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Though it may seem an odd assertion, telecommunications regulators can learn a lot from the game of golf. To succeed, golfers and policy-makers alike must learn to distinguish between what they know and what they believe. The first lesson in golf is that the ball will travel farther and stay straighter if the golfer's swing is easy and unforced. Every golfer knows this, yet one's natural instinct when teeing off is to swing as hard as possible, in the belief that this will make the ball go as far as possible. When golfers act on what they believe, rather than what they know, their shots wind up off-course.

The same knowledge/beliefs dichotomy exists in the realm of telecommunications regulation. We know that regulation is intended as a substitute for competition and is imposed in the absence of competition. Where genuine competition exists, there is no need for regulation beyond the general strictures of the antitrust laws. Yet, the belief underlying most deregulation initiatives in the telecommunications field is that new and complex regulations are needed to smooth the transition and preserve competition in a newly opened market.

The danger is that the complex web of new regulations, however well intended, will become a barrier to achieving the underlying goal of deregulation—the substitution of competition for regulation. The thicket of "transitional" regulations can become so dense that it makes the goal of a competition-driven market impossible to achieve. Indeed, the knowledge/beliefs dichotomy helps to explain why, twenty-five years into the process of introducing competition into the United States telecommunications market, the industry, in many respects, is more pervasively regulated than ever before.

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A more sweeping example of the knowledge/beliefs dichotomy and its consequences can be seen in the worldwide collapse of Communism. Marxist-Leninist theory foresees a process of societal transformation culminating in the "withering" and eventual dissolution of the state. The first, necessary step in launching this process is the creation of a "dictatorship of the proletariat." But the Communist dictatorships established in the twentieth century never withered. In the name of creating the necessary preconditions, the state expanded its authority relentlessly, assuming ubiquitous and permanent control over all aspects of society. The Communist state ultimately became an institutional barrier to the very transformation it was conceived to initiate. Eventually, it collapsed under its own weight.

The same phenomenon could occur in the telecommunications field, albeit on a far less apocalyptic scale. The sixtieth anniversary of the Communications Act is a particularly appropriate context in which to focus on the risk that the benefits of open, competitive markets could be choked off by regulatory complexity imposed in order to manage the transition to competition. We are at a turning point. A new and very strong consensus appears to have emerged in the 1990s in favor of removing all remaining regulatory barriers to entry into telecommunications service markets. There is unusually broad agreement that competition should be allowed and facilitated in the market segments that continue to be served by a monopoly provider, including the local exchange. Debate today is not over whether certain telecommunications markets are natural monopolies but rather the terms and conditions of competition.

Reflecting this consensus, several bills debated in the 103d Congress would have preempted remaining state barriers to competitive entry into the local exchange services market, except in specifically defined rural areas. The bills also would have led to the removal of line-of-business restrictions that prevent the Bell companies from providing interLATA services and manufacturing telecommunications equipment. The restriction that bars telephone companies from providing video programming to their subscribers, in competition with cable TV operators, also would have been lifted.

Congress failed to enact these sweeping telecommunications measures, but the momentum behind the bills' main provisions has not abated. On their own initiative, numerous states have begun to open the local exchange to competition. The leaders in this movement have included New York, Maryland, Michigan, Illinois, Connecticut, Washington, and Wisconsin. At the federal level, the Federal Communications Commission (FCC or Commission) continues, despite court setbacks, to foster "expanded interconnection," the purpose of which is to enable competition in the interstate access services market.[1] To the extent permitted under its existing statutory authority, the FCC also has sought to enable competition in the video programming distribution market through its video dialtone proceeding.[2]

Moreover, shortly after the telecommunications bills died in Congress, Vice President Al Gore and FCC Chairman Reed E. Hundt recommitted the federal government to the principle of across-the-board competition in telecommunications. Both have cast future telecommunications policy-making as a stark choice between perpetuating monopolies and replacing them with competition.[3]

Thus, the United States appears to be on the verge of eliminating the last vestiges of monopoly and throwing its entire telecommunications market open to competition. In principle, this is a good thing. Markets that are not natural monopolies should not be kept closed by regulatory fiat. There is a widespread consensus in the United States that competition in service markets spurs technological development and deployment. In general, what is happening is that public policy is catching up to the market. Regulatory lag has always been a substantial problem in the telecommunications field. For example, private line services and switched services continued to be subject to separate regulatory regimes long after the market had eroded any artificial distinctions between the two types of offerings.

