

Lessons for Modern Regulators from Hippocrates, Schumpeter and Kahn

by

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Recommendations and Conclusion

Given the limited ambition of this essay, our critique of FCC regulation has been necessarily abbreviated, selective and suggestive. Deriving grand lessons from such a thin selection of regulatory episodes will no doubt seem bold if not foolish. Still, we see some persistent patterns in these cases, repeated in other FCC actions not discussed.

Probably the most obvious pattern is the penchant for detailed controls designed to eliminate any unforeseen contingencies that the play of markets might produce. One sees this most sharply in the telecommunications area and the attempts by the FCC to fine tune competition in local service markets. We commented earlier on the FCC's attempts to define competition in those markets by fixed standards rather than seeking to ensure that the dynamic force of competition is not foreclosed by artificial barriers to entry or other market failure considerations. The appropriate recommendation here is simple: Once the minimum conditions for competition are in place, do not attempt to regulate certain outcomes. The Schumpeterian corollary to this is: The conditions for competition should be measured by a long run perspective. We say this fully mindful of Keynes's famous edict about being dead in the long run.¹ By long run we don't mean a life term. But we do mean a period that may exceed the tenure of the regulator.

Admittedly the long versus short run problem is not uniquely in control of the regulator. When Congress enacted the 1996 Telecommunications Act, it directed the FCC to adopt regulations to implement its local market competition provisions within six months. Dutifully responding the FCC fell all over itself to put in place sharing rules, pricing rules that were incompletely considered (to put it charitably), producing more than a decade of litigation in the courts that defeated Congress' desire for quick action — and also immediate results. The FCC had to respond to the six month deadline for rules, but it did not need to craft rules with a view to producing immediate, short-run results, at the expense of a more sedulous, but ultimately more sustainable set of rules for the long run.

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¹ John Maynard Keynes, *A Tract on Monetary Reform*, MacMillan: Great Britain, 1923, p. 65. The relevant passage is worthy of quotation in full. "But this *long run* is a misleading guide to current affairs. *In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again." For Keynes, much like Schumpeter, it was the process of disequilibrium in the market rather than equilibrium that should occupy economists' attention. See also P.J. McNulty, "Economic Theory and the Meaning of Competition," *Quarterly Journal of Economics*, LXXXII, 1968, p. 648 (describing the difference between a condition of equilibrium and the behavioral pattern leading to it).

The disposition to control all contingencies leads naturally to an attempt to develop solutions for problems that have not manifested themselves.² A degree of anticipation is not a bad thing. It is one of the advantages of administrative regulation over other forms of government control, such as antitrust or other forms of ad hoc interventions. But this virtue can also be a vice of regulation when it leads to premature action, as we believe to be the case in the net neutrality controversy. Perhaps taking literary liberties with Hippocrates, we described this as a Hippocratic oath problem for the simple reason that premature intervention almost always produces more harm than good. We don't claim that it is wrong to anticipate problems; the harm lies in rules that are so anticipatory that the problems they seek to remedy are not well defined and may even serve unwittingly to produce additional problems.

In the case of net neutrality, admittedly, the FCC has not adopted any specific set of regulations. Indeed, as we saw, that was precisely one of the objections raised to its enforcement action in the *Comcast* case. However, the FCC's demand for accounting from Comcast will have the effect of inviting regulatory surveillance of managerial decisions by service providers without the benefit of any clear engineering or business standards — and all in order to stave off possible strategic behavior that has not been shown to be a significant threat to the normal, expected operation of the market. Again, the FCC was clearly responding to political pressures. There have been proposals for legislation to set standards of net neutrality.³ In defense of the FCC's action one might argue that its intervention in the *Comcast* case might have the effect of heading off congressional action that would be more mischievous than the FCC's limited actions. Perhaps. However, given the previous history of FCC actions under the claim of “ancillary jurisdiction” (we have in mind the early history of cable television regulation) one must be anxious about entrusting a matter of this potential importance — the regulation of the Internet — to the agency's undefined, standardless discretion is the way to make sensible public policy.

