "The Internet Tax Freedom Act: Let's Say 'No' to Sand in the Friction-Free Economy," testimony before the Committee on Commerce, U.S. House of Representatives, in support of H.R. 1054, July 11, 1997.

25 See Adam D. Thierer, "A Policy Maker's Guide to Deregulating Telecommunications, Part 6: A Free-Market Future for Spectrum," Heritage Foundation *Talking Points* No. 10, March 19, 1996; Tom Hazlett, "Underegulation: The Case of Radio Spectrum," paper presented at a Cato Institute conference, Beyond the Telecommunications Act of 1996: The Future of Deregulation, September 12, 1997; and Evan Kwerel and John Williams, "Free the Spectrum: Market-Based Spectrum Management," paper presented at a Cato Institute Conference, Beyond the Telecommunications Act of 1996: The Future of Deregulation, September 12, 1997.

26 *The Telecom Revolution: An American Opportunity* (Washington, D.C.: Progress and Freedom Foundation, May 1995), pp. 70–79.

27 See also Thomas J. Duesterberg and Peter K. Pitsch, "Wireless Services, Spectrum Auctions, and Competition in Modern Telecommunications," Hudson Institute *Outlook*, Vol. 1, No. 5 (May 1997), and Congressional Budget Office, *Where Do We Go From Here? The FCC Auctions and the Future of Radio Spectrum Management*, April 1997.

- **Eliminate remaining broadcast media ownership restrictions.** All remaining rules and restrictions governing the ownership structure or constitution of broadcast media enterprises should be abolished. There is no justification for the centralized planning of the media market, and as print and electronic media sources continue to converge, it will be more difficult to do so. Any market power concerns that arise should be dealt with under the antitrust laws, as they would be in any other industry.[28]

Protectionism

To guarantee free trade in telecommunications services, Congress should:

- **Eliminate foreign protectionist rules.** Rules that restrict foreign ownership of U.S. telecommunications companies hurt only the American consumer. Since 1934, Section 310(b) of the Communications Act has kept foreign entities 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.[29] It makes little sense to continue such xenophobic and protectionist restrictions on foreign ownership of U.S. firms in light of the great diversity of media and communications outlets that exists today. Countries like the United Kingdom and New Zealand have liberalized their telecommunications markets and now enjoy the benefits of increased capital investment and entrepreneurial competition.

  Although the United States recently negotiated a landmark agreement to open global telecommunications markets to free trade with other members of the World Trade Organization (WTO), Congress still needs to eliminate long-standing protectionist rules if the WTO agreement is to have its intended affect.[30] Unconditionally opening the U.S. telecommunications sector to foreign investment and competition will lower prices, produce more innovative products, and create new jobs.

Free Speech

To ensure that any reform is constitutionally sound, Congress should:

- **Eliminate all "public interest" requirements.** Licensed holders of broadcast spectrum currently are required to meet a series of conditions which supposedly assure that the "public interest" is being served. For example, under the Children's Television Act of 1990 and subsequent regulations, the FCC can demand that private broadcasters air a certain number of hours of "children's programming" as a condition of license renewal.[31] Not only is this another unnecessary regulatory intrusion into the market, but such requirements also are contrary to the First Amendment

28 For more information, see Peter K. Pitsch, "An 'Innovation Age' Perspective on Telecommunications Mergers," Citizens for a Sound Economy *Issue Analysis* No. 43, November 13, 1996; Adam D. Thierer, "Why Mass Media Mergers Are Meaningless," *The Freeman*, Vol. 46, No. 1 (January 1996), pp. 4–5; and William B. Shew, "Are Media Mergers a Menace," *The American Enterprise*, March/April 1996, pp. 69–70.

29 For a comprehensive overview and critique of current telecommunications protectionist restrictions, see J. Gregory Sidak, *Foreign Investment in Telecommunications* (Chicago, Ill.: University of Chicago Press, 1997), and 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.

30 For a more detailed discussion of the WTO rules, see Cynthia Beltz, "Global Telecommunications Rules: The Race with Technology," *Issues in Science and Technology*, Spring 1997, pp. 63–70, and "The WTO and the Global Communications Revolution: The Road Ahead," American Enterprise Institute Conference Summary, August 1997.

because they demand that private-sector parties air certain types of speech. Moreover, the "public interest" is whatever the public, or consumers, say it is—*not* what regulators think it is or tell the public it should be. Such requirements should be repealed immediately.

