



# POLICY BRIEF

## **Eight Principles of Telecommunications Policy**

by Washington Policy Center

**December 2011**





# **Eight Principles of Telecommunications Policy**

December 2011

## Contents

Introduction and Eight Principles.....	1
Basic Principles of Free-market Tech/Telecom Policy.....	2
Technology Sector Issues.....	3
Telecommunications Sector Issues.....	7
Conclusion.....	9
Resources.....	10
About Washington Policy Center.....	11



## Eight Principles of Telecommunications Policy

*Ending outdated fees and regulations would spur new products and innovation*

December 2011

### Eight Principles of Telecommunications Policy

1. Do not regulate what cannot be regulated.
2. Do not regulate what does not require regulation.
3. Legislation is better than regulation.
4. The consumers are the boss, and they know what they want.
5. Neutrality should be the goal.
6. Eliminate artificial distinctions.
7. Substitution is competition.
8. Do not use economic regulation for social goals.

### Introduction

Today's economy relies on information and communication moving rapidly and seamlessly across a wide variety of devices and mediums. The technology landscape continues to evolve quickly, and government regulators — both at the federal and state level — are looking at extending the existing regulatory environment to technologies that emerged decades after the initial regulatory mandates were enacted.

Regulating the Information and Communications Technology (ICT) industry is tricky for a variety of reasons. Foremost is the rapidity with which the industry changes; the iPhone went on sale only four years ago, and the power of cloud computing had yet to be fully realized (also, Facebook had a scant million users then, not the 750 million it has today).

The second issue with regulating in the ICT industry is that of balancing state and federal jurisdiction. Federalism demands more local control, or at least local oversight, yet technology and information management are often ubiquitous and the danger of fifty states laying out fifty different rules for cloud computing, VoIP connections, or privacy stipulations for mobile devices, would drastically cut down the innovation and speed with which these services are rolled out to consumers and businesses.

So, a balance must be struck between federal oversight and allowing state policymakers to weigh in when appropriate.

Often lost in the discussion is the need for smarter regulation, not just jurisdictional clarity. Are there regulations that need adjusting or updating, and what about regulations that simply are not needed anymore because society has moved on?

As a state-based think tank, WPC is focused first and foremost on affecting policy and policymakers in Washington. So focusing on federal regulations is often outside our purview. However, there remains a vital role for WPC and other state-based organizations in both keeping the federal government out of primarily state regulatory matters, and in encouraging state lawmakers to follow the federal example when appropriate (e.g., deregulatory efforts).

This briefing paper — along with the *Communications Policy Guide* — lays out a basic framework for how we can incorporate many of the basic free-market principles used in discussions on budget and tax, education, health care and the environment, and apply them to debates on technology and telecommunications policy.

## Basic Principles of Free-market Tech/Telecom Policy

Many of the basic principles that apply to other policy areas also apply to technology and telecommunications. These principles offer a clear path that holds up no matter how quickly these industries change under our feet. Advancing these principles will encourage entrepreneurs and innovators to maximize their investment and bring valuable products and services to the market.

**Do not regulate what cannot be regulated.** Policymakers are sometimes tempted to enact unenforceable rules as political gestures. For example, laws aimed at the Internet or cloud computing may be evaded by relocating servers or data centers out of the country. One U.S. senator threatened to “pull the plug on the Internet” if his proposed legislation couldn’t be enforced. Such empty threats result in a cynical attitude to all law. Policymakers should accept technological reality and not “tilt at windmills” for the sake of political gain.

**Do not regulate what does not require regulation.** Innovation drives increased productivity, faster growth and higher personal incomes. If something doesn’t absolutely need to be regulated, it shouldn’t be regulated. Regulations designed for the telephone monopoly hinder today’s rapidly changing, competitive market. Regulations designed for old technologies should not be applied to new and emerging technologies.

**Legislation is better than regulation.** The will of citizens is best reflected in the actions of their elected legislators, not in the decrees of a few unelected regulators. Legislation creates a more predictable environment for business planning and is generally more responsive than regulatory oversight. Whenever possible, elected legislators should develop and establish telecommunications policy, leaving as little as possible to the discretion of regulators.

**The consumers are the boss, and they know what they want.** The legal ground rules for the communications industry should respect consumer choice. If consumers want a bundle of services from a single provider, they should be allowed to have it. “Consumer groups” often work under the assumption that businesses seek to harm their customers, leading them to assume the worst and support overly restrictive policies. Existing “consumer protection” rules often protect companies from their competitors, rather than protecting consumers. True consumer protection should be directed at real, concrete consumer harm, like fraud, not some vague or imagined potential for harm. Regulations designed to anticipate and prevent problems are almost always doomed to failure.

