

REFORMING THE FCC AND ITS MISSION: LESSONS FROM THE AIRLINE EXPERIENCE

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INTRODUCTION

I have been involved in one capacity or another with the regulation and deregulation of telecommunications for most of the last 35 years — going back to my five years or more membership on the National Economic Advisory Council to AT&T¹ — as contrasted with a mere 18 months in the Chairmanship of the late, unlamented Civil Aeronautics Board. I nevertheless sympathize with the logic of comparative advantage that recommends adding the subtitle, “lessons from the airline experience,” even though the two cases were and are very different.

Simply put, airline regulation was a regime of governmental cartelization of an industry that was and would otherwise have been structurally competitive — imposing direct limitations on the permissible operations of the several offerers of airline service and strictly prohibiting price competition among them. Telephone regulation, in contrast, set the prices and other conditions of sale on services whose supply was believed to be best handled by designated franchised “natural”

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1. The only substantive product of which I can recall was my widely ignored “Grand Competitive Strategy for the Bell System.” In dreams of eluded glory, I see AT&T avoiding its dreary decline since 1982 by following my advice.

monopolists.

In terms of their effects on efficiency — both productive and economic — cartels are probably worse than single-firm monopolies because of their inherent compulsion to interfere with the competitive displacement of high-cost, sluggish producers by low-cost, innovative ones; and government-enforced and -administered cartels are, in this respect, the worst of all.² The case for deregulation of such industries has to be that competition, once freed of governmental restraints, will better protect the public, weed out inefficient suppliers, and leave it to free consumer choices to confer profits on the ones offering the best possible price and quality combinations. In contrast, the case for deregulation of industries such as telecommunications has to be that monopoly is no longer the most efficient form of supply, if it ever was; and that competition, once released from governmental restraint on the one side and subsidization of competitors on the other, will serve the public far better than public utility-type regulation.

Immediately upon my assumption of the Chairmanship of the CAB, I realized in what ludicrous detail that maxim applied to the airline industry. Within a very short time, I was presented with the need for each of the five members of the Board to independently approve an agreement between an unscheduled cargo carrier and a breeder of horses to transport his charges in time to participate in some race. Shortly thereafter, United Airlines asked for our permission to introduce a skiing-guaranteed airfare between New York and Denver — under whose terms its skiing customers would be refunded their airline ticket prices if there was not enough snow. That, our chief attorney advised us, would be an impermissible rebate in violation of the filed tariff. The same advice applied to an analogous request by a cash-strapped Eastern Airlines for permission to pay for advertising with passes on its flights and to a failure of any carrier to make certain that tour operators to whom it had given passes to inspect the various ground facilities included in a particular tour actually performed the inspections.³

A conscientious regulator — read “government cartelizer” — of a potentially competitive industry finds himself in the position of the fabled Dutch boy holding back the ocean by sticking his finger in the dike.

Control price, and the result will be an artificial stimulus to entry. Control entry as well, and the result will be an artificial stimulus to

2. See Alfred E. Kahn, *The Depletion Allowance in the Context of Cartelization*, 54 AM. ECON. REV. 286, 286-314 (June 1964); Alfred E. Kahn, *Cartels and Trade Associations*, in 2 INT'L ENCYCLOPEDIA SOC. SCI. 320, 320-25 (David L. Sills ed., 1968).

3. See Alfred E. Kahn, Talk to the New York Society of Security Analysts (Feb. 2, 1978) (unpublished manuscript, on file with author).

compete by offering larger commissions to travel agents, advertising, scheduling, free meals, and bigger seats. The response of the complete regulator, then, is to limit advertising, control scheduling and travel agents' commissions, specify the size of the sandwiches and seats and the charge for in-flight movies. Each time the dike springs a leak, plug it with one of your fingers; just as a dynamic industry will perpetually find ways of opening new holes in the dike, so an ingenious regulator will never run out of regulatory fingers.⁴

Analogously, the process of unraveling those irrational government interferences between willing airlines and willing travelers took on a momentum of its own. As a result, deregulation followed with almost amazing speed.⁵

The first two parts of this paper expand and support two propositions: Part I, that airline deregulation has been a great success despite the pitiful financial condition and bankruptcies of the major carriers during the last few years; and Part II, that the recent financial boom-and-bust in neither the airline industry nor in telecommunications justifies the reimposition of competition-restraining regulation any more than it did the cartelization of trucking and airlines after a comparable experience in the 1930s. In Part III of this paper, I proceed to describe the imperfections of the implicit analogy between the experiences in the airline and telecommunications industries. In particular it has been technological progress above all that, first gradually then explosively, undermined AT&T's and its successor local companies' putative natural monopolies, rather than the FCC's ill-advised — not to say politically motivated — effort to create competition by subsidizing competitors. It is that still-exploding technology that now demands not merely abandonment of those misguided efforts, but, where technological competition is demonstrably effective,⁶ leaving it to competition and the antitrust laws to serve the “public convenience and necessity,” as in industry generally.