But deciding to open all markets to competition is not without risk. The danger is that the goal of deregulating everything will fall victim to regulatory complexity. Specifically, the risk is that as we move to open all markets, we will follow the established pattern of imposing additional layers of "transitional" regulations—resulting in a regulatory framework so complex that the goal of open competition is never achieved.

This risk is particularly grave in the local exchange services market, which is by far the largest segment of the United States telecommunications

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1. *In re* Expanded Interconnection with Local Tel. Co. Facilities, *Report and Order and Notice of Proposed Rulemaking*, 7 FCC Rcd. 7369 (1992), *reconsidered by Memorandum Opinion and Order*, 8 FCC Rcd. 127, *reconsidered by* 8 FCC Rcd. 7341 (1993), *vacated in part and remanded sub nom.* Bell Atlantic v. FCC, 24 F.3d 1441 (D.C. Cir.), *modified by Memorandum Opinion and Order*, 9 FCC Rcd. 5154 (1994).

2. *In re* Telephone Co.-Cable TV Cross-Ownership Rules, §§ 63.54-63.58, *Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking*, 7 FCC Rcd. 5781 (1992), *aff'd*, National Cable TV Ass'n v. FCC, 33 F.3d 66 (D.C. Cir. 1994).

3. *See* Thomas Walsh, *Gore Pledges Infopike Fight*, DAILY VARIETY, Oct. 18, 1994, at 2; Reed E. Hundt, Keynote Address at the Interface VIII Conference (Oct. 4, 1994) (copy on file with Author).

services market, accounting for almost two thirds of the industry's $169 billion in revenues in 1993.[4] Moreover, until recently, local exchange services were operated on a pure monopoly basis in most U.S. jurisdictions. Opening this market to competition will be an inherently complex process, requiring solutions to thorny problems including: universal service and carrier-of-last-resort obligations, interconnection of competing local networks, mutual compensation for terminating calls from competing networks, and telephone number assignment and portability. If, in addition to resolving these essential questions, regulators add further rules intended to ensure a competitive local exchange, the regulatory framework could reach such a level of complexity that the market will never emerge from regulation.

THE ORIGINS OF REGULATORY COMPLEXITY

A market characterized by a single company operating as a monopoly is easier to "regulate" than are numerous companies operating in multiple market segments characterized by varying degrees of competitiveness. Before the monolithic Bell System began to face competition, continuing surveillance was sufficient to regulate its operations. There was no need to scrutinize the minutiae of its activities, since there were no competitors to protect from access discrimination, cross-subsidy, or other anticompetitive behavior. But the fragmentation of the Bell System and the gradual introduction of competition in certain market segments have resulted in a steady increase in the number of "borders" regulators must patrol.

A clear and consistent pattern has emerged as previously monopolistic markets have been opened to competition. Each step in the process has coincided with the adoption of new rules and new regulatory mechanisms that result in more, not less, detailed oversight of certain carriers' activities. Private line services were the first market segment opened to competition by the FCC. Before doing so, the Commission undertook the exhaustive "seven-way cost study" to determine the "costs" and "profitability" of different Bell services.

This inaugurated an era of attempts by the FCC to determine the "cost" of providing not just services but individual rate elements and sub-elements, culminating in FCC docket 18,128—one of the most complex and least productive regulatory proceedings in history.[5] Of course, both the

4. U.S. DEP'T OF COMMERCE, U.S. INDUSTRIAL OUTLOOK 29-1 to 29-7 (1994).

5. *In re* AT&T, Long Lines Dep't, *Memorandum Opinion and Order*, 61 F.C.C.2d 587 (1976), *reconsidered by* 64 F.C.C.2d 971 (1977), *further reconsidered by Second Order on Reconsideration*, 67 F.C.C.2d 1441 (1978), *aff'd in part sub nom.* Aeronautical Radio, Inc. v. FCC, 642 F.2d 1221 (D.C. Cir. 1980), *cert. denied*, 451 U.S. 920 (1981).

integrated nature of the network and the distortive impact of regulation make it impossible to identify the "true" cost of individual services, assuming for the sake of argument that such a concept is meaningful.

