Deregulation of Entry in Long-Distance Telecommunications

Paul W. MacAvoy
Yale School of Management

Michael A. Williams
PM Keypoint LLC
To Colleen, Ben, Anne,
Stephanie, and Sheila;
and to the memory of my parents,
Rea and Alan Williams
"I was totally misled by AT&T."

FCC Commissioner Gloria Tristani

"[The FCC's First Report and Order on the Telecommunications Act of 1996] is the most pro-competitive action of government since the break-up of the Standard Oil Trust."

FCC Chairman Reed E. Hundt

"It is in the unshared, not in the shared, portions of the enterprise that meaningful competition would likely emerge. Rules that force firms to share every resource or element of a business would create, not competition, but pervasive regulation, for the regulators, not the marketplace, would set the relevant terms."

Supreme Court Judge Stephen Breyer, AT&T v. Iowa Utilities Board et al.
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Preface

In any industry in which service is provided via networks—whether in trucking or in the distribution of natural gas and electricity—local and long-distance offerings are separated to some extent. The efficiency gains from specialization in local service have been greater than those from integration of local into a long-distance network. With regard to telecommunications, full separation was required by the judgment court in the 1984 antitrust divestiture of AT&T from the regional Bell operating companies. The justification for the action was predicated not on efficiency, but rather on the belief that breaking up the Bell System would give the new long-distance company the opportunity to compete in an open, unregulated market while the Bell operating companies remained regional public utilities. Since 1984, the technologies of digital transmission and the Internet, along with the politics of regulation, have changed these prerequisites. Substantial consumer benefits now follow from integration of local and long-distance, but the operating companies under regulation cannot unilaterally enter long-distance markets, in which AT&T remains the largest service provider. The politics of the regulatory agencies, by statute and their own decree, has it that regional local exchange markets are not sufficiently competitive and that long-
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Distance markets would become less competitive if entry by the Bell local exchange carriers were allowed to take place.

How are subscribers of local and long-distance services affected by these conditions? This monograph seeks to answer that question by developing and then applying a methodology for determining effects on subscribers from a representative local exchange carrier entering the long-distance markets in its local service region. We show "benefits" for these subscribers from price changes in the mass market and large business market, where those representative markets are specified on dimensions quite similar to those extant currently.

The methodology has been developed over the last five years as a cooperative effort between individuals in the research group at the Yale School of Management sponsored by the John M. Olin Foundation for work on industry regulation and members of the consulting firm PM Keypoint LLC. This has resulted in a series of publications, including The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telecommunications (1996); "Testing for Competitiveness of Markets for Long Distance Telephone Services: Competition Finally?" Review of Industrial Organization, Vol. 13 No. 3, June 1998; "Tacit Collusion under Regulation in the Pricing of Interstate Long-Distance Telephone Services," Journal of Economics and Management Strategy, vol. 4 (Summer 1995), by Paul W. MacAvoy; as well affidavits in selected regulatory proceedings. We have extended previous work to develop a generic case of a representative local exchange carrier whose entry results in changes for subscribers in an "average" state and local service region. This allows the reader to infer the nature and extent of results from opening up entry opportunities in long-distance markets to those most capable of making competitive inroads against the tacitly collusive arrangements now dominating pricing of incumbent long-distance carriers.

In the period since we completed data collection for this book, long-distance carriers' prices and marginal costs have continued to follow the patterns found in our research. Effective prices of discount plans have remained roughly steady after taking into account monthly fixed charges, with subscribers having average usage patterns paying in the range of eight to eleven cents per minute. Carriers also have offered more plans with differentiated peak and off-peak rates. Switched access charges have continued to fall to levels below two cents per conversation minute, so that price-cost margins have continued to increase.

Moreover, "Presubscribed Interexchange Carrier Charges" to long-distance carriers have been eliminated, further reducing carriers' marginal costs. These trends confirm that our findings on competitiveness continue to hold, at least through the first half of 2002.

We have been substantially assisted by Michael Doane, Charlotte McAfee, Kristi Davis, Marshall Ungar, Evan Rose, and especially Gary Stahlberg and Colleen Connolly. Two impressively diligent and incisive reviewers for the Institute of Public Utilities provided us with suggestions for improving the first version that, we hope, have been effectively implemented. We thank the John M. Olin Foundation for financial support for this endeavor and HTL Telemanagement for flexible and knowledgeable management of the tariff data of the Federal Communications Commission. Paul W. MacAvoy would like to thank Katherine for patience as well as kindness. Michael A. Williams would like to thank Colleen, Benjamin, Anne, Stephanie, and, most of all, Sheila for their love and support.

Our position, that the FCC's policies forestalling local exchange company entry into long-distance markets cost consumers billions of dollars per year, is entirely our own, but we invite the reader to join us in this deregulatory crusade or to tell us why not.

Paul W. MacAvoy
paulmacavoy@vermontel.net

Michael A. Williams
mwwilliams@pmkeypoint.com

Preface