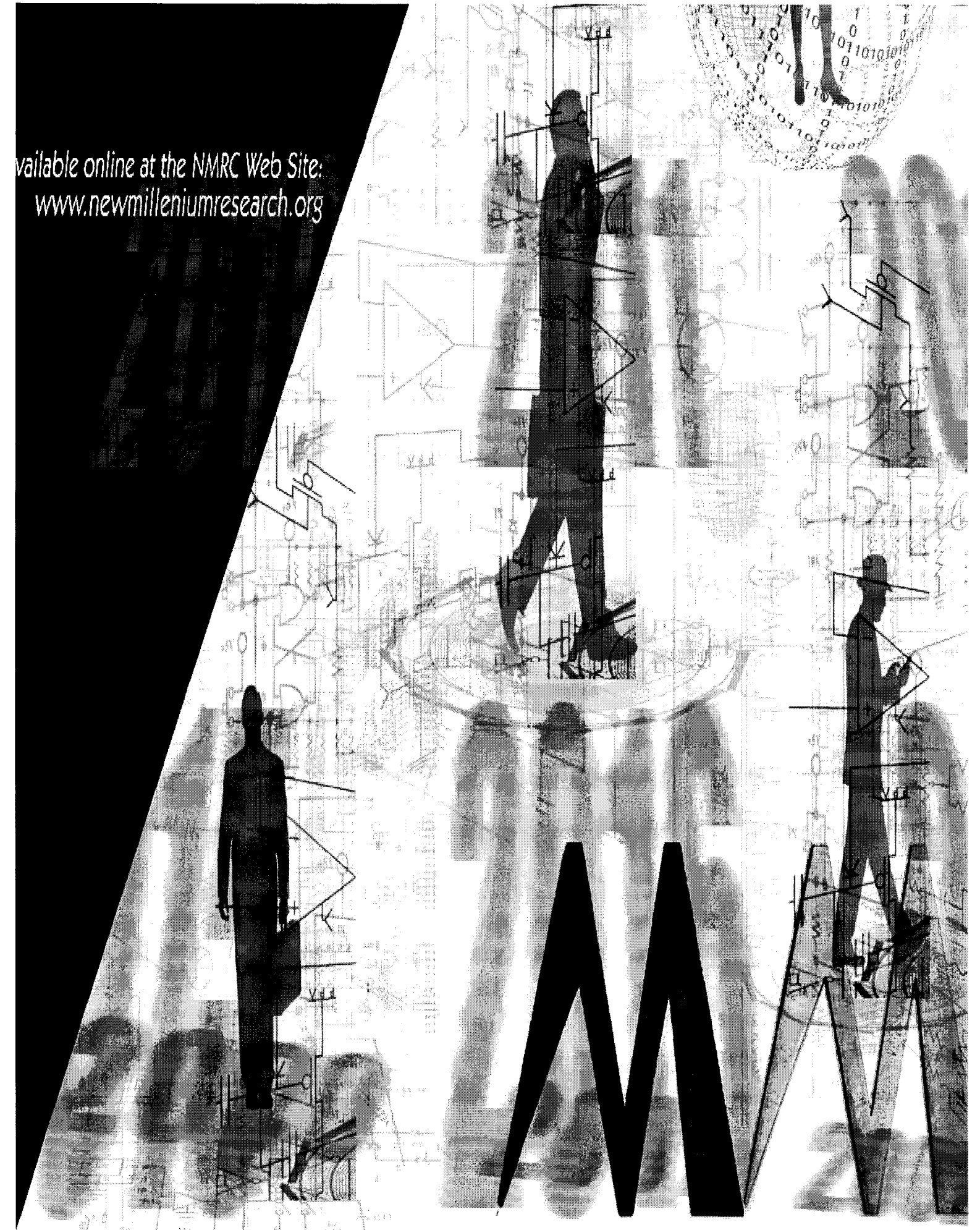
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About the New Millennium Research Center

The New Millennium Research Council (NMRC) is a non-profit research organization based in Washington, DC. It's mission is to foster policy research focused on developing workable, real-world solutions to the issues facing policy makers, primarily in the fields of telecommunications and technology.

The Council consists of independent academics and researchers who are experts in their fields. The research agenda is managed by the Research Board of Directors, which is in formation. Current members include Karen Buller, Dr. Barbara O'Connor, and Dr. Jorge Schement.

The NMRC is an independent project of Issue Dynamics, Inc. (IDI), a consumer and public affairs consulting firm that specializes in developing win-win solutions to complex policy issues.

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The Telecommunications Act at Five

Promoting Investor Confidence, Imposing Gridlock

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For all of its well-meaning intentions and rhetoric about loosening the grip of government, the Telecommunications Act ended up centralizing all fundamental telecommunications policy in the Federal Communications Commission (FCC), effectively federalizing the 50 states with respect to local competition and preempting the judicially-supervised modified final judgment (MFJ) with respect to Bell entry into long distance. This centralization satisfied investors' desire for greater "certainty" and "predictability," unleashing a torrent of inexpensive capital. The increase in investor confidence was, by far, the most positive result of the Act.

