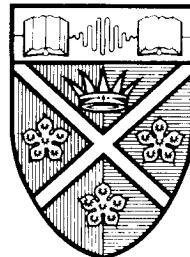


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# STRATHCLYDE PAPERS ON GOVERNMENT AND POLITICS



## *LABORATORY OF DEMOCRACY: TEST-BED OF TELEMATICS?*

*by*

*Doug Pitt, Paul Teske and Kevin Morgan*

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OF TELEMATICS?**

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## **Laboratory of Democracy**

### **Federalism and Its Contemporary Distemper**

Federalism - arguably *the* unique contribution of America to the art of government - is fashionable under critical review. Descriptively, scholars have pointed to the increasing 'nationalisation' of public policy. Ironically, the Reagan administration encouraged this trend in its determination to diminish the scope and role of government across-the-board. The result has been the development of a 'new federalism' (Conlan, 1988) a transformation from the *mutual* or *dual* federalism of the Founding Fathers to the contemporary highly *pre-emptive* variety (Zimmerman, 1988).

Normatively, some critics have pointed to the growing obsolescence and confusion of the federal system. On such arguments, its genius is seen to lie in its relevance to simpler agrarian and frontier conditions. Federalism has been presented as a 'major barrier to flexible government' in an industrial mass society (Choate, 1988: 148). A multiplicity of decision makers is productive of public policy *gridlock*. This inhibits US ability to respond to global competition from countries such as Japan armed with less divided decision making structures. Such crises of confidence in federalism have been pessimistically characterised as a 'subtle process of erosion (in the federal ideal) that....leaves an archaic, sterile structure bound together only by a web of mundane administrative relationships' (Conlan, 1986:46).

Against such mordant and pessimistic accounts prophesying the irrelevance and ultimate demise of federalism is an argument suggesting that it is not dysfunctional in the prevailing conditions of the contemporary

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political economy but, on the contrary, is to be celebrated as a form of government uniquely fitted to the circumstances of post-industrial society. To paraphrase Lindblom (Lindblom, 1965) we can talk sensibly about the 'intelligence of federalism'. And this is on two grounds. First, as Elazer (1987) makes clear, its democratic and participatory potential is in no way diminished. Secondly, it can aid rather than hinder the competitive capacity of the US (Beam, 1988).

One commentator (Osborne, 1988: 14-17) has claimed to discern the recent emergence of a post-New Deal paradigm built around new partnerships between the public and private sectors' and largely spearheaded by state level policy entrepreneurs such as a gubernatorial elite. The recognition of state economic proactivity is evident elsewhere in the claim that the states are in the forefront of pushing through a new 'policy frontier'. New state initiatives include those to 'reform taxation, development finance, trade, procurement, research and development education, training efforts, labor/management relations and employee ownership' (Corporation for Enterprise Development, 1986: 1).

Robust support for the view that the 'states and localities, not the national government....are best positioned to provide meaningful assistance to entrepreneurs and managers' has been advanced (Beam, 1988). On this argument (mirrored in arguments in the UK and Europe about the heightened role for sub-national initiatives in unitary systems) states and local governments are 'more responsive to economic changes in particular firms, industries and regions than is the national government: state and local governments have control over key factors influencing job generation; successful economic development depends upon interactions that can only occur on a regional scale' (Beam, 1988). Thus the states are to be

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conceived as acquiring an enhanced status in the political economy of post-industrialism (Osborne: 1987). Telecommunications, the key infrastructural component of such a society is fast revealing the contribution of many states to the construction of post-industrial public policy.

### **The Changing Face of Telecommunications**

In the last decade a sea change has occurred in the US telecommunications sector which has echoed throughout the developed economies. Telecommunications has been propelled up the political issue agenda in consequence of its newly perceived status as the key element in the infrastructural component of an emerging service society and as an engine of potential growth and generator of employment. Its central role in any economic development portfolio seems readily assured.

The history of telecommunications in the past quarter-century has been one of turbulent change (Morgan and Pitt, 1988). Such changes have subjected the extant regulatory regime to strain leading to pressures for modification. Three broad factors have been responsible for this regulatory sea-change:

- (a) accelerating technological transformation causing the collapse of boundaries between voice and data transmission has compromised the regulated natural monopoly characteristics of the telecommunications marketplace;
- (b) a trend towards a more information-intensive economy inclining major corporate users to place telecommunications high on their strategic

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agenda and demand greater regulatory flexibility;

- (c) the pursuit of minimalism by the Reagan administration anchoring telecommunications deregulation to the promise of 'getting government off the backs of the people'.