- **Guarantee First Amendment parity for all media.** All media, whether print or electronic, should be accorded similar First Amendment protection under the law. It makes little sense to regulate an on-line service provider of news differently than a daily newspaper. The existing double standard provides print media with sweeping First Amendment freedoms but grants electronic media lesser protections. As print and electronic technologies converge, it will become difficult, if not impossible, to regulate them under different standards. Policymakers should recognize the importance of placing all technologies on equal regulatory footing by reaffirming First Amendment protections.[32]

Encryption

To ensure the free development of computer security software, Congress should:

- **Prohibit government–mandated encryption standards and controls.** Probably the most hotly debated communications/computer question facing the 105th Congress is whether the federal government should regulate the production, exportation, or domestic use of U.S.-produced encryption software. The remarkably entrepreneurial U.S. computer sector has developed state-of-the-art encryption software to ensure maximum security and privacy for encoded data communication. Such software is obviously essential as electronic communication explodes and as more and more personal and business-related activity is carried on over interactive networks. "In essence," summarizes George A. Keyworth II of the Progress and Freedom Foundation, "encryption technology empowers people to protect their digital property from unauthorized use."[33] The digital property protected by encryption software includes medical records, sensitive business information, and financial records and transactions, as well as daily electronic mail, facsimile, or voice communications.

  However, some law enforcement officials and others in government (including the Clinton Administration) have argued that this software could be used to protect secret communications between parties who wish to undermine American national

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31 See Adam D. Thierer, "Who Will Mind the Children? The Regulation of Children's Programming in the Information Age," in *Speaking Freely: The Public Interest in Unfettered Speech* (Washington, D.C.: Media Institute, 1995), pp. 47–66.

32 See Adam D. Thierer, "A Report Card on the Pressler Telecommunications Plan (S. 652)," Heritage Foundation *Issue Bulletin* No. 209, May 5, 1995, p. 15–16; Fred H. Cate, "The First Amendment and the National Information Infrastructure," *Wake Forest Law Review*, Vol. 30, No. 1 (Spring 1995), pp. 1–50; Jonathan W. Emord, *Freedom, Technology, and the First Amendment* (San Francisco, Cal.: Pacific Research Institute, 1991); Lawrence Gasman, *Telecompetition: The Free Market Road to the Information Highway* (Washington, D.C.: Cato Institute, 1994), pp. 141–151; Michael Schrage, "In the Emerging Multimedia Age, the 1st Amendment Must Come First," *The Washington Post*, September 30, 1994, p. B3; and Thomas G. Krattenmaker and Lucas A. Powe, *Regulating Broadcast Programming* (Washington, D.C.: AEI Press, 1994).

33 George A. Keyworth II, testimony before the Subcommittee on Telecommunications, Trade and Consumer Protection, Committee on Commerce, U.S. House of Representatives, *Hearings on Encryption*, September 4, 1997; available on the Internet at *http://www.townhall.com:80/pff/congtest/ct090497.html.*

security interests. Therefore, they feel encryption software should be tightly controlled or heavily regulated by the federal government. Basically, these officials are saying (1) that a limit or cap should be placed on how powerful the U.S.-produced encryption software can be and (2) that the Federal Bureau of Investigation (FBI) or some other federal law enforcement body should be given a "master key" to unlock all encrypted forms of private communication. Such proposals to allow the government to hold a master key (or collection of keys) often are referred to as "key recovery," "data recovery," "key escrow," or "trusted third party" systems.

The problems with these proposals are numerous.[34]

First, they raise serious Fourth Amendment concerns regarding unlawful government search and seizure. Senator John Ashcroft (R–MO) argues that "The state's interest in effective crime-fighting should never violate the people's Bill of Rights" and warns that such controls would "hand Big Brother the keys to unlock our e-mail diaries, open our ATM records or translate our international communications."[35] According to Steve Forbes, editor in chief of *Forbes* magazine, it is in America's best interest to encourage the development of strong encryption software to promote freedom globally: "This is an issue of protecting not only intellectual property but also human rights. Political and religious dissenters around the world would welcome strong encryption software and equipment so they could communicate without it being so easy to be 'overheard' by Big Brother."[36]

Second, such heavy-handed encryption controls would stifle the further development of this budding segment of the American computer industry. U.S. law already prohibits the exportation of encryption software that is stronger than 56 bits. As *The Washington Times* has noted, "That's not very advanced. In fact, a bunch of college students deciphered a 56-bit 'lock' in a few months, and a government agency like the FBI (with a $300 million computer) could break a 56-bit 'lock' in under 12 seconds."[37] Few companies or individuals would want to buy U.S.-manufactured encryption software that was powerless against sophisticated computer hacking or theft. As a result, with data security thus sacrificed, the United States would quickly lose its overwhelming competitive advantage in this field. It also would lose a growing job base to overseas interests and, over the long term, could lose its technological domination of the entire computer industry.

