Slicing Through Static Over the Telecommunications Act

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The Telecommunications Act was signed into law five years ago this month. Critics have celebrated each anniversary with boilerplate: The act, which promised competition, has delivered only mega-mergers and higher prices. In fact, the real story -- blemishes and all -- compares quite favorably to other landmark legislation in the field.

The Telecom Act focused on promoting new rivalry in long distance telephone markets, local telephone markets and local cable TV service. In all three, some progress has been seen.

The most modest has been in long distance. Local Bell telephone companies (including Pac Bell, now owned by SBC) were blocked from competing with AT&T, MCI and Sprint until gaining permission state-by-state. The act made that process painful. Today, the Bells are permitted to compete in only two states -- New York and Texas.

Slowing long distance rivalry was done to prod local phone monopolies: they would be allowed to offer additional toll calls after helping open their markets. But taking consumers hostage is risky. Direct measures to promote competition are safer.

For instance, the act rendered monopoly franchises illegal for local exchange carriers. That simple reform encouraged the growth of hundreds of new rivals. Innovative firms such as Winstar (capitalized at $2 billion), Level 3 ($16 billion), XO Communications ($10 billion) and Time Warner Telecom ($8 billion) are challenging established incumbents, particularly in business markets.

What has gone less well is the act's ambitious regulatory approach to "unbundling." Congress directed the Federal Communications Commission to mandate that incumbent phone networks serve customers of their new rivals for reasonable wholesale prices.

Great idea: one system delivers many offerings. But the FCC's lawyer-rich/rich-lawyer process has led to prolonged wrangling over terms and conditions, discouraging investment by incumbents (who must share new facilities with competitors) or entrants (who may rent cheaper than they can build their own).

In dramatic market realignments beginning in 1998, all three major U.S. long distance carriers chose to acquire their own "last mile" connections. AT&T purchased the largest and third-largest U.S. cable systems, while MCI/WorldCom and Sprint acquired essentially the entire U.S. wireless cable industry. These three firms were the leading candidates to compete with the Bells using existing phone lines. They have instead spent billions to opt out. Policy-makers should catch a clue. Encouraging new networks yields payoffs while complex sharing arrangements do not.

The Telecommunications Act phased out cable TV rate caps as of March 31, 1999. Rates rose 2.4 percent per annum, inflation adjusted, in the six and one-half years they were "controlled" under the 1992 Cable Act -- nearly four times the rate of increase in the 21 months of deregulation. But while rate controls failed to lower prices, they managed to seriously retard the

digital upgrades now (with decontrol) bringing new channels, broadband Internet access, and local telephone service to millions of residential customers.

Much of the recent price restraint by cable operators owes to competition from satellite TV providers, a sector largely bypassed in the Act. Yet, the measure did spur cable competition by ending rules prohibiting phone companies from providing video service. A new generation of cable TV rivals has emerged, led by Ameritech (over 300,000 subscribers) and RCN (over 325,000).

While the new cable and telephone competitors have lots of ground to make up, the trend is positive. Previous communications legislation failed to deliver as much. The 1927 and 1934 laws regulating radio protected major commercial broadcasters in de facto cartels. For decades, nurturing AT&T's monopoly was an active goal of FCC policy. And legislation promising to unleash new competitors -- like the 1984 Cable Communications Policy Act -- actually retarded competition by banning rivals.

The 1996 Telecommunications Act was an ugly piece of law. Congress ignored opportunities to open wireless markets to new competition, provided scant relief in long distance, and went overboard in monitoring local telephone markets. The dean of U.S. regulation economists, Alfred Kahn, entitles his book detailing FCC implementation of the Act: "Letting Go: Deregulating the Process of Deregulation."

But, despite its flaws, the Act delivered benefits. It ended monopoly state telephone franchises, it reversed the federal prohibition on jointly providing cable and telephone service, and it put cable rate controls out of their misery. The success of these measures illuminates the path to further pro-consumer reforms.

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