The major values of telecommunications administration remained largely intact until the mid-1950s; *inter-alia* rate of return, universal service and monopoly/monopsony. This period witnessed the inception of the Bell empire and its expansion on the basis of what Theodore Vail - the head of the Bell company - called 'one system, one policy, universal service' (Schlesinger, et al, 1987:8). The 1934 Communications Act provided the institutional bedrock of this system; the Federal Communications Commission and the relaxation of antitrust law on AT&T.

By 1956, a series of technological developments were buffeting this structure. The crumbling of boundaries between telecommunications and data processing allowed computer firms to challenge AT&T's hegemony in the equipment field (particularly in that of customer premises equipment such as PABXs). New technology also provided the threat of by-pass opportunities - the wayleaves of the dominant carrier, AT&T, could be circumvented by the provision of alternative pathways such as microwave (Brock, 1981).

Additionally, large user groups (such as the International Communications Association (ICA) and the American Newspaper Publishers' Association), were stressing that the traditional mode of supply of telecommunications facilities and services was beginning to act as a

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limiting factor in the installation and utilisation of computer systems (Schiller, 1982:35).

Finally, the FCC itself began to question its own regulatory mission. The encouragement of open market entry (the *quid pro quo* for regulatory relief on the dominant carrier AT&T) and the development of a competitive crescendo in telecommunications can be traced from the FCC's historic 'above 890' decision in 1959 to its 'computer inquiries' of the 1970s and 1980s. The first permitted firms to own and operate communications systems (private networks) for their own internal use. The second, *inter alia*, relaxed regulatory constraints, such as 'structural separations' over AT&T (Faulhaber, 1987). This had effectively prohibited AT&T from offering 'enhanced' - computer based - services in addition to its basic telephone point to point service.

What seems clear from any analysis of events since the key outcome of the divestiture of AT&T in 1984 is that it has proven to be behaviourally unstable. Far from delivering the final solution to the telecommunications question, it has acted as the backdrop for the construction of a telecommunications deregulatory game exhibiting the characteristics of 'partisan mutual adjustment'. The Consent Decree, the judicial mechanism utilised for the enforcement of the antitrust case against AT&T which led to the divestiture agreement has proven particularly vulnerable to strategic bargaining: it has altogether failed to deliver a 'bright line' solution (as was intended) by quarantining the Bell Operating Companies - or 'BOCs' - (the severed limbs of AT&T) within 'lines of business' restrictions. Two broad coalitions of industry players are in contention over these restrictions (on manufacturing, information services and long distance); these, in turn, are associated with competing bureaucratic players within the Federal

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government.

The first coalition comprising the BOCs stresses the opportunity costs of the line of business restrictions. It has complained that the extant judicial edict is depriving the US public of the full fruits of the information age. By precluding the BOCs from full market entry into fields such as equipment manufacturing and information services, the decree is handicapping the US in competition with Asian and European companies (Weiss, 1988). Arraigned against the BOCs is a wide ranging body of stakeholding opinion. This coalition, comprising representatives of virtually every firm in the data processing and telecommunications industries (including AT&T), is resolutely opposed to any loosening of the restrictions on the BOCs.

A linked inter-agency dispute has found expression within the federal system of government. Pressures to further ease the restrictions have arisen (remarkably) within the Department of Justice, the very agency charged with enforcement of the decree. These have been supported by key elements within the Commerce Department (most obviously the National Telecommunications and Information Administration or 'NTIA'). This latter has supported legislative attempts to loosen the restrictions further such as that by Senator Robert Dole to shift jurisdiction away from the DC Court of Judge Harold Greene, (the judicial arbiter of the decree) to the FCC in the hope of greater regulatory relief. Under the aegis of Judge Harold Greene, the District Court has resisted these efforts. Greene has resolutely refused to accommodate many of these company inspired initiatives in the face of lack of evidence that they would desist from cross subsidising new activities from their local exchange monopoly franchises.

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### **A New State Political Economy - Telecommunications and Development**

It is perhaps unsurprising that examination of telecommunications issues at state level reveals the reproduction of the debates and related political activities surrounding deregulation at the federal level. Just as a new telecommunications policy paradigm is in evidence at the federal level, so too are important and novel developments 'on the wing' at sub-national level. In the first place, the forces which have been highly active in the attempted 'disinvention of divestiture' in Washington have been busily engaged in spearheading a de-regulatory advance in the states. The 'multiple entry port' structure provided by US federalism continues to ensure that the states, like their federal agency counterparts, will be visited and re-visited by the BOCs in their efforts to crawl out from under remaining regulatory restrictions. As assuredly active will be those - consumer advocates and others - determined to oppose any threat to the 'widespread availability of high-quality, low-cost telecommunications services, the cornerstone of America's information-based economy' (ICA, 1989).