Choosing between an unfettered agency and an uncontrollable legislator is, we concede, a little like choosing between two equally loose cannons. Congress's action in the case of the broadcast group ownership rules is a case in point. In 1984 when the FCC decided that the rules were irrelevant to the ostensible purpose of promoting diversity, Congress cut off funds to implement the change. Fast forward a little more than decade, Congress in 1996 directed the FCC to take a close look at its multiple ownership rules, including the group ownership rules, with a view towards relaxing or removing any that were not shown to be currently needed. Although slow to respond at first, the FCC under prodding from the courts made a number of far-reaching changes in all of its ownership rules in 2003, including raising the cap on the group ownership limits that it had attempted to remove in 1984. Congress immediately responded with what was basically

² We do not fault the regulator for this behavior *per se*. It is arguably a rational response to an environment that holds the regulator to account for performance metrics that are easily measured (e.g., prices, blocked Internet applications), but not for performance metrics that are less easily measured (e.g., products and services that do not find their way to market, but would have otherwise.) This explains why regulators are not predisposed to foster the type of dynamic competition that Schumpeter viewed to be the most important for consumer welfare.

³ See, e.g., Internet Freedom Preservation Act, S. 215, 110 th Cong. (2007).

a reprise of 1984: a demand to cease and desist from any changes in the cap, followed by a compromise solution to allow a slight increase in the limit in order to accommodate two of the national networks. Political scientists will no doubt shrug and say, well, Congress is run by politicians not philosophers.

As it happens so is the FCC, and here we suggest is the appropriate place to draw the line between politics and principles. The Communications Act does delegate to the agency a considerable degree of policy-making discretion, but it is not a “home rule” charter conveying independent political sovereignty. The lesson, and the correlative recommendation, is simple: Do not anticipate legislative commands or respond to the wishes of congressional members except where they are clothed in formal legislation. Make Congress do its own work. We cannot say that such a recommendation, if followed, would have changed the outcome of the national ownership rules, but it might have. When Congress in 1984 cut off funds to implement the elimination of the rules, it was only a one-year moratorium. At any time thereafter the agency could have acted on its 1984 judgment. It did not do so. Indeed, it did not do so even after the 1996 Act directed a review of its rules. Its failure to follow through on its 1984 conclusion could not be defended as principled; indeed, it was precisely on that score that the court of appeals reversed the agency in 2002 and forced it to confront the issue.

We began this essay with the idea that the collective wisdom of Hippocrates, Schumpeter and Kahn could constructively inform the role of regulation in the rapidly evolving telecommunications industry. The objective of regulation in telecommunications, regulating the monopoly prices paid by consumers, is no longer the primary focus of regulation; competition has made that objective largely moot. Today regulators have shifted their focus to regulating that competition in order to ensure its success. While there may be some legitimate role for regulation to play in facilitating the transition from monopoly to competition, we think it is one that poses great risks of undermining the very competition it is supposed to foster. As a result, due deference to the Hippocratic oath calls for a more limited role for *ex ante* regulation going forward. Schumpeter believed that the regulators’ efforts to control transitory market power were misguided because they interfered with the competitive process — dynamic efficiency always trumps static efficiency. It would be difficult to point to an industry more technologically dynamic than the telecommunications industry. Kahn recognized that the regulator’s penchant for competitive handicapping interfered with market rivalry in a manner that served to harm rather than benefit consumers.⁴ And both Schumpeter and Kahn would counsel that regulators should serve to protect the integrity of the competitive process rather than protect selected competitors. Their counsel, though often unheeded, is precisely on point.

⁴ Indeed, as FCC staff officials Haring and Levitz long ago observed: “If one of the runners in a race is artificially handicapped, that may make the rivalry less intense and the contest less capable of producing a superior performance.” John Haring and Kathy Levitz, “What Makes The Dominant Firm Dominant?” Office of Plans and Policy, Working Paper Series, No. 25, Federal Communications Commission, April 1989, note 10.

The collective wisdom of these teachers serves to reinforce the fundamental theme of this essay that in refereeing the struggle between competing firms, the referee's role must be circumscribed. The referee must not be an active party to the contest. Nor should it seek to shape the outcome according to narrowly defined, pre-fixed outcomes. These ideas are not natural for those steeped in the centrifugal model of traditional regulation. And yet, it is only in escaping these traditional modes of thought and expression that we can complete the transition to the centripetal model of regulation that the times require — a model that is focused less on the control of market power and more on unleashing the power of markets.