STATEMENT OF COMMISSIONER HAROLD FURCHTGOTT-ROTH, CONCURRING IN PART, DISSENTING IN PART

Re: *Access Charge Reform*, Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-262.

Until today, competitive carriers could freely enter into contracts and adopt tariffs for exchange access on terms and conditions as determined by the market. Now, as a result of this order, the tariffs and contracts that competitive carriers may offer are substantially circumscribed. Specifically, the order creates a "safe harbor" range for CLEC access charge tariffs, which, over time, coincides with the regulated tariffs of the ILECs. Although the order permits carriers to contract for access charges above the safe harbor, it is difficult to imagine the circumstances under which such contracts will be adopted. Buyers are entitled to insist on the safe harbor rate, and they have no incentive to agree to higher rates. Indeed, in most markets, buyers seek to contract a price *lower* than the posted tariff rate. The Commission's safe harbor rule is thus a kinder, gentler term for price regulation.

The majority finds this course of action necessary, because, as a result of our myriad regulations that limit separable contracts and markets for exchange access services, the parties that consume exchange access services rarely receive accurate price signals. Rather than remove the regulations that limit the clarity of price signals, the majority resorts to the opiate for regulators – price regulation.

Two wrongs do not make a right. We should correct the regulations that interfere with price signals, not enshrine price regulation forever while doing nothing to remove the regulatory barriers to exchange access services. To be sure, the Commission's adoption of price regulation in this context is probably lawful, and I do not ordinarily dissent from items that I believe are merely unwise. However, restraint in the face of unwise decisions has its limits. Here, the Commission's decision to initiate price regulation runs counter to basic economic principles as well as the deregulatory mandate of the Telecommunications Act of 1996. Accordingly, I dissent from this order with the exception of Section IV.

I concur with respect to Section IV, which clarifies the circumstances under which carriers may refuse to accept or deliver access traffic. That section reinforces the importance of contractual relationships, rather than regulatory compulsion, in setting access charges.

I. Government, Markets, Consumer Welfare, And The Public Interest

Modern economics is laid upon two foundations: first, individuals can better protect their own interests than can others; and second, a higher social welfare – under almost any measure – is obtained by individuals making decisions in their own interest rather than by a single individual or government making decisions on behalf of others. This is the basis of market economics. While there are some situations (externalities) in which government intervention may be helpful, these are merely exceptions, not rules.

Individuals look after their own interests best when they are free to enter into whatever arrangements they choose with other individuals or businesses. When government limits the types of arrangements that individuals or businesses can make, the individuals, businesses, and society at large are no better off, and, quite likely, are worse off.

For example, individuals can purchase a loaf of bread from one of countless shops and bakeries. Or individuals can buy flour, yeast, water, and an oven from many different providers and bake their own bread. An interventionist government might issue an edict that requires millers to sell flour only to bakers and not to consumers. Such an edict would likely harm not only millers and bakers, but the bread-consuming public as well.

Governments are often confronted with petitions pleading for such intervention. Given the harm that comes from limiting freedom in the market, a wise government must be extremely careful in considering such action. A wise government must be able to distinguish between problems that warrant *attention* and those that do not and between those that warrant *intervention* and those that do not.

In the above example, bread prices might be high, and the government may receive a petition to regulate the price of bread or the price of flour that millers sell to bakers. It may be that some suppliers of flour, or yeast, or baking facilities exercise some degree of market power in some local markets. Prices of these wares may exceed those that some believe to be competitive. What should the government do for the market where undue market power may be present?

Before answering the question of what the government can do for a market, the government should ask what the market can do for itself. Nothing stimulates the imagination of an entrepreneur more than observing a price that seems too high. A "high" price is an invitation to an entrepreneur for at least a momentary profit. The profit may prove transitory, ephemeral, even elusive. But the entrepreneur's struggle, investment, and efforts to capture that profit are real. The greatest threat to "high" prices from the exercise of market power is the zeal of an entrepreneur. Indeed, without the efforts to enter a market by entrepreneurs thirsting for profits, the conditions creating the market power that led to high prices in the first instance will remain in place.