Paralleling the ascendancy of telecommunications as a focal issue in national discussions about America's industrial performance and competitiveness has developed a similar debate at state level. Members of state public utility commissions, legislatures and relatively new entrants to the telecommunications policy arena (gubernatorial policy entrepreneurs for example) have come to appreciate the lightened salience of telecommunications issues and appear to share a sudden realisation that the economy has moved away from an emphasis on manufacturing and towards a service economy where telecommunications is a vital, integral asset.

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The biography of state telecommunications developments since divestiture reveals a transition from a reactive to proactive phase. During the first period of the post-divestiture process, the states adopted a fundamentally defensive posture in reaction to federally inspired discontinuous policy developments. Until federal regulators at the FCC started encouraging competition in the 1970s, the goals of federal and state telecommunications policy were symmetrical - the sustenance of affordable universal service. Congruity of vision was matched by the pursuit of mutually compatible policies. With federal encouragement of competition through deregulation and divestiture, the states were faced with an unfamiliar and turbulent policy environment.

The first aspect of this arose from the FCC's access charge program, the aim of which was to eradicate what the agency perceived to be a 'toll to local' subsidy problem (i.e. the claim, often contested, that long distance rates effectively subsidised local rates) and distorted economic pricing. The FCC, 'desiring to substitute competition for rate and entry regulation wherever possible, adopted policies that shifted costs from the federal to the state jurisdiction....In most states these policies are seen as causing substantial increases in the prices of intrastate services' (Noll, 1986). The main effect of the access charge plan has, indeed, been to raise local rates - a policy which has inevitably shifted a greater proportion of the 'local loop' costs directly to the users of the services. Decision makers at state level well understood the potential negative political impact on them of local price increases on residential telephone subscribers.

Linked to this issue was that of 'by-pass'. It was widely contended by the BOCs and other local exchange companies that the emergence of

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competition would eventuate in the migration of large users from the public telephone network into a myriad of private networks. Such would again have an impact on revenue flows threatening the revenue base of the local exchange company, once more to the ultimate financial detriment of domestic subscribers. Finally, the states discerned a threat in the perceived tendency toward federal preemption in the telecommunications policy domain. The FCC was frequently presented throughout the eighties as infringing the jurisdictional authority of the states under the 1934 Communications Act. As Noll (1986) has concluded this was a time when the assumptive world of state regulators was quickly becoming 'unravelled'.

### **State proactivity**

There is increasing recognition among commentators and members of the telecommunications policy community in America that the states have moved from a defensive to offensive policy stance on deregulation. Several factors appear to account for such a posture. Most importantly, there appears to be an overt or subliminal recognition that telecommunications policy is intimately linked to the wider issue of state economic development. A recent survey of policy influentials on regional development needs in the north-east United States produced four important observations.

First, telecommunications until very recently 'has been excluded from overall considerations of infrastructure'. Secondly, public policymakers are only beginning to realise the 'intrinsic economic value and commercial appeal of the telecommunications infrastructure'. Thirdly, the public sector 'is similar to the private sector as a user of telecommunications and, in many

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instances, is learning the same lessons'. Finally, 'any future modification or upgrading of the telecommunications infrastructure is to a large extent dependent upon the initiatives of state and local policymakers and regulators' (Arnheim, 1988). Telecommunications are increasingly recognised at state level as being just as important to the development of 'post-industrialism' as the railroads were to the industrial age. They are crucial to 'the hope of American industrial revival - the fabrication of high value/added, high/technology goods' (Schmandt et al, 1988).

The states are, seemingly, in the throes of recognising the centrality of issues concerning the telecommunications infrastructure as part of their industrial policy (Noam, 1986). Indeed, 'new state activism' across a wide ranging industrial policy continuum has been widely noted (Fosler, 1988). In the 1980s, state governments have demonstrated a new aggressiveness in economic development. 'The budgets of state economic development agencies have quadrupled. Many states have developed new economic development initiatives, such as state-supported venture capital funds; export development programs; state funded research, development and technology programs; customised job-training; and small business assistance' (John, 1987); all this is seen as evidence of an economic development renaissance at state level. There is also wide recognition of the peculiar aptness of state level industrial policy initiatives not only as a local response to a local economic problem, but also to the broader improvement of America's global competitiveness....'many contemporary economic challenges are more amenable to public action at the regional and local levels...because for the moment, the federal government has willingly relinquished its leadership role in domestic policy' (Fosler, 1988).

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Ironically, the new federalism has not, in the event, marginalised the states as might have been predicted. As one commentator reminds us, obituaries for the states as influential policy actors have been premature (Conlan, 1988). It is undoubtedly true that Reaganism like its Thatcherite counterpart in Britain has been paradoxically centralist in its efforts to reduce the role of government. Yet, state expenditures on health, education and welfare and economic development have increased during the years of the Reagan incumbency. Reduced reliance on federal funding has 'prompted greater state and local self-reliance, which [has] supplemented [a] capacity for independent policy innovation with the desire to utilise it' (Conlan, 1988: 229).