**Neutrality should be the goal.** Tax and regulatory policy should be technologically neutral. Why should one method of accessing the Internet be highly taxed and regulated, while others are not? Why are communications companies more highly taxed and regulated than other industries? One would think they should be taxed at lower rates given our reliance on communications to improve so many facets of life.

**Eliminate artificial distinctions.** Technological convergence makes old legal and regulatory distinctions irrelevant. In the digital world, the distinction between local and long-distance phone service has no meaning. Also meaningless are different regulatory regimes for cable, telephone or satellite companies, since they are all delivery of the same product. Regulations based on invalid distinctions will fail in their purpose and do real economic harm.

**Substitution is competition.** If consumers substitute one technology for another this is, in reality, competition, regardless of any so-called antitrust policies. Wireless, cable telephony, VoIP, e-mail and instant messaging compete with traditional wireline phone service. Over-the-top video services (such as Netflix or Hulu) and IP video now compete with cable television providers. Consumers can choose between these media and substitute one for another, meaning providers of these services compete against each other.

**Do not use economic regulation for social goals.** For every new service, someone always claims regulation is needed to supply protected classes in society. These include low-income populations who cannot afford the service, and the elderly. But complex price and revenue regulation for this purpose makes no sense. State legislatures and Congress can authorize direct social spending to provide direct subsidies to those in need without disrupting the marketplace. A better approach than regulating business' prices and services would be to identify social or policy objectives and let private businesses innovate to achieve these goals.

## **Technology Sector Issues**

The technology sector largely encompasses the front end, or user experience, that the interconnectivity of the Internet provides. Much of the technology sector is based on hardware and software that enables consumers and businesses to interact and share information. This sharing of information can lead to complications and concerns in areas such as privacy and protection of intellectual property.

### *Privacy*

Data show that Americans are relying more on their mobile devices for communications, and increasingly, data delivery and geolocal activities. Privacy concerns have prompted consumer groups to encourage greater government oversight, both federal and state, in how these technologies are used. Services such as Foursquare, Yelp and Groupon can use a person's location to send geo-specific advertisements. This is similar to websites that enable cookies to track users' web activities anonymously, in order to send targeted advertisements to which the consumer is more likely to respond. Facebook similarly places ads on the pages of viewers it thinks a third-party advertisement would be relevant.

Americans are rightfully concerned about who has access to their personal information, and in what manner. Likewise, consumers are weary of security breaches to personal files held by private companies. But consumers are also concerned the government may gain unwarranted access to personal information without legal justification.

Policymakers often focus on one particular type of technology or service as posing a drastic threat to consumers' privacy, yet these fears are often hypothetical only and do not take into account new consumer benefits. Many services are offered online free of charge (such as e-mail services or review sites) but still the service is collecting some type of information from the user, perhaps age, sex and general location, so future offers can be tailored to fit the user's interests, thereby making the service more appealing to the consumer.

Policymakers should focus on law enforcement — punishing bad actors — rather than on trying to regulate away any privacy concerns. Privacy concerns and data breach threats long preceded this recent growth in mobile or cloud computing. Targeting technology through regulation could actually provide a disincentive to the creation of safer computing and data protection.

### *Electronic Computing Privacy Act*

In 1986, Congress passed the Electronic Computing Privacy Act (ECPA). The law is a broad framework detailing how law enforcement could conduct surveillance on the then-nascent electronic communications networks. The law lays out Fourth Amendment protections for citizens but also allows for circumstances when law enforcement could access user information. But the ubiquitous communications networks of today, and the growing reach of cloud computing, have changed the landscape in the past 25 years. As a result, ECPA is a patchwork of confusing standards that have been interpreted inconsistently by the courts. This is causing further confusion to providers of computing services, especially cloud computing services.

The reasons for ECPA reform are myriad. Today's electronic communications rely on many services that did not exist in 1986. E-mail, mobile services, cloud computing and social networking have all emerged as the dominant electronic communications services outside of wireless telephony.

As an example, a document stored on a desktop computer is protected by the warrant requirement of the Fourth Amendment, but the ECPA says that the same document stored with an electronic service provider may not be subject to the same requirement. ECPA does not clearly state the standard by which the government can access someone's location information, perhaps stored on a user's mobile device.

