capable of producing thousands of different kinds of products, each exquisitely tailored to specific needs of relatively small groups of consumers, what better than Adam Smith's invisible hand to bring together buyer and seller in such an environment, thereby ensuring the "adequate facilities" sought by the 1934 act? And what better than true competition and the pricing mechanism to guarantee "reasonable charges?"

What then would an agenda for the 104th Congress look like if Congress took upon itself the old New Deal goal of providing adequate facilities at reasonable charges, but acknowledged the leading role that market forces can play in achieving that goal?

Only a policy of free markets fits the rapidly changing technology in the communications industries; such a policy cannot be based in any significant way on the universal service doctrine.

Such an agenda would require that Congress
- abandon the urge to make telecommunications a branch of social policy;
- free communications resources from the weight of existing regulation; and
- abolish the FCC and other government agencies that micromanage private communications resources.

Universal Service: Against the Public Interest

As noted above, the New Dealers built limited "public interest" goals into the 1934 Communications Act. Today's New Agers have extended those goals, building them into the enhanced versions of the universal service doctrine. That doctrine, a sacred cow for legislators and regulators of all persuasions, requires telephone companies to provide service at reasonable rates to all American homes.

Universal service is a vaguely defined concept, the precise details of which seem to shift with the political winds. In its purest form, universal service is underpinned by a system of subsidies: long-distance subsidizes local service; business subsidizes residential users; and urban users subsidize rural users. Under the old Bell System, what AT&T lost on one type of service, it gained on another. But ever since the Bell System was broken up, the framework of subsidies has become increasingly fragile. In a free telecommunications market, the universal service doctrine would fall apart entirely, since in a free market with many service providers and no government interference, prices must ultimately reflect costs. The costs are quite different for each of the various sectors and services of the telephone market. Only a policy of free markets fits the rapidly changing technology in the communications industries; such a policy cannot be based in any significant way on the universal service doctrine.

That simple piece of economic analysis has been carefully ignored by regulators and legislators, who have continued to support both the universal service doctrine and free telecommunications markets. Without universal service, some believe there would be real suffering for the elderly and sick who cannot afford telephone service. But that need not be the case. Clearly, an explicit subsidy to the poor for basic telephone services would be a drop in the ocean compared to the subsidies underlying universal service as a whole. Such a "lifeline" subsidy would not, it is true, be wholly compatible with a free market in telecommunications, but administered at a local or state level, it need not be a major interference with the pricing mechanism.

A plausible, albeit unconvincing, argument could be made for retaining universal service in the form described above, on the grounds of political expediency. Those opposed to universal service are likely to be accused of depriving the elderly of communication with their physicians, in much the same way that those seeking to reform welfare are accused of wanting to starve children. However, given the incompatibility of universal service and free telecommunications markets, it is a little surprising to find bipartisan support for actually *extending* the meaning of universal service to include much more than simple voice telephony.

Some influential legislators want a new basic package of advanced services to be included under the universal service doctrine. In fact, there is strong bipartisan support for such ideas. In the 103d Congress, the bill that was passed overwhelmingly in the House stated that the goals of universal service should include public access to advanced telecommunications services "as soon as technically feasible and economically reasonable." Video programming for educational institutions, libraries, public broadcasting sta-

tions, and other tax-exempt institutions and governmental entities would be provided "as soon as technically feasible." To pay for video programming, public institutions would be charged a preferential rate amounting only to what it would take to recover the added costs of providing such a service. The House bill also contained a call for the FCC and the Commerce Department's National Telecommunications and Information Administration to examine the possibility of a mandate for the telephone companies to provide Internet access at a "flat rate."

The tradition has continued into the 104th Congress. Though Senator Pressler's proposed legislation is much more modest, it still gives complete support to the older form of universal service and opens the gate for future extensions of the universal service concept in the direction suggested by the House in the previous Congress. Thus, in the language of the Pressler bill universal service is defined as "an *evolving* level of intrastate and interstate telecommunications services that the [FCC] . . . taking into account advances in telecommunications and information technologies and services, determines should be provided at just, reasonable, and affordable rates to all Americans, including those in rural and high-cost areas and those with disabilities, to enable them to participate effectively in the economic, academic, medical, and democratic processes of the Nation."

