

Chapter 10

SUMMARY COMMENTS

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In reading the collected articles of this volume, I have tried to think about how a hard-working and well-intentioned FCC Commissioner—or Assistant Secretary of Commerce, or state Public Utility Commissioner—might react to them. From the point of view of my imaginary public servant, the ideal state of affairs would be for all of the authors to tell the same clear and plausible story about the way to regulate the various telecommunications markets. Unfortunately, my hypothetical bureaucrat is bound to be somewhat disappointed.

My remarks focus on two broad areas of policy: the potential for competition in the interexchange, or long distance market, and the question of whether local telephone operating companies should be permitted to expand their operations beyond the provision of local exchange services. In discussing these issues, I consider both the way in which policy analysis is performed and the varying views about the effectiveness of regulation held by different authors.

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THE INTEREXCHANGE MARKET

My conscientious regulator must begin by reconciling the following six statements about the long distance market.

1. Long Lines will possess great market power. . . . The current competitors are small and highly vulnerable to Bell's pricing policies. They and other possible competitors could be easily excluded or limited by Long Lines . . . after separation occurs. [Shepherd at page 112.]

with

2. [I]n the short run, the new AT&T . . . will be facing significant competition so that its ability to recover the shortfall [between market and book value of physical plant] will be quite limited. . . . AT&T's competitors have had considerable time to position themselves to take advantage of market opportunities that overpricing by AT&T would afford. [Cornell and Pelcovits at page 322.]

Or

3. [I]nterstate service entails a *de facto* monopoly situation in which AT&T can engage in unfair cross-subsidization unless a fully separated subsidiary is employed. [Geller at page 220.]

with

4. AT&T is substantially less well positioned in the 1980s to erect effective entry barriers and to engage in predatory pricing than it was in 1970 . . . [Noll at page 62.]

And, finally,

5. The principal major competitor to AT&T by 1990 is likely to be not the struggling competitive fringe of 1980, but the computer industry, and IBM in particular. [Noll at page 61.]

with

6. [T]here are large impediments to cross-entry and future competition. [IBM and AT&T] are likely to maintain their separate specializations . . . rather than to begin actions which will jointly minimize their profits. [Shepherd at page 116.]

These differences in conclusions depend, I would argue, on two principal factors. First, a substantial divergence of views exists about the incentives and opportunities of AT&T in a divested, and perhaps deregulated, environment. Unfortunately, the various writers embrace different explicit, or more often implicit, theories of firm behavior. Second, views diverge about the effectiveness of regulation. Although every article that comments on regulatory performance takes pains to be critical, some writers clearly are more sanguine than others about the ability of regulators to distinguish between anti-competitive behavior and "normal" competitive responses, and to fashion remedies to deal with any abuses.

Those who are pessimistic about the opportunities for competition seem to hold the view that, without regulation, AT&T would be essentially unconstrained in the interexchange market. It could raise prices and earn supranormal returns and, if necessary, it could effectively discipline actual or potential competitors by means of predatory price reductions or other actions. However, these authors contend that regulators, perhaps because of the existence of fully separated subsidiaries, can detect monopoly pricing or predatory behavior and effectively prevent AT&T's prices from being *either* too high or too low. Finally, advocates of this viewpoint seem to believe that the incentives and ability of AT&T to engage in anti-competitive behavior will not be much affected by divestiture. (I cannot resist commenting that the notion that regulators can detect cross-subsidization involving new services is somewhat at odds with the controversy that has emerged in these articles about whether or not interstate service had, in the past, subsidized local exchange service. If we cannot agree on even the direction of a long-standing subsidy, is it reasonable to expect regulators to be able to identify subsidies for new services using what are necessarily forward-looking cost estimates?)

The alternative view is that AT&T will have some ability to limit competition but that its ability to do so will vary among markets,

that the divestiture will eliminate an important competitive advantage, and that distinguishing predation from ordinary responses to competition will be extremely difficult. Advocates of this view appear to be willing to run the risk that AT&T may occasionally behave in an anti-competitive fashion in order to avoid the opposite risk, that it may be excluded from markets where it has a true cost advantage. Moreover, these writers argue, the opportunities for predation will atrophy over time. Finally, although they accept the need for continued regulation in some markets, they recognize that the remaining islands of regulation may be one of the sources of a continuing incentive to cross-subsidize markets threatened by competition. (As a further indication of the divergence of viewpoints, it is notable that the two sides even have widely different interpretations about recent developments in markets newly opened to competition, one viewing the response as too meager to take seriously, the other seeing it as evidence of bigger things to come.)