Regulatory complexity also has been a problem in the area of enhanced and information services, despite the FCC's stated objective since the 1970s of fostering development of a competitive market. The first regulatory regime it established, in the *Computer I* proceeding,[6] to further this goal became rapidly obselete. It was followed by the *Computer II* regime, which created a distinction between "basic" services provided by network operators under traditional common carrier regulation and "enhanced" services. Moreover, AT&T (and later the divested Bell companies) were required to offer enhanced services via a separate subsidiary.[7] The stated purpose of this rigid structural separation requirement was to ensure equal treatment of all enhanced service providers, whether affiliated with a Bell company or not. But the practical result of this requirement, coupled with the information services restriction imposed on the Bell companies under the AT&T antitrust consent decree, was that the U.S. information services market grew slowly and developed inefficiently. In the mid-1980s, the FCC sought to remedy this situation through its *Computer III* proceeding which, among other measures, replaced the structural separation requirement by accounting safeguards, including the joint cost rules, cost allocation manuals, annual independent audits, and uniform reporting requirements.[8] Yet, this effort to remove regulatory impediments to the efficient operation of a competitive enhanced services market remains in doubt to this day, due to successful court challenges of aspects of the *Computer III* regime. Also, the decree's information services

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6. *In re* Reg. and Policy Problems Presented by the Interdependence of Computer and Comm. Servs. and Facils., *Tentative Decision*, 28 F.C.C.2d 291, paras. 34-38 (1970), *Final Decision and Order*, 28 F.C.C.2d 267 (1971), *aff'd sub nom.* GTE Serv. Corp. v. FCC, 474 F.2d 724 (2d Cir.), *aff'd by Order*, 40 F.C.C.2d 293 (1973).

7. *In re* Amendment of § 64.702 of the Commission's Rules and Regs. (Second Computer Inquiry), *Final Decision*, 77 F.C.C.2d 384, *modified by Memorandum Opinion and Order*, 84 F.C.C.2d 50 (1980), *aff'd and clarified by Memorandum Opinion and Order on Further Reconsideration*, 88 F.C.C.2d 512 (1981), *aff'd sub nom.* Computer & Comm. Indus. Ass'n v. FCC, 693 F.2d 198 (D.C. Cir. 1982), *cert. denied*, 461 U.S. 938 (1983), *aff'd on second further reconsideration*, *Memorandum Opinion and Order*, 56 Rad. Reg. 2d (P & F) 301 (1984).

8. *In re* Amendment of § 64.702 of the Commission's Rules and Regs. (Third Computer Inquiry), *Report and Order*, 104 F.C.C.2d 958 (1986), *reconsidered by* 2 FCC Rcd. 3072 (1987), *further reconsidered by* 3 FCC Rcd. 1150 (1988), *vacated and remanded sub nom.* California v. FCC, 905 F.2d 1217 (9th Cir. 1990); *In re* Computer III Remand Proceedings: Bell Operating Co. Safeguards and Tier 1 Local Exch. Co. Safeguards, *Report and Order*, 6 FCC Rcd. 7571 (1991), *vacated in part and remanded sub nom.* California v. FCC, No. 92-70083 and No. 92-70186 (9th Cir. Oct. 19, 1994).

restriction was not lifted until 1992. A key lesson of this experience is that transitional regulations, once imposed, are difficult to remove, even if they prove unnecessary or a hindrance to the goal of a fully deregulated market.

THE NEED FOR A NEW APPROACH

The drawbacks of regulatory complexity must be recognized, and a new approach must be developed to address the same concerns in a manner that does not threaten to cancel out the potential benefits of deregulation and competition. Many of the concerns that have prompted regulators to impose new restrictions and border patrols when opening a market are legitimate, including the need to prevent cross-subsidy, ensure access, and ensure the interconnection of networks. The key is to find ways to achieve these objectives without resorting to regulatory complexity.

In particular, regulations adopted to smooth the transition to a competitive market should, by definition, be of limited duration. Their expiry should be triggered automatically by changes in the affected market. Many of the regulations the FCC has imposed in opening markets to competition nominally have been temporary. Frequently, however, a formal FCC proceeding is required before these restrictions can be eased or removed. The delays inherent in such a cumbersome process mean that regulation continues to bog down the market.