Such language is hardly that of laissez faire. But even if there was not such a glaring contradiction between the free-market approach to telecommunications and the goal of expanded universal service set out in the Pressler bill and its immediate predecessors, there would be reason to be skeptical of the concept of universal service. That is because in its current version the universal service doctrine spills over into the area of industrial policy. Whatever its other virtues and vices, the older universal service doctrine was predicated on the fairly safe assumption that there would be a widespread demand among businessmen and residential consumers, and in both rural and urban settings, for garden variety telephone service—known as POTS (Plain Old Telephone Service) among the cognoscenti. The newer version of the universal service doctrine makes all kinds of assumptions about consumer demand for advanced services.

Regulators and capitalists both have very poor track records in forecasting such demand, but when capitalists are wrong, investors suffer, and those investors made a free choice to put their money into a particular technology in the first place. When governments are wrong, forced investors—that is, taxpayers—take the hit. More is involved than "taking into account advances in telecommunications and information technologies and services," as the Pressler bill puts it. If universal service in its extended form is to be meaningful, somebody or, more likely, some committee is going to have to guess what future services are going to be in wide demand and then second guess the marketplace and come up with a formula for "just, reasonable, and affordable rates."

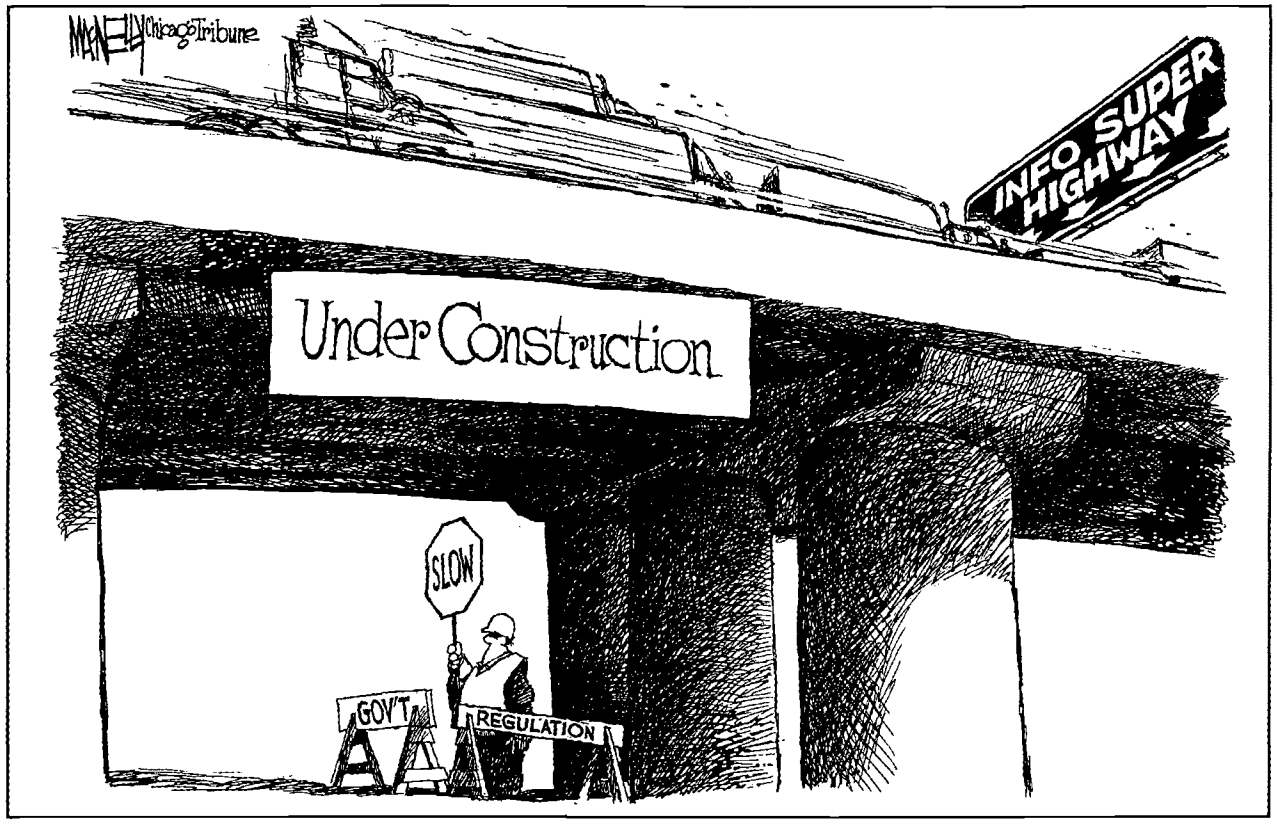
For too long U.S. telecommunications policymakers' fear of a communications monopoly has operated to the detriment of the American consumer.