In the telecommunications policy field, state assertiveness has been revealed in notable successes in reversing the trend of federal preemption. Most notably, the Louisiana decision of the Supreme Court in 1986 concluded that FCC depreciation prescriptions - designed to put pressure on the states to force telephone companies to speed equipment modernisation - did not, in fact, preempt the states (McKenna, 1986). However, this landmark precedent should not be interpreted as a victory in a federal/state war of competing economic doctrines. The lesson of the Louisiana case is that opposition to federal policy has 'often centered on the issue of states' rights rather than economic theory' (NTIA, 1986). Having jealously and successfully protested such rights in the face of Federal preemptive competition policy many state regulatory and legislative officials have now got religion. As one federal agency has observed, 'historically the least progressive sector of the telecommunications regulatory structure, many states are now at the forefront of regulatory reform' (NTIA, 1986:41). It has further observed that 'available data indicate that state officials have

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been more progressive in managing the transition to competition than anticipated, especially given their history of conflict with Federal officials' (NTIA, 1986:2).

## **Policy Entrepreneurialism**

While the mutation of state telecommunications policy (from reactive to proactive) owes its origins in large part to the impulsion of the economic development urge and roll back of preemption, it is also clear that the ascendancy of new policy actors ('policy entrepreneurs') at state level is highly significant. They have frequently acted as the accelerators or instigators of the deregulatory drive. They are best portrayed as pivotal players in the unfolding state telecommunications deregulation game. Just as telecommunications deregulation has opened up the economic marketplace to new corporate entrants, it has encouraged 'entryism' of new players to the state telecommunications political marketplace.

One commentator (Osborne, 1988) has discerned the arrival of a 'new breed of governors' in the wake of Reaganism committed to a new 'post-industrial political paradigm' and determined to encourage state economic and infrastructural development. Typical of the genre have been Dukakis (Mass.) and Sununu (NH). Others have pointed to clear evidence that the role conception of governors in relation to telecommunications public policy is undergoing a sea-change. Telecommunications policy, originally treated by governors with passive avoidance, 'will be increasingly shaped by the governors to reflect their concerns and issues, their goals and objectives' (Silkwood, 1989).

The National Governors' Association (NGA, 1988) has formally

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recognised the salience of the governors' position in the telecommunications policy process. In August 1988 it declared the public policy roles of the governors to include support for network modernisation, the need to support US competitiveness, encouragement of flexible regulatory alternatives, and protection of universal service. It boldly declared in favour of 'continued development of the telecommunications infrastructure as a national resource with emphasis on maintaining quality services to all areas of the country at reasonable rates and without jeopardy to any single area of the country' (NGA, 1988). Alongside the developing telecommunications gubernatorial role is that of the state legislature. Unlike Congress which has demonstrated an inability to pass an up-to-date omnibus (Tele) Communications Act to replace its 1934 predecessor - in the face of countervailing industry pressures - state legislatures have not always shown a similar reluctance to legislate in the intra-state domain. State legislatures have increasingly revealed themselves as a receptive to deregulatory pressures and willing to pass legislation to consummate them. State legislatures are often more ready to pursue regulatory relief than state regulators often determined to cross subsidise services to hold down monthly local rates.

Nonetheless, it is also notable that public utility commissions have increasingly demonstrated 'policy elasticity' and moved away from traditional rate of return regulation. Their changing policy approach has been occasionally driven by eponymous figures like Louise McCarren in Vermont inseparably identified with distinctive deregulatory policy initiatives.

Finally, and significantly, key 'carriers' of telecommunications

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deregulation have been the divested BOCs. Widely viewed as ponderous, if worthy, public utilities before the break up at AT&T, they have displayed the same determination to remove regulation at the state level as they have displayed in their quest for regulatory relief at the federal counterpart.

The idiosyncratic post-divestiture behaviour of US West - the maverick of the BOCs - is illustrative of the pressures brought to bear on state policy makers to secure regulatory relief. Led by a quiet-spoken but innovative policy entrepreneur (its CEO Jack MacAllister), US West fast constructed for itself a macho image of a company in a hurry. It quickly declared in favour of competition, deregulation and diversification into high technology markets (Dyer and Clough, 1986). It has authored a 'rush to deregulate' in its fourteen state bailiwick in the mid-west, Rocky mountain and desert states (the most extensive geographical area of any of the BOCs). Together with its federal deregulatory activities which have included a 'waiver blitz' on the Washington DC District Court for the lifting of court-imposed business restrictions, has been engineered an assault on the state regulatory fundament facing the company. Tactically, US West has employed a cafeteria of techniques (widely characterised as blatantly opportunistic by its opponents). The most aggressive of these was its policy of 'regulatory relief shopping' successively dangling the promise of locating an R&D facility (involving 1500 jobs) in front of the regulatory commissions in its region in the hope that they would compete among themselves to deregulate services and ingratiate themselves with it for the bestowal of investment favours. Determined to 'give history a push', MacAllister decided to 'by-pass the regulators' (Teske, 1988a) - viz, circumvent the public utility commissions - and put pressure on state legislatures. His strategy worked well: of the 15 state legislative

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deregulatory bills passed between 1984 and 1986 for example, 9 were passed in US West states (Teske, 1988a).