In Parts IV and V, I conclude with a brief look at two tough problems for which simple deregulation of telecommunications may not be politically acceptable or sufficient: political pressures to subsidize basic

4. Alfred E. Kahn, *The Changing Environment of International Air Commerce*, 3 AIR LAW 3 (1978) (on file with author). This work was first presented at the Symposium on the Changing Environment of International Air Commerce at Georgetown University on May 4, 1978.

5. See Alfred E. Kahn, *Applications of Economics to an Imperfect World*, 69 THE AM. ECON. REV. 1, 5-12 (May 1979).

6. See, e.g., The “Two-Facilities Bright-Line Test for Forbearance” proposed by the Canadian TELUS Corporation to the Canadian Radio-television and Telecommunications Commission (CRTC) (PN 2005-2, June 22, 2005), with separate supporting testimonies by Robert Crandall and Alfred E. Kahn.

residential service, particularly in rural areas; and problems of consumers making wise choices when confronted by a bewildering and ever-changing mix of options.

I. THE SUCCESS OF AIRLINE DEREGULATION

Even though it invites the retort, "*But the patient died!*" I maintain with all the objectivity I can summon up that airline deregulation has been an outstanding success. The competition that it unleashed—including most importantly the freedom it conferred on both incumbents and challengers to configure and re-configure their operations, enter one another's markets, and price their services freely—has conferred billions upon billions of dollars annually on consumers.

That the carriers have exercised this freedom to adopt increasingly fine differentiations in their fares has been a source of bewilderment, if not anger, particularly among consumer organizations.⁷ As to the former, however, travel agents and then the Internet have reduced those search costs to tolerable levels. As for the latter, differentiations reflecting differences in cost (e.g., between long and short, dense and thin routes, and peak and off-peak flights, all previously curbed or suppressed by regulation in a deliberate policy of cross-subsidization) are clearly unexceptionable. Moreover, truly discriminatory fare structures, reflecting differences in elasticities of demand, are typically necessary to permit suppliers to recover the heavy fixed costs of maintaining convenient scheduling in the presence of marginal costs typically far below average; and are likewise unexceptionable when, as in commercial aviation, profits overall are modest at best. The consumer benefits have taken the form not only of huge monetary savings but also more convenient access to a greater number of origins and destinations.⁸

An essential accompaniment and instrument of these huge savings has been an approximately 20 percentage point increase in industry-average load factors, from the low 50s to the low 70s—which goes far to

7. I duly note defections from the deregulation cause by such once-enthusiastic allies as the Consumer Federation of America, Consumers' Union and The Public Citizen (but not of other early supporters such as Common Cause, the Antitrust Division of the Department of Justice and the Federal Trade Commission).

8. One might have expected some dilutions of the latter benefit in the last few years, as hub-and-spoke carriers, which seemed a decade or so ago to have swept the field, have had to trim marginal operations under the intense and increasingly pervasive competition of lower-cost, point-to-point challengers. They have, however, offset this tendency by increasing recourse to regional affiliates, code-sharing alliances and the use of regional jets. Between June 2000 and June 2005, the period of their most severe losses, American, Continental and Delta increased the number of cities served in these two ways by 2 percent, 18 percent and 15 percent, respectively, while Northwest, United and US Air—the last two under bankruptcy protection—have curtailed their operations, thus measured, by 15 percent, 19 percent and 9 percent, respectively (data from the Air Transport Association).

expose both the inefficiency of the previous cartelization and, after its removal, the very large decrease in average real fares, along with the longer lines and more crowded planes (the lower-price/quality combination that regulation had suppressed and the overwhelming majority of travelers thereafter embraced).

But surely it is time to pay attention to that protest from the small voice in the balcony — “*Yes, but the patient died!*” Undeniably, both airline deregulation, which was genuine and complete, and telecommunications deregulation, which remains incomplete, have been accompanied by appalling financial losses to the incumbents and — especially catastrophically, in telecommunications — to new facilities-based competitors.⁹ Whether the one *caused* the other is less obvious.¹⁰

In the airline case, financial losses have had two unique causes in addition to the historical sensitivity of the industry to the business cycle: (1) 9/11 and (2) the suddenly increasingly successful inroads of the low-cost, essentially point-to-point carriers,¹¹ representing a dramatic reversal of the apparent complete triumph of the major hub-and-spoke operators during the first two decades of deregulation. If any patients actually “die,” it is likely to be one or more of those hub-and-spoke operators. Southwest has been profitable every year since deregulation and the low-fare, low-cost carriers have increased their combined share of the domestic business from less than one-tenth to one-third in the last few years.¹² However painful to the incumbents, that is the nature and virtue of the competitive process that deregulation unleashed.¹³