However, to assuage the concerns of the habitually warring and suspicious factions in the industry (and in the Congress itself), the Telecom Act did not simply establish broad policy goals (i.e., competition in all markets and less regulation) and then leave it to the FCC to achieve them. Rather, Congress, perhaps concerned that the majorities of the FCC and Congress are usually from different political parties, and in any case enjoying the attentions of all the industry factions, felt it necessary to micromanage the implementation. For example, the statute specified three separate pricing methodologies for interconnection between incumbent and new local telephone companies, established a detailed system for negotiating, mediating and arbitrating interconnection agreements, and specified a 14-point checklist to be satisfied before a Bell could offer long distance services. There is nothing substantively wrong with these policies except that they took away much of the freedom of the implementing agency – the FCC – to adjust policies later in light of unexpected or changed circumstances. While this micromanagement may have been necessary to get broad support for the Act, the result has been a legal gridlock that has, so far, thwarted achieving of the Act's fundamental objectives.

If the Act took flexibility from the FCC, it took even more from the States. With respect to local competition, it is useful to recognize that the Telecom Act was neither revolutionary nor innovative. This has been often overlooked by Washington-centric reporters and financial analysts. The Act largely codified into national law and policy the results of many experiments conducted by State public utility commissions (PUCs) over the prior decade to introduce local competition.[1]

Unfortunately, this state-by-state process – with its admittedly untidy look of "muddling through" – did not provide the certainty and predictability sought by investors. Because the PUCs were operating under often archaic state laws that broadly directed them to regulate in the "public interest," PUC decisions were neither predictable nor uniform. Even "pro-competition" PUC decisions sometimes looked serendipitous, and where local competition emerged, its foothold seemed tenuous. And there was a general perception that the telephone incumbents wielded political power in many state capitals.

Thus, by establishing one law encompassing one local policy and by federalizing the PUCs' competition initiatives under the direction of the better understood FCC, the Telecom Act of 1996 dramatically changed institutional investors' risk assessment and hence willingness to sink capital

into all industry segments, particularly local start-ups.

But the certainty and predictability proved illusory. The state-by-state experimentation, which was inexorably leading to vigorous local competition wherever there was a substantial market demand, largely ceased. The Act froze much of local competition around the technological and market perceptions and realities of the mid-1990s. Of course, the Internet – virtually unmentioned and unconsidered in the Act – has emerged dramatically and challenged some of the foundations of the Act, making it less relevant with each passing year.

Ironically and not appreciated by investors, the "muddling through" of local competition is actually less risky than a single federal policy because it allows for a continuous and low-risk process of field experimentation, testing, and fine-tuning of policy before major investment bets are placed. By contrast, it is difficult for the FCC to make any small decisions: everything becomes a case of national significance. Since almost every FCC decision leads not to finality but to litigation, fundamental decisions end up made not by an expert agency but by judges and their law clerks. Similarly, because the FCC is a national agency, it is almost impossible for it make rules that are tailored to the circumstances of a particular locality. Yet local telecommunications, by definition, vary across the country and require different approaches: New York and Montana are so different from each other in needs and circumstances that no national policy will be optimal for either state or for the investors in each state's telecommunications infrastructure.

The Telecom Act also gridlocked the entry of the Bell companies into long distance markets. The flexible standard of sec. VIII(C) of the MFJ[2] became the detailed, specific and rigid "14 point checklist" of the Telecom Act. Each of the 14 points on the checklist became a point of contention, friction, and delay. Ironically, by the end of 1995, at least two Bell companies (New York Tel and Illinois Bell) were ready to seek interLATA relief under the VIII(C) standard on the basis of competition in their major markets (i.e., New York and Chicago). Whether their initial applications would have been granted is, of course, unknowable. But it is certainly arguable that Judge Greene and the Department of Justice would have allowed them to enter to establish the regulatory carrot that would encourage other BOCs to open up and to begin to free themselves from the MFJ stick.

One major strength of telecommunications policy innovation in the Untied States has been its ability to make incremental but steady changes based on real-world experience and observation. In contrast, other countries' policy changes were part of big "omnibus" national communications legislation, involving blue ribbon commissions, national coalition politics at the highest level, and labor versus government strife, all of which tied up the process forever. The United States, in contrast, progressed towards competition in a series of numerous regulatory skirmishes before state commissions, courts, and legislatures, but without a single plan or a decisive battle. That is, until the 1996 Act, which emulated the omnibus model. And, sure enough, the progress to competition and deregulation has slowed down since then.

In the guise of promoting competition, the Act and the FCC regulations that followed have created an enormous regulatory apparatus and set of requirements. And while there are many beneficiaries of such detailed regulations - not the least of them the communications bar - the Act has created a set of companies and industries whose very survival is by the good graces of regulators. This dependency relationship is not one that makes for a healthy policy environment or acceptable investment risk.

An evaluation of the Telecom Act must therefore consider whether the temporary gain in investor confidence has been worth the loss of innovation,

experimentation and lower policy risk. With the benefit of 20-20 hindsight, it probably was not.

If telecommunications competition is presently gridlocked, what should be done? If statutory micromanagement is a root cause of the gridlock, additional statutory micromanagement in the form of further amendments is not the solution. For better or for worse, everyone now understands the current version of the Telecom Act.

Rather than micromanaging the substance of telecommunications policy, Congress should focus on broad goals and an easy process. Congress needs to have greater confidence that the FCC will not undercut it and the FCC needs to have more confidence in the state PUCs. The FCC and the states should have clear authority to promote competition through focused experiments and with regulatory flexibility. Gridlock can also be reduced by a "Telecommunications Regulation Sunset Act" that requires every regulation to sunset at a date-certain (which can be extended by affirmative decision) or when objective measures are achieved.

Clearly, we are not yet at the stage of substantial competition and complete deregulation, but it is time to chart an end-game scenario and work towards it.