### **Policy Experimentation**

Justice Brandeis conceived of the notion of the states as laboratories in which novel solutions to obdurate social and economic problems could be tested before being universalised to the rest of the United States. This key advantage of federalism has been underwritten by one influential regulator (Levy, 1987). He has declared the positive advantages of state regulation to be:

each public utility commission will do what it thinks best for its particular state, based on the economics, demographics and politics of that state. In general, this is a better way of making policy than relying on one federal body to adopt a one-size-fits-all approach for the entire country.....Such 'portfolio diversification' will limit the risk of any one body making a wrong decision to the local exchange companies and ratepayers of one state, and information sharing among the public utility commissions will, in the long run bring about greater benefits for the entire country.

Consistent with the point noted above that state policy entrepreneurs have latterly become more proactive on deregulation, the laboratory of the states has played host to a variety of telecommunications deregulation initiatives. One important feature of this development has been the recognition not only that telecommunications and economic development are interwoven, but also that the states are in a competitive bidding situation for companies seeking comparative locational advantages such as lower labour costs or more liberal telecommunications regimes (Irwin, 1986). Such competition, in fact, has been productive of a classic 'race to the bottom' as

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more and more states join the deregulatory camp.

Two of the most obvious examples of deregulatory innovators have been Nebraska and Vermont. In both - 'smart' - states, policy makers recognised early on the inherent economic development potential of telecommunications and actively worked to bring their regulatory regime into congruence with what they perceived to be a changing technological and competitive environment. Nebraska, markedly rural, occupies a position in the nation's geographical heartland. It has been able to exploit this locational advantage to good effect - for instance, it has used continental time zone differences in such a way as to encourage the establishment of telemarketing firms. Nebraska is the exemplar of 'competitive deregulatory bidding'; enlightened policies of deregulation are seen as offering the potential of attracting telecommunications intensive firms to move into the state from their more regulatory conscious neighbours.

Nebraska's fascination (particularly given its marked Republicanism and agrarian infrastructure) lies in its deregulatory telecommunications radicalism. Politicians in the state adopted a different approach to telephone deregulation than all other states (Teske, 1988a). In 1986, the legislature passed and the Governor signed a law to allow radical price deregulation of all (including local) service. The legislation (HB 835) allowed local telephone companies to increase prices up to 10 per cent annually unless 2 per cent of affected consumers signed a petition opposing the increase. The law retained some state regulatory control over telephone companies for a five year period. After 1992, however, telephone companies in the state will be free to set all such rates as the market will bear.

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A fascinating feature of the deregulation game in Nebraska is the state's institutional structure. Alone of all the states it possesses a unicameral legislature. US West was able to exploit this situation fully to its advantage in its efforts to by-pass a public utility commission unwilling to grant it rate increases. It was aided too in its deregulatory drive by a governor (Robert Kerrey) who well recognised the link between telecommunications and economic development and, as lead telecommunications spokesperson for the National Governors' Association sold the bill as enhancing Nebraska's attractiveness to high-technology, telecommunications-dependent firms. The Nebraska Public Service Commission, itself hostile to the legislation but bound to work within its parameters, has concluded in a recent report to the legislature that the sunsetting provision on the right to petition should be stricken from the law. It has also recommended that those telecommunications services which are indispensable and to which there is no alternative should be re-regulated (Nebraska PSC, 1989).

Louise McCarren, former Public Utility Commissioner in Vermont pioneered the 'social contract' approach to deregulation. Under such proposals, deregulation occurs through an agreement between state authorities and individual telephone companies. In essence, the company is required to limit local rate increases to a specified figure and to make specified capital investments during the contract period to maintain and upgrade its network. In return, the companies are freed from the burdens of rate of return regulation 'being subject at most to minimal regulation of particular services' (Fowler et al, 1986). Vermont's social contract does indeed follow these principles. Charges for basic local rates are negotiated between commission and company and subject to fixed percentage

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increases; the telephone company is prohibited from relinquishing existing services and it must commit itself 'to a modernisation program that would ensure the development of new technology throughout the state in a timely manner' (Vermont Tele Commission, 1985).