Price signals are essential to entrepreneurs (as well as to consumers). Price regulation discourages entrepreneurs by destroying the hope of ever observing "high" prices. Why struggle, invest, and enter a market where profits are proscribed?

And exactly when are prices too *high* or too *low*? Prices, like beauty, are in the eye of the beholder. Different entrepreneurs and different consumers will respond differently to different price signals. The beauty of markets is that they beckon for buyers and sellers to respond to price signals. Through the responses of buyers and sellers, through the interest they exhibit and the investments they make, markets become stronger and more resilient. Price signals are the very oxygen that makes markets viable.

Price regulation is a harmful, addictive hallucinogen. It deludes those who administer it into believing that they are helping markets. Once price regulation begins, regulators seem to want more, not less, intervention as markets perform ever more poorly. Yet price regulation enervates markets by depriving them of the very oxygen that sustains them. To the outside observer, a market under price regulation is the subject of pity: listless and slowly sinking into the abyss of dysfunction. Entrepreneurship and investment wane. Problems of quality of service wax.

Perhaps there are some examples where price regulation has unambiguously succeeded. A wise government must be able to distinguish between the successes and the failures and to identify the circumstances that will lead to one and not the other. The prescription for the narcotic of price regulation that can guarantee that it does not lead to side effects more harmful than the symptoms has yet to be written.

Moreover, even where intervention may be warranted, a wise government must be able to distinguish between instances in which the harm sought to be remedied is the result of too little government intervention and instances in which the harm is caused by too much. Price regulation is rarely the first government-created wrong in a market. More often, other forms of government intervention have distorted markets leading to requests for yet more government intervention such as price regulation. In the above example, high bread prices are most likely not the result of a market externality but instead the result of excessive government intervention, which has prohibited consumers from purchasing flour directly from millers.

Two wrongs do not make a right. Price regulation should not be the solution to market failures caused by excessive regulation. Instead, the barriers to consumer transactions should be removed. Long-distance markets are a case in point.

II. Long-Distance Service, Insurance, And Moral Hazard

This order concerns federal regulation of compensation arrangements among different, specialized providers of the component services that comprise a long-distance call. A long-distance call can be divided into five discreet, separately regulated, services: local exchange service for origination, exchange access for origination, transport, exchange access for termination, and local exchange service for termination. For each of these five services, billing and collection are also separable services.

In practice, originating local exchange service and exchange access are usually provided by a single carrier, as are terminating exchange access and local exchange service. A call involving five or more different services in five different markets is usually provided by, at most, three companies.

The consumer – the party originating the call– perceives just one market and is billed by just one company for the long-distance call, usually the IXC, which provides some, but not all, of the other services. The IXC then compensates all of the other companies providing the other services.

The actual charges associated with each of the five services in each long-distance call can vary substantially from call to call and from customer to customer. However, the customer's bill does not reflect the actual charges incurred by the carriers providing these services. Instead, the customer generally receives a bill for all long-distance calls based on the same per-minute rate, regardless of actual cost incurred. With respect to access charges, the customer's bill incorporates only an average cost, as the Commission's rules require IXCs to spread the cost of both originating and terminating access among all their end users. *See* Order ¶ 31.

The IXC thus typically acts as an insurer. By charging a flat rate regardless of the actual costs of a particular call, the IXC insures against losses from the distribution of unknown charges, as well as against losses from the distribution of uncollectibles – instances where consumers fail to pay their bills. The IXC charges customers a premium for this insurance, which is more than the expected value of losses.

This system has led to four broad "problems," which are explicitly or implicitly raised in this order:

(1) Consumers are largely limited to purchasing long-distance services in packages that bundle all five regulated services, plus insurance, billing, and collection.