Choosing between these two views is not an easy task. In part, this reflects the inherent difficulties of designing and conducting empirical tests to distinguish between competing hypotheses. In this case, however, these difficulties are compounded by a failure to specify the alternatives carefully and completely. One needs to know, for example, the extent to which differences in policy conclusions are primarily due to different views about (a) whether AT&T would be able to cross-subsidize its activities in markets subject to competition with what otherwise would have been excess profits in its regulated (monopoly) activities, (b) whether AT&T could engage in predatory behavior even if it were completely unregulated, and/or (c) whether the FCC could prevent cross-subsidization or predatory behavior without, at the same time, limiting the entry of AT&T into markets where its entry would be efficient.

If, for example, the disagreement revolves largely around the effectiveness of regulation, attention should be focused on past FCC behavior in dealing with similar issues. If, however, the differences arise largely from different views about the likely behavior of AT&T under alternative forms of regulation, analyzing the potential for anti-competitive behavior in different markets would be the appropriate research strategy. To this point, unfortunately, the differences seem to depend as much on the writers' philosophical predispositions—biases, if you will—as on any empirical analyses.

THE LOCAL EXCHANGE MARKET

Turning briefly to the behavior of the local operating companies, I was struck by the widespread—indeed, almost unanimous—view evident throughout the articles in this volume that the restrictions imposed on these companies by the Consent Decree should be removed. I am not entirely surprised that those who favor less regulation in the long distance market also favor it here, although the opposite viewpoint is possible since there appears to be considerable agreement that the markets in which the new AT&T will operate will be more competitive than the local exchange market. What *is* surprising is that most of those who favor continued detailed regulation in the interexchange market seem also to favor easing restrictions on the local operating companies. (It should be noted that advocates of this viewpoint will undoubtedly feel that permitting the operating companies to distribute, but not manufacture, terminal equipment does not go far enough.)

Several reasons may be put forward for the apparently anomalous position of these authors that the operating companies will require less regulation than will AT&T. It may be that they disagree with the conventional wisdom that the long distance and equipment markets will be more competitive than the market for local exchange service. Perhaps they believe that the existence of fully separated subsidiaries can prevent cross-subsidization, and can do so more effectively here than in the interexchange markets. Perhaps they believe that it is the absolute size of AT&T, not its market share, that gives it market power. But none of the articles advocating this viewpoint contains an extended or convincing analysis to support it.

Among the questions that the analysis should address are these: Would the authors have favored entry by an undivested AT&T into these markets so long as it was through a fully separated subsidiary? To what extent does their recommendation reflect a belief that the opportunity for cross-subsidization by the operating companies is limited by potential competition from “bypass” technologies in the local exchange market? And, do their conclusions apply equally to participation by the operating companies in all of the markets in which they might compete? Only by providing a fuller analysis can these policy recommendations be evaluated.

CONCLUSION

Noll comments that "it is time for scholars to put up or shut up about what their work has to say about the proper role of public policy in the new [telecommunications] regime." (Noll at pages 41-42.) We seem unable, collectively at least, to "put up," by providing definitive advice to regulators and policymakers. But we are also unlikely to "shut up," which is, I think, fortunate. If there is one thing that everyone seems to agree on it is that the Consent Decree does not definitively resolve the question of the appropriate mix of competition and regulation in the various telecommunications markets.

We may have continuing regulation, as some would advocate, or the burst of antitrust litigation that Noll predicts, but it is clear that the problems discussed in this volume will be with us for a long time. Whether it is incumbent firms attempting to escape regulatory restrictions in order to compete more effectively, or new entrants contending that they have been victimized by the incumbents, no one is likely to feel inhibited in pressing a claim before the Congress, the courts, or the FCC because of the existence of a consent decree.

What research would be helpful to these agencies in resolving such claims? First, we need more work to formalize what are at best only sketchy models of the behavior of AT&T and the operating companies. One difficulty in assessing the policy conclusions reached by the authors in this volume is that it is unclear precisely how they were obtained. Second, we must do more to determine how well these models explain behavior in actual telecommunications markets. This will be a tedious process, but a necessary one, if we are to go beyond broad generalizations about the competitiveness of markets. Finally, we must carry out detailed investigations to learn whether regulators can, and do, engage in the kind of subtle balancing of the risks of permitting predatory behavior against those of restricting the activities of more efficient firms that sensible regulation in this area requires.