The social contract, enshrined in the 'Vermont Telecommunications Agreement' is again rooted firmly in the notion that telecommunications and economic development are inextricably intertwined. McCarren has done much to popularise the idea of the social contract as an alternative form of regulation but insists that it is merely one form of deregulation amongst several which may be more apposite under conditions prevailing in other states (Schmandt, et al, 1988). One variant of this approach which has been tried elsewhere is that of 'banded pricing'. This formula allows telecommunications companies the discretion to raise or lower prices within a prescribed range without seeking regulatory approval (Jones, 1987).

Within the compass of this relatively short paper it is impossible to outline the many state efforts made since divestiture to deconstruct regulation. Clearly states have followed the lead of 'first movers' like Nebraska and Vermont with varying degrees of enthusiasm. This undoubtedly reflects variations in their rural/urban mix, the nature of their partisanship and the size and resources of their regulatory bureaucracies (Teske, 1988a). However, even in states which are widely characterised as 'regulatory retentionists' there is increasing awareness of 'the growing obsolescence of traditional (regulatory) policy tools' (Horringan, 1988).

California, for example, is among those that have been extremely wary of going down the Nebraska route, erstwhile PUC chairman Donald Vial arguing, that since 80-90 per cent of local telephone services are

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monopolistic, we're not going to be moved into deregulation' (Teske, 1987). Preservation of universal service has long been a primary policy goal of the public service commission (Schmandt, et al, 1988). A close relationship between telecommunications and society policy has been 'driven' for many years by a tradition of strong consumer advocacy within the state. This is evidenced in its so-called 'lifeline' program for low-income households established in 1984. However, 'pressure from the industry, technological change making market entry easier, and a new interest in economic development have all forced the PUC to reconsider its traditionally protective regulatory policy' (Schmandt et al, 1988). Like other states, California has experienced the vagaries of economic recession. This and the realisation that to lag competitively behind other states will have major negative economic consequences, has forced a re-evaluation of a policy of deregulatory minimalism. Recent changes have included pricing flexibility on 'enhanced services' and the award to the BOC (Pacific Bell) of the ability to charge cost-based rather than average cost rates to individual large customers.

By this expedient, it is hoped that 'Pacific Bell [can] compete with new service providers who are attempting to capture the large business market while at the same time discouraging uneconomic bypass of the local exchange' (Schmandt, et al, 1988). Pacific Bell has also played a proactive role in the re-definition of 'universal service' to include access not only to basic telephone service, but also to an array of 'information' services. Its Network Task Force Report in 1987 recommended that residents of the state should have access through an 'intelligent network' to, *inter alia*, education and health service information. Intelligent network services would be included in the state's lifeline program. The economic development

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potential of such a proposal would seem to be enormous.

A state which is cautiously pro-deregulatory is New York. Its non-partisan expert PUC has developed a tradition of heavy reliance on the technical merits of issues (Schmandt, et al. 1988). This approach has frequently raised the ire of critics who characterise it as conservative. Once again, however, can be discerned the impact of economic development factors on the regulatory process. The New York metropolitan area, host to one of the largest financial centres in the world, is the nation's 'by-pass capital'. The use of facilities bypass - the utilisation of an alternative network to circumvent its public switched counterpart - is much in evidence. Technological developments have, on occasion, led to the flight of companies out of state to escape the high cost/high burdens of the city. In the early 1980s, for example, Citicorp relocated its credit-processing operations from New York to Sioux Falls, South Dakota in just such a move.

The salience of economic development issues and recognition of the central place of telecommunication as the 'infrastructure of the information age' is evidenced in the partnership between New York city, Merrill Lynch and others to form 'Teleport', an example of the growing number of so-called 'metropolitan area networks' (MANs) in the United States. This is a measure, both to 'enhance the telecommunications infrastructure of the [city] and retain businesses by offering cheaper telecommunications-linked sites as an alternative to fleeing New York' (Schmandt et al, 1988). Regulatory flexibility has been introduced in the form of 'generic' hearings on rate cases in place of a laborious case-by-case approach. Here the intention is to settle broad principles of rates and pricing ensuring the

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telephone companies both greater predictability of PUC response and a speedier regulatory response to changing market conditions.

These and a myriad of other examples serve to illustrate the general trend towards state telecommunications deregulation which has clearly gained momentum in the past decade. Between 1983 and 1987, twenty two states enacted various general statutes to deregulate telecommunications services and service providers. By the middle of 1988, seventeen states had removed traditional rate of return constraints in favour of more flexible pricing dogmata over AT&T the dominant long distance intra-state carrier. A further sixteen had reduced regulation on AT&T. Traditional rate of return regulation on local exchange companies (including the BOCs) remained in only twenty one states (FCC, 1988).

## **The Recrudescence of Cooperative Telecommunications Federalism?**

The conclusion seems unavoidable that state telecommunications policy since divestiture shows clear signs of evolution from an (at times) confrontational pattern of federal/state relations to one exhibiting more harmonious tendencies.