Obviously, that is not possible, especially when one considers the technical issues involved. For example, should videophone service be included in the definition of universal service? If so, should it be provided at 64 kbps, at which image quality is quite poor? Or should it be at 384 kbps, at which the quality is excellent? As with the definitions of switched and private line service discussed above, an individual question of that kind can be settled quickly in an arbitrary manner. But as more and more of such questions crop up, the flow will overwhelm the human regulators, leaving the market mechanism as the only possible regulator of which services are provided to whom and in which locations.

That would mean the end of the universal service doctrine and of the public interest dimension to telecommunications policy. But it would mark a great leap forward towards "adequate facilities at reasonable charges," which was the stated goal of the New Dealers. Since in a truly free market the consumer is king, we would in fact be replacing the so-called public interest with the consumer interest.

The Communications Monopoly Myth

Eliminating the public interest considerations explicitly incorporated in all U.S. telecommuni-



cations legislation for more than 60 years will be an important step on the way to ensuring that Americans receive the best that communications technology has to offer, but we must also allow market forces to bring forth the corporate and spectrum resources that will make that possible.

Economic reality also dictates that we should be on our guard against "fairness" criteria in assessing the degree of competition in any local marketplace.

For too long U.S. telecommunications policymakers' fear of a communications monopoly has operated to the detriment of the American consumer. The only meaningful definition of a communications monopoly is an exclusive government franchise—a definition that applied to the old Bell system, but does not apply to either the Baby Bells or any other currently existing communications company. Any purely numerical measure of market power—based on market share or share of industry capital assets—can significantly misrepresent market power. Thus, for example, CompuServe and WilTel, long-distance companies with relatively small market shares and levels of deployed assets, pioneered the frame relay business. They were able to do that without apparent harm either to themselves or to consumers using the dominant long-distance carrier, AT&T.

Current legislation bans the Bell companies from entering the long-distance business and manufacturing, and also restricts their ability to enter the cable television business. The rationale for the restrictions is that the market power of those companies, defined primarily in terms of market share, could be used to destroy competitors and harm the consumer interest. But the existing rules actually hurt the U.S. consumer by denying the marketplace potent competitors who would help to keep prices down and ensure a continued flow of innovative new products. That fact is now widely recognized, but legislators face a problem: in their core business of local voice communications the Bell companies are still subject to a regime in which they are essentially guaranteed profits in return for providing universal service. Regulators fear that if the Bells are

turned loose in other markets, they will use profits from their regulated local markets to subsidize their other activities.

That is a legitimate fear, and it is one that the regulators have tried to address through the use of separate subsidiaries through which the Bell companies must operate when acting outside of their traditional markets. There is much emphasis on such structural safeguards in the Pressler bill. But as pro-regulation critics have often pointed out, separate subsidiary rules, unless closely monitored, can easily be abused. In any case, it is far from clear that merely building accounting or organizational firewalls between two parts of a business is enough to stop the benefits of guaranteed profits flowing in a manner that benefits the business as a whole.