The vague nature of the "third-party doctrine" undermines confidence in cloud computing. Users will be less likely to use cloud services if they think their data is not protected against unwarranted searches by the government. Consumers and businesses that operate in the cloud need clear rules of the road when it comes to third-party data protection and law enforcement access.

Updating ECPA while keeping in mind the principles of technology neutrality, consistency in laws and regulations, simplicity of understanding, and assurance of law enforcement access will help this rapidly growing sector to continue to develop.

### *Neutral Government Procurement Policies*

Most computer software and hardware is sold like any other commercial product and is protected by U.S. intellectual property laws (primarily copywriting and patent protection). High-tech companies that develop software and sell it under license have a strong economic incentive to stand behind their product, to create improved versions of it and to search continually for ways to protect it from viruses and hackers.

Open-source software is different. Users can access and alter the source code at will without violating copyright. But what is particularly appealing about open-source software (OSS) is that many times it is provided for free. However,



the free software is often bundled with maintenance services that do cost money and create a revenue stream for the vendor.

Regardless of whether a government chooses to pursue business with a vendor of proprietary software or OSS, procurement practices should include the technology neutrality principle (government shouldn't choose winners and losers). In some instances, governments will benefit best from open-source software; at other times, proprietary programs will best fill a need.

A few cities and states over the last decade have pursued procurement policies mandating that only open-source software be used in state or city government. Many times, however, those pushing these mandates are doing so to push procurement officials toward one type of business model (open source) over another (proprietary). This does not serve the taxpaying public, because total cost of ownership is often ignored. Instead, advocates of open-source software look only to the initial cost outlays and not the entire picture.

Policymakers should be aware that arbitrarily mandating the use of open-source software reduces the ability of government managers to use all available resources to run an efficient public operation.

#### *State Nexus/ Affiliates Tax*

Several states, in an effort to collect more revenue from businesses and consumers, have enacted new “nexus thresholds” in order to circumvent the 1992 *Quill* U.S. Supreme Court decision. The *Quill* ruling upheld the long-standing rule that businesses with no physical presence in a state, but that did business there (e.g., a mail-order catalog with no storefront), are not liable to collect and remit sales taxes to the local or state jurisdiction.

The Supreme Court held that there was a serious threat to interstate commerce as states try to impose thousands of state and local-level sales taxes. There are over 8,000 different sales tax jurisdictions nationwide.

Seven states have adopted tax rules that are based upon an “affiliate” connection between an independent contractor and the out-of-state business. Affiliates are not employees of the business, affiliates have a website that contains a link to an online retailer's (e.g., Amazon.com, Overstock.com) website and nothing more, but these states are demanding that any sales made by the affiliates in these programs are subject to taxation.

In addition to attempting to collect new revenue, backers of these proposals claim traditional brick-and-mortar businesses deserve a level playing field. While a level playing field is desirable, the way these tax laws are implemented creates further distortions. The bottom line is that the consumer should be paying use taxes on any out-of-state purchase. The problem for government officials is they have no way to track who does not pay use tax, and there is no legal way to force out-of-state businesses to report customer activity.

There are several alternatives to having states take this issue on one state at a time. In doing so, states are creating pockets of economic inactivity as affiliate programs are being shut down, harming people who are primarily small business owners.

Some alternatives include:

1. Replacing the collection obligation with a requirement that the out-of-state vendor notify the customer that a use tax obligation may exist.
2. Switching to an origin-based system in which all state businesses collect state sales taxes on their sales, regardless of where the customer is located.
3. Setting a *de minimis* threshold of \$1 million or more of in-state referred sales for the law to apply to a particular out-of-state company. Most affiliates refer far less than \$1 million of business to these companies.

States that have enacted this nexus affiliate tax have yet to see higher revenues as a result. In fact, states that also collect income taxes could see a *negative* result. If affiliate programs are shut down, government collectors would see a corresponding decrease in income tax revenues.

The best way to resolve this issue is through a national approach. Either Congress could address the issue or the courts could determine if *Quill* is still applicable. The emerging patchwork of different regulations and jurisdictions is rapidly becoming counterproductive.

#### *Intellectual Property/Piracy*

Piracy in any industry is a destructive and damaging action and it is no different in the software and technology sector. While counterfeit drugs can cause bodily harm and bootlegged DVDs violate copyright, pirated software can cause immense economic damage.

Intellectual property rights are the foundation of our market economy and as our nation's economy continues to rely more on information technology than ever before, the threat of economic damage is increasing as well.