Suspicion of the FCC during the first - 'reactive' - period was undoubtedly fuelled by state perceptions that it was dominated by a Reagan ideologue (Mark Fowler) determined to pursue deregulation at any price. This suspicion is clearly one that the states have shared with Congress. Similarly suspicious of Fowler's successor as FCC Chairman (Dennis Patrick), the latter has so far failed to respond, as noted, to the clamour of the BOCs for removal of the District Court's oversight responsibilities for

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the Consent Decree in favour of their relocation at the more amenable FCC.

The great irony of the Reagan administration, favouring centralised deregulation over decentralisation, further turned the ratchet of federal preemption. If FCC actions during this phase confirmed the worst fears of some state regulators that telecommunications decision making could only take place at the behest of the FCC, they were equally offended by the perceived display of rampant deregulatory aggressiveness displayed by the unleashing of the BOCs. U.S. West's stance, in particular, outraged regulatory sensibilities. Its obfuscatory strategy of proliferating separate subsidiaries to shield cross subsidy from the eyes of state regulators was viewed with deep resentment. Also alarming was its seeming propensity to jog the elbows of potential legislative supporters by means of financial inducements while threatening utility commission opponents with strong negative economic sanctions (Roberts, 1987).

Clearly, some of these issues have been addressed in the more recent - 'proactive' - phase following divestiture. The Louisiana case yielded the appearance of an important impediment to federal preemptive encroachment. *Pari passu*, the more unrestrained activities aimed at quick fix or 'flash cut' deregulation by change agents such as U.S. West have confronted their nemesis. The company/sponsored 'proposition 100' referendum aimed at deregulation in Arizona was defeated in 1986. In 1987 the company suffered a parallel rebuff in Idaho when a deregulatory bill it had sponsored was vetoed by the Governor.

Undoubtedly suspicion still lurks in the minds of state commissioners

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about this company. Its former reputation as the 'bully boy of the BOCs' still lingers. Gene Kimmelman of the Consumers Federation of America, for example, has pointed to the artificiality of experiments such as that of Nebraska. Here the consumers have been protected from monopoly practices only in the short run by a company which wishes to trumpet the virtues of Nebraskan policies to other states in the hope that they will follow its lead. In what is perhaps the forerunner of similar initiatives elsewhere in the United States, state commissioners in U.S. West's operating area have formed themselves into a 'regional oversight committee (ROC)' under the chairmanship of Sharon Nelson (Washington State), an outspoken company critic. Operating as a shared information exchange the ROC is intended to impede U.S. West setting one state against another. In the light of this pressure (and perhaps reflective as well of disappointing financial results in 1988) the company is currently massaging its public relations image and has promised a more measured and less confrontational approach in the future. This may be indication of a 'relational maturation' in the links between players in the deregulation game at state level (Business Week, 1988).

Certainly, there is no shortage of voices asserting that, in generic public policy terms, we are witnessing the development of 'partnership' or 'progressive' federal models, 'a new set of shared relationships between Washington and the fifty state capitols (which) has changed how we determine national priorities, develop policy ideas, legislate and implement laws' (Tarr-Whelan, 1988).

The laboratory of the states is of heightened significance as a central dynamic in this model. Through an experimental policymaking process

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involving continuous innovation and replication the states can provide 'new but tested models for national policy' (Tarr-Whelan, 1988). On this argument, decentralisation offers an 'organic' solution to chronic American unresponsiveness to a changing global marketplace.

### **State Activism - A Janus Faced View**

This latter issue - global (non)competitiveness - is high on the post-divestiture policy agenda in the United States. Echoing the words of the late Commerce Secretary, Malcolm Baldridge, there is a widespread concern that one of the dysfunctional consequences of deregulation in the eighties has been a lurch into a policy of 'unilateral telecommunications disarmament'. The following statistics indicate the parlous telecommunications trade position currently occupied by the United States. By 1992 the overall trade deficit in telephone equipment should be about \$4.9 billion, the Bell companies should be spending about 58 per cent of their annual procurement budgets with foreign based companies and AT&T will have slipped to fourth or fifth place among worldclass telecommunications manufacturers (Robinson, 1989).

There is no shortage of critics pointing to the institutional weaknesses of the United States in an age of asymmetric deregulation, in which the US has relentlessly pursued a policy of 'deregulation in one country'. In the race of unrelenting competitive pressures from Japan and the NICs and with the impending threat of a powerful trading bloc in Europe after 1992, many have argued that there should be greater agency 'concentration' at the federal level. The spectre of catatonic inter-agency dispute has haunted the industry since divestiture. The Court, Commerce Department and the FCC

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have too readily appeared to take their eye off the competitive ball as they have engaged in squabbling over jurisdiction. Contrasting the concerted agency approach of the Japanese with the much more fragmented US bureaucratic model, critics have argued strongly that the executive branch has no central locus of telecommunications authority and that policy implementation should be undertaken by a single agency (Harris, 1988; Geller, 1988; NTIA, 1988).

