Comments on

"THE FUTURE OF TELECOMMUNICATIONS REGULATION"

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The article by Roger Noll on "The Future of Telecommunications Regulation" is a useful introduction to the topic under discussion here, and I agree with much of it.

Noll examines the future of government regulation in the area of telecommunications. He offers not merely a forecast of the future course of regulation but rather a prescription. It "is that AT&T should continue to be regulated, but should be permitted to enter essentially any market it wants" (p. 61). Even in the case of a post-divestiture AT&T, he finds that regulation still has a useful role to play. It is interesting to ask how he comes to this conclusion, especially in an era where government regulation is not looked on with much favor.

The goal of direct regulation, at least in the textbook version, was to prevent the exercise of monopoly power in the provision of local telephone service. This service was considered a natural monopoly,

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and regulation was required to protect consumers in the absence of effective competition. This of course is the traditional rationale for regulation.

Whether this story is correct or not—and Noll finds that regulation did have the effect of reducing average prices—it played an important role at the outset of the antitrust case now in the process of settlement. There is a close relationship between that view of regulation and this particular antitrust case.

When Donald Turner became Assistant Attorney General for Antitrust in the Department of Justice in the summer of 1965, one of his original objectives was to reopen the earlier antitrust settlement dealing with AT&T. The 1956 settlement was not looked on with much favor by the antitrust fraternity at the time. Though imposing certain behavioral restrictions, it had left the structure of the industry essentially unchanged, and there was concern as to whether mere behavioral remedies were sufficient to deal with monopoly problems in this industry. Turner's goal was explicitly structural. His aim was to separate Western Electric from AT&T and thereby require vertical divestiture.

In his first year at the Department of Justice, Turner commissioned an external economic study of vertical integration between Western Electric and the remaining parts of AT&T. While our knowledge of the economics of vertical integration was then more rudimentary than it is today, still there was growing recognition that monopoly power was largely a horizontal phenomenon.

In the Antitrust Division at the time, a story was told concerning the effect of integration on regulation. Since Western Electric had a captive market, equipment prices and product designs were not subject to the test of the market. As a result, higher prices charged by Western Electric would lead to higher costs, which could then be passed on to consumers. Monopoly returns would be reflected in higher equipment prices rather than in higher profit margins for telephone service, and regulators would find it more difficult to prevent the exercise of monopoly power. *Divestiture was therefore required to make regulation work.* Without divestiture, regulation would prove unequal to its task. With vertical divestiture, on the other hand, increased competition in the market for telephone equipment would result in lower prices both for equipment and for telephone services.

Note two aspects of this story. First, it was told with regard essentially to a single product: what we now regard as basic telephone service. There was little expectation of the myriad of services which have since become available, and which form much of the background for current policy discussions. In addition, there was little consideration of long-distance service, perhaps because it accounted for a small share of total revenues. The focus of the debate was on local telephone service, and long-distance service seemed merely an ancillary part of the whole.

What transpired from these early discussions is well known. An antitrust case evolved from these discussions and was finally settled. As currently proposed, the end result is indeed the vertical divestiture which was the original objective of the Antitrust Division in the mid-1960s. This settlement, however, is quite different from that which was originally imagined. Local telephone service, rather than equipment manufacture, is to be divorced from AT&T. Although through a different route, the goal of vertical divestiture would be reached.

The future of regulation must therefore be examined in the setting which this settlement will create. Noll recognizes that the operating companies will remain subject to state regulatory authority. However, the question remains as to the proper scope of regulation for AT&T. In particular, what role is there for regulation of long-distance services, which will remain with AT&T under the antitrust settlement, and what is the proper scope of regulation for the other communication services to be offered?

Particularly in regard to the large number of enhanced communication services, Noll raises the following problem: since new suppliers of these services will inevitably purchase some necessary inputs from AT&T at the same time that they compete with it, competitive problems are inevitable. AT&T will remain a dominant firm in these markets; like all such firms, it will possess "great opportunities for erecting entry barriers, making close calls in a self-serving way that will take regulators and the courts years to unravel." (p. 56)

While this firm may indeed use its dominant position in a strategic manner to maintain its market position, the policy issues raised here are the same as with other dominant firms. There is little reason to believe that this is a unique example. There is also no reason

to reach a different policy judgment here than elsewhere. And the general solution to such problems is to rely on antitrust principles rather than on direct regulation.

It is useful to recall that most antitrust cases do not involve government on either side of the litigating table. Most cases concern only private litigants. Moreover, explicit exclusionary behavior is often a source of private litigation, and there are many private attorneys who actively seek such cases. The critical question is whether we should be content to rely on the treble-damage sanctions which result from antitrust litigation, or whether an additional response through direct regulatory authority is also required.

Noll makes another point which leads us to a similar conclusion. He suggests that AT&T's principal competitor at the end of the decade may not be the struggling firms of today but rather the computer industry in general and IBM in particular (p. 61). If this is so, then explicitly exclusionary conduct on the part of AT&T is a less likely strategy because of the expected responses. Perhaps a greater fear in such circumstances is a more collusive arrangement, which is far less likely to result in private litigation.

Both considerations point to the same conclusion. Policy judgments should not deal differently with a reconstituted AT&T than with other similarly situated firms. This viewpoint can of course be tempered if we identify pockets of natural monopoly.

That consideration brings us back to long-distance service, which will remain with AT&T. Noll observes that long-distance service will continue to be regulated, but we need to ask whether this continued regulation is required. How much competition is needed before we should recommend dispensing with direct regulatory control? Although not explicit on this point, Noll seems to find that existing competitive pressures are not sufficient. Although this is a difficult issue since AT&T has market shares which exceed 90 percent, the well-recognized problems inherent in direct regulatory control may lead to the opposite conclusion.

In the original discussions at the Department of Justice regarding this antitrust action, the view was held that if only we could separate the natural monopoly segment of telecommunications from the rest, regulatory authority could deal effectively with the former, and we could leave the rest to the marketplace. It is not that the market operates perfectly, but rather that the imperfections present in the

marketplace are no greater than those found in the regulatory process, and may even be less. Furthermore, our recognition of the cost of regulation has certainly increased since those days. Even though regulatory authority may be required in certain circumstances, we should dispense with it whenever possible.

If we have succeeded in achieving the original goal of the Department of Justice regarding the structure of the telecommunications industry, we should be willing to adopt the original policy conclusions as well. The appropriate role for direct regulation of AT&T's remaining activities would then be quite small.