Businesses engaging in piracy lower their cost of doing business, thereby providing a competitive advantage over businesses that play by the rules.

One recent report shows the United States faces a 21 percent software piracy rate. Considering businesses and consumers in the U.S. spend over half a trillion dollars on IT per year, even reducing piracy rates by half would generate almost \$41 billion in increased economic activity and over 30,000 jobs.

States have taken different approaches to curtailing software piracy. As with any policy approach that attempts to take on a jurisdiction-less problem (the IT sector spans all states) with a state-by-state approach, potential problems arise. Whether states or Congress spearhead piracy or intellectual property concerns, what policymakers should not do is prohibit certain technologies or business models as a way to solve the piracy problem. Any business model or technology could theoretically be used to an advantage through illegal means, but the policy focus should be on illegal acts, not by picking winners and losers in the market.

While Congress has expressed interest in reducing piracy — which has international implications due to much higher piracy rates overseas — little has been accomplished.

## Telecommunications Sector Issues

Even though more of our communication is moving toward digitization, as opposed to older analog technology, we still rely heavily on traditional wired telephones and similar technologies that have been around for generations. As telecom providers balance their communications infrastructure, often they must fit their new and innovative technology into old regulations written in the early-to-mid twentieth century. Regulators are often hesitant to update many of the regulations governing telecommunications services, even though consumers are benefitting from robust competition.

### *Streamlining of Traditional Landline Telephony*

In many states current telecommunications regulations are outdated and in need of updating or wholesale reform. Much of the regulatory landscape is based on the old wireline-dominated telephone system (the “Ma Bell” era) and has yet to adapt to the rapidly changing environment that has introduced a number of competitors, namely wireless and IP-delivered communications.

Much of the old wireline system is still regulated with price controls, rate-of-return requirements, burdensome intrastate connection fees, and universal service funds that accomplish little public good.

Several states — most recently Tennessee, Kansas and Indiana — have recently attempted to reform these antiquated regulatory regimes, but more needs to be done.

Any attempt to streamline the regulatory regime governing local exchange carriers should focus on market regulation, rather than retail pricing regulation, so companies can have the flexibility to provide prices, products and services their customers want, rather than what government regulators require. Competing services from wireless and IP-driven devices (such as VoIP) are not subject to similar regulations and therefore present a competitive disadvantage to the wireline providers, with the higher cost often being passed onto consumers.

States should follow the FCC’s recommendation, as laid out in the 2010 National Broadband Plan that “reform should move carriers’ intrastate terminating switched access rates to interstate terminating switched access rate levels in equal increments over a period of two to four years.” Implementing this type of regulatory reform would chip away at the long-held practice of smaller, rural phone carriers charging disproportionate access charges in order to connect long distance phone calls. The artificially high access charges act as a way to subsidize phone service and offer lower prices to their own consumers. Ultimately, the entire system of call termination fees should give way to a technology-neutral system based upon competition.

### *Reform of Universal Service Fund*

Prior to the breakup of the AT&T monopoly in the early 1980s, the federal government set up a Universal Service Fund (USF) to provide guaranteed service to high-cost service areas, most often in rural or remote locations. The goal was to ensure that every American had access to affordable telephone service. Each subscriber line paid into this large fund, which was then distributed around the nation to help pay for the sometimes exorbitant cost of connecting remote lines.

However, decades have passed since the USF has largely fulfilled its goal (landlines are available to over 99 percent of Americans today) yet the \$8 billion per year fund continues to extract fees from consumers to pay for service in areas that now have wide consumer choice (like wireless phones or VoIP, for instance).

Regulators want to use a USF-styled mechanism to roll out broadband connections to high-cost areas throughout the nation. But before this is done, the federal government and the states that have their own USF should take a step back to acknowledge how the industry has changed in the last two decades.

The bottom line is that the USF system is broken. Many of the subsidies are targeted at large private carriers who win the political lottery and yet demand the continued payment of subsidies. Unless substantial reform takes place (such as switching from a carrier subsidy system to a means-tested consumer voucher system similar to food stamps), we can expect this type of broken system to carry over to the universal broadband era.

#### *Municipal Broadband Networks / Public Telecommunications Providers*

One of the more prevalent arguments for governments to become providers of telecommunications or broadband service is the supposed failure of the private market to provide the service in question.