A better way would be simply to declare local markets open to competition and then let the Bell companies and others fight it out in any markets in which they choose to compete. A variety of competitors, notably the cable television companies, stands ready to provide local telephony using various cellular-like wireless technologies. But regulators are unlikely to permit that, because they are obsessed with quantitative measures of market power. Before local competition is declared to be in place, a certain percentage of the market will have to be held by companies other than the local Bell company, or a certain number of companies will have to be active in the marketplace.

As noted above, such quantitative measures are largely arbitrary. While putting specific numbers on market power in the telecommunications marketplace looks scientific, it is in fact highly subjective. Most observers would consider the long-distance industry to be highly competitive. There are several hundred companies in the industry, and some—MCI, Sprint, LDSS, and Cable & Wireless, for example—are quite big and successful. Yet the Clinton administration's antitrust chief recently testified before the Senate that even long-distance markets could not be considered truly competitive because of AT&T's dominant market share.

As long as the conditions for competition are defined in such a manner, government will continue to insist on an active role in the local telecommunications marketplace. If we have to wait until the Bells have, say, 35 percent of market share or there are five companies providing local communications before we move to complete deregulation, we may have to wait forever. The economic realities of the telecommunications marketplace may never produce such a situation.

Economic reality also dictates that we should be on our guard against "fairness" criteria in assessing the degree of competition in any local marketplace. Once again, that definition of competition can be found in the Pressler bill, where it is stated as follows, "Achieving full and fair competition requires strict parity of marketplace opportunities . . . on the part of incumbent telecommunications service providers as well as new entrants into the telecommunications marketplace." But one wonders whether there ever has been or ever will be an industry in which all participants have equal opportunity in this sense. Indeed, one could argue that the reason that there are multiple firms in any marketplace is precisely because they do *not* have equal opportunities. There are no level playing fields in business. Worse still, insisting on equal opportunity for firms is standing up for producer interests, not consumer interests.

Business history is replete with David and Goliath stories. Telecommunications should be no exception.

That can be seen in a current debate about interconnection "rights" in local telecommunications. Encouraged by support of the level playing field argument in legislative circles, potential new entrants say they need special interconnection rights with the Bell network. Without interconnection, subscribers to an alternative carrier may only be able to speak to those who are also subscribers to that carrier. And some believe that without interconnection rights being well defined, local companies would discriminate in favor of their own long-distance subsidiaries as they are allowed into long-distance markets.

The last point sounds plausible but is actually dubious. Sprint runs many local telephone companies, but does not discriminate against customers who choose MCI as a long-distance carrier. Why should Ameritech or NYNEX behave differently? The lack of mandated interconnection would not automatically lead the Baby Bells to close competitors out of their markets. In the real world, businesses frequently cooperate with their competitors.

although there has been growing flexibility here. Commercial radio broadcast licensees can only use their licenses for commercial radio. But the new personal communication services licensees can use their spectrum for a broad range of messaging, telephony, and data services. That is an improvement. But in a real free market, spectrum would be sold off for use in any way the owner chose, as long as he did not interfere with others' rights. The problem here is that both the new wireless technologies and their applications are rapidly emerging and are defined primarily by the entrepreneurial imagination. In such an environment, a policy in which a government agency lays down which portion of spectrum will be used for which service simply will not do.

What we need instead is a system of freely transferable spectrum rights. Given such a system, a mobile communications service provider, for example, would have a title that described his spectrum rights, including relevant frequencies and maximum transmission power. The spectrum owner could then choose to use the spectrum for providing mobile communications or for any other purpose—low-power television, perhaps.

It is not simply because there will be no work for it to do that the FCC must go; the FCC must go because it is a negative force in and of itself.