(2) No one, including the company bundling the long-distance services, can choose the lowest cost and highest quality providers of local exchange service and exchange access. Providers of these services are assigned independently by the originating party and the terminating party.

(3) Entry into all of the regulated services except for transport, billing, and collection is difficult. Entry into exchange access without being bundled with local exchange service is rare.

(4) Given (1), (2) and (3), providers of exchange access face a moral hazard in pricing their services. Parties consuming their services do not have a direct contractual relationship with them, and a third party insures all expenses. Under these circumstances, there are substantial economic incentives to engage in monopoly pricing. Moreover, with extremely inelastic demand over a wide range of prices resulting from the insurance scheme, the monopoly price is higher than it would be if exchange access providers contracted directly with the end users.

III. The Regulatory Solution

The majority's solution to these problems is to engage in more government regulation – specifically, to regulate the rates that exchange access providers may charge. It is a regulatory solution, not a market solution. It does not address the root problems in either (1), (2), or (3). Consumers will still suffer from a lack of contracting options for long-distance services. No one will have the authority or incentive to seek out the lowest cost and highest quality providers of local exchange service and exchange access for long-distance calls. Market entry, particularly in exchange access, will still be difficult. Moreover, the moral hazard associated with the insurance scheme will only be limited, not cured.

Resorting to price regulation for access charges based exclusively on Section 201 jurisdiction, while perhaps lawful, is a giant step backwards for those who believe in the power of markets to allocate resources and services in society. Price regulation not required by law is a declaration of defeat by those entrusted with implementing a law dedicated to removing regulatory barriers and promoting competition in telecommunications markets. Practically every introductory economics text book describes the ills of price regulation: either prices are set too low, and supplies wither despite excess demand, or prices are set too high, and demand withers despite ample supply.

Section 201, which requires that rates be "just and reasonable," should never be invoked to require price regulation where multiple competitors are present. There is simply no better approximation of "just and reasonable" rates than those that exist in a market with multiple competitors. Where multiple competitors are present in a market, limitations on consumers' ability to perceive price competition are almost always the result of government regulation. That is certainly the problem in this order, where providers are not permitted to compete separately for transport, exchange access, and local exchange service, nor are packagers even allowed to bill separately for those services. Removing those barriers is the proper solution, not price regulation.

IV. The Deregulatory Solution

A far different solution from that adopted in this order would be to deregulate entirely the market for long-distance services. It would allow any and all contractual arrangements to be made available to consumers. It would encourage entry into all elements of long-distance service, including separate entry into exchange access. Carriers could offer any combination of the five components of long-distance service as well as any combination of the peripheral services such as billing, collection, and insurance for variability in the range of charges. Under this market solution, all of the four problems identified above, including moral hazard in the pricing of exchange access, would be largely resolved. Exchange access providers – whether ILECs, CLECs, or competitive access providers – would have no ability, much less incentive, to subsidize other services with revenue from exchange access. Consumers could contract directly or as part of a larger package for all services, including exchange access services – presumably at the lowest price and highest quality – and be billed directly for those services. The consumer, not the regulator, would be sovereign.

Practically all markets for complex services work well without substantial government interference to set prices or prevent transactions. For example, housing, clothing, and food can be purchased on a bundled or unbundled basis through both explicit and implicit contractual arrangements. Except where government has intervened to prohibit certain explicit or implicit contractual arrangements, consumers can choose to purchase goods and services with embedded insurance against the distribution of underlying costs for components, or the consumer can purchase the components separately. Consumer welfare is enhanced with a variety of contractual options for services with varying degrees of bundling. Depriving consumers of some or all options only harms them.