There are areas in the nation where service is considered cost-prohibitive by the private carriers. Many of these areas are remote locations that present topographical or geographic challenges to existing, or affordable, communications technology. It is easy for a provider to connect a multi-family dwelling to a local loop or fiber connection for fast telephonic or data connection. It is another thing to connect a house in the foothills of a mountain, dozens of miles away from existing infrastructure. Any attempt to connect this house to the communications grid would cost both the consumer and company an exorbitant amount.

But there is a difference between an “unserved” area and an “underserved” area, where at least one provider is present but the market is deemed to lack sufficient competition or services on par with other, more competitive areas.

Proponents use the “underserved” justification to push government into becoming a provider that competes with existing private operators. Unfortunately, government often inhibits private investment because government service providers operate outside of normal market forces.

Government ownership of facilities that produce goods and services will make the private sector reluctant to enter those markets. As inefficient as government-run systems are, government has a virtually bottomless source of capital in a captive taxpayer base. They do not have to pay private sector interest rates for capital. Governments can cede to themselves preferential access to municipal rights of way, and price their product below cost.

Government entry is unfair to private businesses and bad for the public as a whole. It means consumers will never reap the benefits of competition. When government owns and operates the facilities that produce a product or service there is no return on investment and hence little or no capital formation as a result of improved productivity.

The other argument made in favor of government-run telecommunications networks is that they should be considered a public utility. However, just about every city that runs a water, sewer, garbage, road or mass transportation system is losing money on these operations and must make up the difference through taxpayer subsidies, an option no private competitor can rely on. Communications products have an extremely limited lifespan, becoming obsolete almost immediately. Witness the continued problems that several municipalities have had setting up “free” Wi-Fi networks.

The last and perhaps most serious concern with government becoming a provider of communications networks is that of content control. Any private business that begins censoring its customers’ communications faces intense backlash (e.g., market forces) and possible loss of revenue or profit. Because governments operate largely outside of these normal market forces, there would be little restraint toward the possibility of content control. This would be a dangerous road to travel and is why governments in this country do not own media outlets.

## **Conclusion**

The technology and telecommunications industries are fast changing and present difficulties in balancing federal, state and local taxing and regulatory jurisdictions. It is unfortunate that many federal and state regulators want to continue outdated regulatory regimes rather than embrace the competitive landscape that has emerged in place of the old monopoly-style system.

The underlying principles for a free-market technology and telecommunications system laid out in this paper will help provide policymakers the foundation they need to encourage that these dynamic industries remain vibrant and strong.

## Resources

“The Emergence of the Digital Precautionary Principle,” by Carl Gipson, Washington Policy Center, June 2011.

“Communications Policy Guide, Release 2.0,” by the Institute for Policy Innovation and Washington Policy Center.

*Hi-Tech Chapter*, “Policy Guide for Washington State, fourth edition,” published by Washington Policy Center.

“10 Principles of Telecom Policy,” The Heartland Institute, February 2011.

Digital Due Process Coalition – DigitalDueProcess.org (coalition of research, advocacy and business entities endorsing ECPA reform).

“Red Tape Under the Tree: FCC Plans Internet Regulation for Christmas,” James Gattuso, Heritage Foundation, December 2010.

## Think Tanks that work on Tech/Telecom Policy

- Digital Liberty ([digitalliberty.net](http://digitalliberty.net))
- Discovery Institute ([discovery.org](http://discovery.org))
- Cato ([cato.org](http://cato.org))
- Competitive Enterprise Institute ([cei.org](http://cei.org))
- Heritage ([heritage.org](http://heritage.org))
- Institute for Policy Innovation ([ipi.org](http://ipi.org))
- Mercatus Center at George Washington University ([mercatus.org](http://mercatus.org))
- TechFreedom ([techfreedom.org](http://techfreedom.org))
- Technology Liberation Front ([techliberation.org](http://techliberation.org))
- Washington Policy Center ([washingtonpolicy.org](http://washingtonpolicy.org))

## About Washington Policy Center

Chairman	<b>Greg Porter</b>
President	<b>Dann Mead Smith</b>
Vice President for Research	<b>Paul Guppy</b>
Communications Director	<b>John Barnes</b>

For more information contact Washington Policy Center:

PO Box 3643  
Seattle, WA 98124  
p 206-937-9691  
f 206-624-8038  
wpc@washingtonpolicy.org  
www.washingtonpolicy.org

*Washington Policy Center is a 501(c)(3) non-profit research and education organization that promotes sound public policy based on free-market solutions. Nothing here should be construed as an attempt to aid or hinder the passage of any legislation before any legislative body.*

© Washington Policy Center, 2011

