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One Policy, One System, Universal Service

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Under that Orwellian slogan, the American Telephone and Telegraph Company operated its telephone monopoly for the better part of the 20th century. For sixty years, regulators nurtured AT&T's control of the industry, convinced that the telephone market was a natural monopoly. AT&T's grip was so tight that the company owned not only the wires in our walls but also the telephones we plugged into them, and its stranglehold lasted until the forceful breakup of the company in 1984.

Today, as the FCC invites comments on "a national broadband plan for our future," no one seriously believes that telecom monopolies are a good idea. Even pro-regulation advocacy groups like Free Press now advocate "competition policies." In its comments [1], Free Press advises the FCC to "look for ways to spur the deployment of higher capacity networks…by promoting competition in these markets." In the same breath, however, they tack on a to-do list of "social and economic outcomes":

- Universal service
- Affordable rates
- Net neutrality and open access rules

At a glance, those sound like nice things. We like talking to everyone, we like it cheap, and we hate people telling us what to say. Unfortunately, nothing is ever so simple.

In a 1994 article [2], Adam Thierer of the Cato Institute described three political factors that were crucial in the growth of AT&T:

- Universal telephone entitlement
- Regulation of rates to achieve universal service
- Elimination of "wasteful competition" through interconnection requirements

The rules that Free Press is advocating are precisely what created the Bell monopoly in the first place, and their comments are a case study in the Law of Unintended Consequences.

When regulators intervene to ensure universal service, they inevitably thwart competition. In any business, unserved markets are the biggest open door to new entrants. That was precisely how companies like Texaco, Shell, and Gulf broke into the Standard Oil monopoly in the early 20th century. The only way to ensure universal service, however, is to create artificial incentives for existing companies and to shield those companies from failure. AT&T's rural profits were protected by exclusionary licensing requirements, ostensibly to prevent unnecessary duplication. In the modern telecom industry, the FCC dispenses funding from its Universal Service Fund. Even Free Press, which advocates extending the USF to cover broadband, admits that the fund is full of "waste, fraud, and abuse."

Another problem with the USF and similar efforts is that the definition of "service" changes rapidly. Voice telephony, once an essential service, is today's legacy technology. But the USF, under pressure from incumbents, continues to subsidize telephone services. Beyond simply wasting money, the fund now inhibits broadband adoption by exaggerating the cost difference. While universal service can accelerate the spread of new technologies, it also entrenches old ones.

Universal service proposals always go hand-in-hand with subsidies that accelerate adoption by new customers. For AT&T, rate-averaging policies aimed at increasing rural telephone adoption were crucial in establishing its monopoly. Even before the creation of the FCC, federal and state agencies raised prices in established urban areas to subsidize more expensive rural service. These rates effectively restricted rural telephone markets to companies that were already established in urban areas. It should go without saying that artificially high rates preclude competition. Artificially low rates, however, also damage competition, because they must be accompanied by subsidies. As AT&T demonstrated for decades, and as the USF demonstrates today, subsidies go to the competitor with the most political clout, almost always the incumbent.

Even as Free Press pushes for broader FCC authority, they admit that the agency has been "captured by [the telecom] giants" and that it "chose to follow the wishes of the industries it regulates." They urge the FCC to do better, but they do not suggest exactly how to teach that old dog a new trick. The

implication is that the problem stems from corruption of some temporary sort, but in reality the problem is inherent in the business of utilities regulation. Alfred E. Kahn, who orchestrated the successful deregulation of the American airline industry, described the regulator's dilemma this way [3]:

> When a commission is responsible for the performance of an industry, it is under never completely escapable pressure to protect the health of the companies it regulates, to assure a desirable performance by relying on those monopolistic chosen instruments and its own controls rather than on the unplanned and unplannable forces of competition.

If service and rate regulations are the surest way to create a monopoly, network sharing is the easiest way to keep it. This seems counterintuitive, since the stated goal of open access is to let new competitors use an incumbent's lines at fair cost. What is created, though, is competition only in the most useless sense: multiple firms selling access to a single line, the price of which is determined by an incumbent utility and its regulators. Real competition exists only when there is competition in the network infrastructure, and open access removes any incentive to build competing lines. Regulators complain about unnecessary duplication, but there is no better way–indeed, no other way–to reliably provide modern services at competitive prices.

AT&T knew this a century ago when it opened its networks to placate antitrust regulators. In the Kingsbury Commitment of 1913, the company gladly accepted interconnectivity requirements while cementing its monopoly. The president of AT&T at the time, Theodore Vail, announced that "effective, aggressive competition, and regulation and control are inconsistent with each other," and like Free Press, he advocated the latter. More recently, Thomas W. Hazlett studied the effects of line sharing requirements [4] on DSL service, which were lifted in 2003. Critics predicted that the newly deregulated incumbents would dig in their heels and slow DSL growth. Instead, the growth rate of DSL shot above that of cable, as prices continued to drop. In theory, broadband providers were newly empowered to gouge their customers. In practice, however, the added incentives for investment put consumers in an even better position than before.

It is no surprise to hear the New AT&T salivating at the prospect of broadband funds. In their comments [5] they propose a less Orwellian but equally self-serving new mission statement: "Ensure Broadband Access for 100% of Americans. Ensure Broadband Adoption by 100% of Americans." At the same time they urge the FCC not to burden them with neutrality or openness regulations, what they describe as the "'dumb pipes' vision of the Internet."

At the other end of the dumb pipes, Google's comments [6] downplay the possibility of infrastructure competition and push open access. This is no surprise either: their business model benefits from the inherent nonneutrality of open lines, which guarantees them faster connections than their competitors by leveraging worldwide server farms. Yet of course, when it comes to content providers like themselves, they caution the FCC against tarnishing its "strong legacy of non-regulation."

There is nothing new under the sun. Every businessman alive wants the government to leave him alone but regulate his suppliers and his competitors, sometimes even for laudable reasons. Theodore Vail genuinely believed that One System under regulation was better for the American people, and his regulators saw the world through his eyes. We have paid dearly for the privilege of learning from their mistakes.

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URLs in this post:

[1] In its comments: **http://www.freepress.net/files/FP_National_broadband_plan.pdf**
[2] In a 1994 article: **http://www.cato.org/pubs/journal/cjv14n2-6.html**
[3] this way: **http://books.google.com/books?id=x01ew7Emw0MC&pg=RA1-PA46&lpg=RA1-PA46&dq=%22When+a+commission+is+responsible+for+the+performance+of+an+industry%22&source=bl&ots=Mzfo0d9MCI&sig=Ux7tkedR-Tm1Xli_A1ZBLVIjgCs&hl=en&ei=C6Q2Ss79DovOMrq0pYcK&sa=X&oi=book_result&ct=result&resnum=1**
[4] studied the effects of line sharing requirements: **http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1093393#**
[5] In their comments: **http://www.att.com/Common/about_us/public_policy/Broadband_NOI_Comments.pdf**

[6] Google's comments: **http://www.google.com/googleblogs/pdfs/google_noi060809.pdf**

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