For the critics of federal fragmentation, the involvement of the states in the telecommunications policy process is an added impediment to the development of a vigorous American challenge to those foreign competitors who are seeking to engage the U.S. in economic telecommunications warfare. For them:

while local involvement in many policy areas is certainly valuable, telecommunications are national networks, providing interstate services. National policy should take account of regional needs and differences, and might even incorporate limited participation and local decision making in policy implementation, but we cannot afford local policies that are inconsistent or at odds with national interests (Harris, 1988).

New technological developments (such as ISDN - requiring high degrees of standardisation) may be prejudiced by polycentrism. Other disadvantages include regulatory 'inflation' (multiple regulatory jurisdictions are inherently more costly than one central regulator such as the FCC) and the imposition of financial penalties on the local taxpayer (forced to subsidise state governments in their pursuit of competitive economic advantage).

There are, of course, many arguments in support of a continuing state telecommunications policy making role - even in the face of strong

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exogenous challenges. First, there is the general Madisonian point that systematic variation between states in public policy is a useful testbed of ideas. Novel approaches to, say, deregulation in one state can be tested and the results circulated to others through policy networks such as that provided through the National Association of Regulatory Utility Commissions (NARUC). As already noted, linked to this is the argument that decentralised decision making will yield greater flexibility of response to changing conditions. On the broader policy front, recession has forced many of the states into strategies for economic revival far in advance of federal policy. They thus may act as bellwethers for national policy initiatives. On the broad trade front, recent state initiatives are very much in evidence. The states have lately realised that their fate is bound up with that of the international economy.... 'world politics are now local politics' : telecommunications is a key component of state policies designed to attract inward investment. Many, for example, have established trade offices in Japan in an attempt to access this most obdurate of foreign marketplaces (Grubel, 1988). Thirdly, there may be opportunistic advantages inherent in federalism, 'state regulation makes the US market much more complicated for foreign competitors (to penetrate) and therefore acts as a non-tariff trade barrier. From the perspective of US interest in 'fair trade', state regulatory fragmentation may be considered a plus.' (Teske, 1988b).

The future biography of telecommunications federalism is by no means clear. The recrudescence of 'dual' or 'cooperative' telecommunications federalism in the wake of the Louisiana decision could still prove short-lived. The FCCs 'Open Network Architecture (ONA)' plan, permitting users to interconnect with the basic network on an equal access basis is currently under state challenge (e.g. California) in the courts for its alleged preemption of state regulatory power. This suggests that the

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Louisiana decision may yet prove to be less of a limitation on federal authority than was at first thought (Haring, Levitz, 1988). Yet Irwin's (1985) early obituary notice for state regulation - seeing a vastly diminished role for state regulators in the face of 'technological, gubernatorial and federal preemption' seems over-stated. As he himself acknowledged, such regulators have a stake in their own survival. They are joined in this endeavour by key local stakeholders such as residential consumers. They can, only too well, recognise the propensity of federal regulators to shift cost burdens to their disadvantage.

In fact, it seems difficult to conceive of the possibility of partial or complete state withdrawal from the telecommunications policy arena, even in the face of arguments that trade issues will force long term regulation by the federal government alone. For the present there are small but hopeful signs of a potential for greater cooperation than in the recent past. Technological change is undoubtedly contributing to a greater willingness on the part of many states to move away from rate base regulation and try more flexible regulatory alternatives. It may be achieving more peacefully what federal preemption could only attain at the cost of greater rancour - policy convergence. There are signs, too, that greater concentration may be present in the apparent willingness of the FCC to resort more readily to the 'joint board' process as an important conflict resolution mechanism. Developments such as ONA may be extremely important accelerators of new concertationist trends. ONA, comprising a set of technological and accounting protocols for yielding service providers access to local exchanges on the same basis as the local exchange (monopoly) company, is currently viewed as the key mechanism for furthering competition and for providing the basis upon which the BOCs may be freed from the court

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imposed line of business restrictions. Its implementation may demand a process of imaginative 'institutional reconstruction' in the existing patterns of relationship between federal and state regulators (Noam, 1989). This could involve the assembly of new tripartite forums involving the FCC, states and industry representatives to settle questions of standards, and issues of national uniformity and local diversity. Operating with considerable informality, such bodies might be the harbingers of future cooperative endeavours. Developments such as these may yet presage the renunciation of pre-emption in favour of partnership. Just as assuredly what they will not do is terminate once and for all the venerable debate within the telecommunications policy community about the proper allocation of power between states and federal government.

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