For example, when the FCC implemented price cap regulation of AT&T's interstate services, the FCC contemplated the removal of the price caps for particular classes of services upon a finding that AT&T no longer exercised market power in those services. But no self-effectuating trigger for easing the regulations was included in the price cap rules. Thus, the FCC undertook a comprehensive review of the state of competition in the interexchange services market before deciding in 1991 to remove price cap regulation of AT&T's large business services.[9] Only a year later, the Commission launched another comprehensive review of the AT&T price cap regime, resulting in proposed revisions to the rules that were still pending in late 1994.

A formal FCC proceeding should not be required for every step in the process of deregulating a market. The regulatory structure should include its own form of entropy. To prevent a constant escalation of regulatory complexity, particularly as the local exchange is opened to competition, a

9. *In re* Competition in the Interstate Interexchange Marketplace, *Report and Order*, 6 FCC Rcd. 5880, paras. 72, 74, *modified on reconsideration by Memorandum Opinion and Order*, 6 FCC Rcd. 7569, para. 7 (1991), *modified on further reconsideration by Memorandum Opinion and Order*, 7 FCC Rcd. 2677, para. 32 (1992).

new approach is required. Transitional regulations should expire automatically, either at a certain date established when they are adopted, or when certain empirically measurable conditions have been met in the affected market.

THE ROLE OF REGULATION IN COMPETITIVE MARKETS

There nonetheless is a clear need for at least some forms of regulation, even in a world without market barriers. The border patrol function of regulators will continue as multiple new competitors enter the market. Regulation will continue to be essential, for instance, in ensuring unfettered access to and use of carriers' facilities because of the possible existence of externalities.

Meeting the objective of preventing the abuse of consumers who are still served on a monopoly basis does not require the imposition of regulatory complexity through burdensome cost allocation schemes and reporting requirements. The best solution is to impose price regulation on carriers' regulated service offerings. By divorcing the rate a carrier can charge for a service from the cost of providing the service, price caps remove any incentive for cross-subsidy. Where possible, market-based solutions should be used to address ongoing problems that arise in a market opened to competition.

Second, regulations will be needed to ensure access to certain carriers' network facilities. In a sense, the telecommunications industry is moving "back to the future"—back to the existence of "full-service carriers" that provide bundled local, long-distance, and ancillary services. The effect of lifting all remaining barriers to entry likely will be the emergence of multiple full-service network operators and resellers.

Different segments of the telecommunications services market will, for an indefinite period, experience differing degrees of competition. For example, while several competing interexchange carriers currently offer ubiquitous network coverage, competitive local loop providers may not achieve comparable coverage in the near future. As interexchange carriers and local exchange carriers enter one another's markets or, conceivably, merge their operations, access rules will be needed to ensure that these carriers do not use their "bottleneck" local transport facilities to block other carriers from accessing their customers. Otherwise, conditions in the less competitive market—local loop provision—will determine how competitive the other market segments will be.

Third, regulation must continue to serve its essential role in addressing externalities and ensuring that "public goods" are not lost in competitive telecommunications service markets. For example, rules will be needed to ensure that the multiple networks that will emerge in a market without entry barriers interconnect with each other. In some circumstances, a network operator's private, profit-maximizing interest may lie in refusing to interconnect to other networks, but this may be inconsistent with the general welfare. Interconnection of networks is a public good, arising from the critical role of the communications infrastructure as the central nervous system of the national economy and society. These networks serve vital social, cultural, political, and economic functions that extend far beyond the private interest of their shareholders.

CONCLUSION

There is little doubt that the view that the full benefits of competition can be secured merely by the immediate and total removal of regulations (including entry limits) is both overly simplistic and wrong. Such an approach is not, however, considered to be a viable option within the realm of public policy debate. At the same time, it is equally simplistic for policymakers to believe that a pervasive and perpetual layer of "playing field leveling" regulations is needed to ensure competitive markets.

This deeply held (but infrequently voiced) assumption regarding the role of regulation in competitive markets poses the most serious challenge to the achievement of the true market-oriented competitive environment—which is a necessary, if not sufficient, precondition for the development of the information society. Developing a deregulatory mechanism which avoids the pitfalls of this approach is the most important task facing our regulators today.