Such suggestions are usually condemned as unworkable. Some critics say that market mechanisms could actually result in fewer consumer options. They believe that if spectrum owners could do whatever they like with their property, consumers would be denied essential emergency services or have services abruptly eliminated. But if a local community was to determine that a particular type of uneconomic service is essential, the community could provide an explicit subsidy for the service. Otherwise, the absence of particular services would merely reflect the real and inevitable tradeoffs that are constantly made by persons deciding where to live and work.

The real challenge lies in creating true spectrum property rights, and what is important here is the creation of those rights, not the way they are established. Auctions and lotteries may play a role; so may "homesteading." For example, very low power television stations are now springing up to meet local needs in small urban communities. The stations are illegal and will remain so indefinitely. The FCC has no intention of licensing them, because they are too low powered to fall under the agency's purview. Thus, a criminal class of low-power broadcasters has been created. Curiously, those broadcasters are exactly the type of people the New Agers want to give special access to the information superhighway. Under a homesteading mandate, we would let those broadcasters register their intent to use a particular portion of spectrum at a certain power range and in a specific locale. If no one had previously registered the claim or some subset thereof, the broadcaster would be able to develop his new service.

Whither the FCC?

With the public interest philosophy of traditional telecommunications policy replaced by a consumer interest criterion, and with communications resources allocated by markets rather than politics, there will be little reason to keep the FCC in existence. It is not simply because there will be no work for it to do that the FCC must go; the FCC must go because it is a negative force in and of itself. That is the case for at least four reasons. First, most telecommunications laws give the FCC broad powers of action and of legal interpretation. That is presumably because telecommunications law is written by congressional staffers who often know relatively little about the industry from a business or technical perspective. So they leave the details (the place where the devil is) to the FCC. Second, while the current trend may be deregulatory, that could change, and leaving the FCC in place would give a valuable weapon to a future administration bent on interfering with telecommunications markets. Third, as the Manhattan Institute's Peter Huber has pointed out, the FCC, while it has scored some deregulatory brownie points, has also been the main force standing in the way of deregulatory progress. Huber cites the case of the active participation of the telephone companies in the cable television business. Such activity remains explicitly banned by the FCC, even though several courts have struck down the ban as unconstitutional.

Finally, there is the cost of the FCC itself.

Adam Thierer of the Heritage Foundation has pointed out that the FCC is out of control. Thierer notes that during the Reagan years FCC spending declined by 6.5 percent, while during the Bush-Clinton years it has risen by 71 percent. Thierer points out that "the 1980s saw decreased telecom bureaucracy. But by 1990, FCC staffing had leveled off. With the imposition of the Cable Act of 1992, [which reregulated the cable industry, setting price controls on some levels of programming] staffing began to rise rapidly." And according to Thierer, "Under the current Clinton administration budget requests, staffing [at the FCC] is set to rise from 1,753 full-time employees in 1993 to 2,267 in 1996."

Telecompetition: Politically Possible?

Such trends should serve as a warning sign that, despite talk in all quarters about deregulation, we may be moving in another direction. The Pressler bill, while deregulatory in spirit, only tinkers at the problem. How politically realistic, then, is the radical deregulation I have called for in this article? It is clearly unrealistic to expect everything that I have suggested here to occur during the 104th Congress, although pressure from more libertarian members in the House might make a 1995 telecommunications reform package better than what was in the Senate at the time of this writing. It is also possible that there will be no telecommunications reform at all during the 104th Congress. In that case, the future of telecommunications policy will depend on the composition of the next Congress.

Ultimately, however, telecommunications deregulation will occur, de facto if not de jure. If the marketplace is not deregulated by Congress, it will be deregulated by the logic of the technology itself. As cable companies enter the telephone business and telephone companies cross the lines into entertainment video, and as broadcasters move into the computer industry, regulators will simply be unable to keep up. What we may see, then, over the next few years is a series of reforms, none of which lasts very long, as the communications industries and technology make them irrelevant. In this scenario, Congress will eventually grow tired of trying to regulate the communications marketplace. And we will then finally have reached the age of telecompetition.

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