According to the majority, 47 U.S.C. § 254(g), which requires the Commission to adopt rules governing interexchange services, presents a substantial impediment to adopting a similar market-based approach for long-distance service. *See* Order ¶ 31. Under section 254(g), the Commission's rules must "require that the rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas." 47 U.S.C. § 254(g). In addition, these rules must "require that a provider of interstate interexchange telecommunications services shall provide such services to its subscribers in each State at rates no higher than the rates charged to its subscribers in any other State." *Id.* The Commission has previously determined that section 254(g) mandates that IXCs spread the cost of exchange access among all of their end users. *See* Order ¶ 11 & n.15; *Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of § Section 254(g) of the Communications Act of 1934, as amended*, Report and Order, 11 FCC Rcd 9564, ¶ 9 (1996). As a result, IXCs billing their end users cannot pass through the actual cost of exchange access and thus cannot send their end users accurate price signals.

However, the Commission's interpretation of section 254(g) – while not unreasonable – is by no means compelled. To the contrary, the language of the statute merely requires "providers of interexchange telecommunications services" – IXCs – to provide "interexchange telecommunications services" at the same rates in different geographic areas. It says nothing about the rates for exchange access, which are generally imposed by local exchange carriers and for which IXCs act merely as billing agents. From the IXCs' perspective, these charges are no different than state-specific gross receipts taxes, which the Commission already allows IXCs to pass through to end users on a deaveraged basis. *See Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of § Section 254(g) of the Communications Act of 1934, as amended*, 11 FCC Rcd 9564 at ¶ 12. Section 254(g) thus need not prohibit IXCs from passing through the actual costs of exchange access to their end users. Moreover, the statute is no bar to allowing local exchange carriers and special access providers to bill the actual costs of exchange access directly to end users.

If the Commission abandoned its broad reading of section 254(g) and removed the other regulatory barriers in the long-distance markets, companies could compete for business by offering differing packages of services. Some would offer to provide all billing and collection services as well as insurance for the risk associated with the distribution of access charges. Others would offer different types of insurance, and still others would offer no insurance, instead passing all charges directly to the consumer.

Indeed, despite the Commission's restrictive regulations, some companies have already begun to offer such differentiated services. For example, some carriers, such as iPhonebill, implicitly pass access charges on to customers. Rates for their long-distance service vary by the combination of the originating and terminating area code and carrier-specific three-digit exchanges. The IXC iPhonebill charges more for calls with higher access charges and less for those with lower access charges. Because customers, rather than the IXC, bear the risk associated with the distribution of access charges, iPhonebill does not charge an insurance premium for bearing that risk. Consequently, iPhonebill's rates are among the lowest of any IXC.

Other IXCs, such as OPEX and Unitel, offer originating service only to ILEC customers with low originating access charges. In this way, the risk associated with the distribution of originating access charges is reduced, and the insurance premium that these carriers charge is less than that of major IXCs offering ubiquitous service.

Removing regulatory barriers would promote the development of more services like these and would resolve the problems identified by the majority. Unfortunately, however, the majority has not chosen this course of action.

V. CONCLUSION

The proper role of government in a free society is to protect property, enforce contracts, and tear down barriers to markets. Yet vestiges of ill-conceived government remain from the days when contracts were restricted by government fiat, when property was limited by government restrictions, and when opportunities to deploy, manipulate, and engage in the trade of property, services, and contracts, were severely curtailed.

A government of a free society should be the champion of free markets and unfettered competition. It should intercede where market barriers prevent entry but turn a cold shoulder to those who petition for price regulation or other government action noxious to a free market.

If wisely interpreted, the Telecommunications Act of 1996 would serve as a basis for the proper government role in a free society. For more than five years, however, the Act has not been interpreted wisely. Indeed, it has served as a vehicle to support the ideas of those more comfortable with the opiate of regulation than with the nourishment of competition. Such regulation is no less harmful when, as here, it is masked in pro-competitive rhetoric.

Today's order is a profound disappointment to those who seek competitive markets rather than the oxymoron of managed competition. It may be a lawful order, but it is unwise. An order that is both lawful and wise would tear down market barriers rather than erect new ones, enforce contracts rather than effectively outlaw them, and protect property righ