Third, government encryption controls and standards could have an adverse effect on the continued vitality and security of the entire free-market system as the United States enters the Information Age. "Without a secure and trusted infrastructure," says a group of leading cryptographers and computer scientists, "companies and individuals will become increasingly reluctant to move their business or personal information on-line."[38] By capping encryption software at artificially low levels, policymakers would make all forms of digital communications less secure, threatening the billions of sensitive daily electronic transactions that take place

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34 See, generally, James P. Lucier, Jr., "The Government Would Like a Key to Your Computer Files," *The Washington Times*, March 5, 1997, p. A15, and Solveig Bernstein, "Tangled Internet Encryption Intentions," *The Washington Times*, July 19, 1997.

35 See Senator John Ashcroft, "Welcoming Big Brother," *The Washington Times*, August 12, 1997, p. A15.

36 Steve Forbes, "Thwarting Internet Thieves and Peeping Toms," *Forbes*, April 21, 1997, p. 27.

37 Editorial, "Cracking the Code," *The Washington Times*, September 24, 1997, p. A24.

between companies and individuals. If Americans have no confidence that their domestic communications systems and networks are secure, the entire landscape of the future information-based economy could be undermined.

Fourth, although stringent controls on more sensitive technologies or items that could pose a serious threat to national security might be appropriate, it is not in the best interests of the United States to impose such controls on encryption software. U.S. law enforcement capabilities would not be compromised or rendered useless by the free development and wide marketing of strong encryption software. Moreover, the reverse might be true: Federal encryption controls could jeopardize U.S. security interests by forcing American encryption developers to relocate overseas and sell their software to global customers. "Allowed to continue," argues Dr. Keyworth, "this phenomenon eventually will deny America—*including the intelligence community itself*—the latest in encryption technology."[39]

With countless firms in dozens of countries around the world racing to catch up to the United States in this field, alternative foreign suppliers of strong encryption software certainly will arise to fill the void if U.S. companies are prohibited from improving their encryption products. As Netscape Communications Corporation President and CEO Jim Barksdale explains, "criminals will still be able to buy advanced encryption technology outside the U.S., where is freely available today."[40] In fact, 128-bit encryption software already has been developed and marketed overseas.

"Today the intelligence community is worried about controlling the latest encryption technology developed in the United States," warns George Keyworth. "With export controls in place, Americans may find in just a few short years that the true national security problem is trying to obtain the latest encryption software developed *outside* the United States."[41] In the words of ***The Washington Times***, "It's scary to think that in today's world our cops might be technologically outgunned by the bad guys. But, if that's really the case, then our cops need bigger guns in the form of better technology, not intrusive laws that fly in the face of the Fourth Amendment."[42]

CONCLUSION

Although the passage of the Telecommunications Act of 1996 was heralded as a watershed moment in the history of the American communications industry, the Act has not lived up to its billing. While it gave companies some important freedom from unnecessary rules and mandates, it hardly has represented an unapologetic embrace of free markets and deregulation. The authors of the Telecommunications Act placed their trust in the wisdom

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38 Hal Abelson, Ross Anderson, Steven M. Bellovin, Josh Benaloh, Matt Blaze, Whitfield Diffie, John Gilmore, Peter G. Neumann, Ronald L. Rivest, Jeffrey I. Schiller, and Bruce Schneier, *The Risks of Key Recovery, Key Escrow, and Trusted Third Party Encryption: A Report by an Ad Hoc Group of Cryptographers and Computer Scientists* (Washington, D.C.: Center for Democracy and Technology, 1997), p. 4.

39 Keyworth testimony, *op. cit.*

40 Jim Barksdale, "Washington May Crash the Internet Economy," *The Wall Street Journal*, September 26, 1997, p. A22.

41 *Ibid.*; see also G. A. Keyworth II and David E. Colton, "The Computer Revolution, Encryption and True Threats to National Security," Progress and Freedom Foundation *Future Insights* 3.5, June 1996.

42 "Cracking the Code," *op. cit.*

of central planners rather than in the spontaneity of an evolving decentralized market. Too many decisions were left to the discretion of regulators and not enough to private companies and consumers. The result has been an endless series of legal squabbles in the courts—and even within the FCC—that have placed the process of telecommunications deregulation on hold.

The introduction of the Internet Protection Act, however, represents a truly historic opportunity to correct or (more appropriately) to eliminate the deficiencies of the current regulatory regime. It offers a model for how all segments of the communications industry, not just the Internet, should be treated by the federal government. By expanding on the framework established in the Internet Protection Act and adopting the many necessary reforms that were not incorporated in the Telecommunications Act of 1996, Congress could erase six decades of centralized regulatory planning and set the industry on the path to telecommunications freedom.

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