II. THE BOOM AND BUST IN TELECOMMUNICATIONS

As to the telecommunications case, a balanced appraisal must take into account several additional considerations, rather than focus solely on deregulation. For one, exuberant over-investment, particularly in the exploitation of new technologies, has always been characteristic of capitalist economic development. This over-investment occurs in the absence as well as presence of regulation — witness the railroad constructions of the nineteenth century, the boom and Great Depression of the 1920s and 1930s, respectively, and the dot-com boom and bust of the last decade. The recent massive over-investment in fiber-optic

9. See Alfred E. Kahn, *Lessons from Deregulation: Telecommunications and Airlines After the Crunch*, 49-50 (AEI Brookings Joint Center for Regulatory Studies 2004).

10. With respect to telecommunications, see *id.* at 26-34.

11. As of the spring of 2005 it is necessary to add the explosion of fuel prices.

12. See Michael Allen, *Back Aviation Solutions*, at <http://www.backaviation.com>.

13. It was, precisely, the impossibility of knowing which form of operation would prove to be the dominant one—or in what proportions they would prevail—that was the strongest argument for leaving it to the deregulated market to tell us, See, e.g., Kahn, *supra* note 3.

facilities, ending up with at least 95 percent of fiber in the ground “dark,” was, in exactly the same way, the product of revolutionary technological developments, which increased the number of channels attainable from a single strand of fiber from two to over 100, with the possibility it will eventually exceed 1,000.¹⁴ Much as after those earlier booms, in which investors lost huge amounts of money, the physical capital survived: in this latest case, the excess fiber-optic capacity, once laid in the ground, remains physically available and can, and almost certainly will, be reactivated at a comparatively low incremental cost.¹⁵ The over-investment in telephony was encouraged also by the previous regulatorily distorted rate structures — in particular the grossly inflated charges of the local companies for initiating and terminating long-distance calls and the entire range of retail services to businesses, in order to generate multi-billion-dollar annual subsidies of the charges for basic residential service, especially in rural areas. With the introduction of fiber-optic transmission, there sprang into being, especially in concentrated metropolitan areas, a host of competitors constructing their own access facilities to bypass those of the incumbents and to compete directly with them at both wholesale and retail.

Further contributing to the subsequent failure of those ventures from 2000 onward was the FCC’s ill-advised policy of making available to competitive local exchange companies (CLECs) the ineffable, oxymoronic UNE-P (totally bundled “unbundled network elements”), at rates intentionally far below the actual costs of the incumbent carriers, both historical and incremental.¹⁶ The result was a sharp increase in

14. See J. Gregory Sidak, *The Failure of Good Intentions: The WorldCom Fraud and the Collapse of American Telecommunications After Deregulation*, 20 YALE J. ON REG. 207, 216 (2003). See also T. Ohara, et al., *Over 1000 Channel, 6.25 GHz-spaced Ultra-DWDM Transmission with Supercontinuum Multi-carrier Source*, 3 TECHNICAL DIGEST OFC/NFOEC 16-18 (Mar. 6-11, 2005).

15. For a reminder, however, that while “For certain, . . . [the carriers] won’t need to lay new fiber, . . . lighting dark fiber or adding wavelengths on existing fiber can be extremely expensive.” Press Release, TeleGeography, Most Intercity Bandwidth Still Unlit (Apr. 20, 2005) available at <http://www.telegeography.com/press/releases/2005-04-20.php>.

16. See Thomas W. Hazlett, et al., Declaration Submitted to the Federal Communications Commission by Verizon Communications, Reply Comments of Verizon Telephone Cos. in Support of Petition for Expedited Forbearance from the Current Pricing Rules for the Unbundled Network Element Platform, WC Docket No. 03-157 Sept. 2, 2003, available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&cid_document=6514783810; Alfred E. Kahn, et al., *The Telecommunications Act at Three Years: An Economic Evaluation of its Implementation by the Federal Communications Commission*, 11 INFORMATION ECONOMICS AND POLICY, 319-65 (1999); Alfred E. Kahn, *Whom the Gods Would Destroy or How Not to Deregulate*, 3-16 (AEI-Brookings Joint Center for Regulatory Studies 2001); Robert S. Pyndyk, *Pricing Capital Under Mandatory Unbundling and Facilities Sharing* (April 2005) (unpublished draft, available at <http://www.nber.org/papers/W11225>); Robert S. Pyndyk, *Mandatory Unbundling and Irreversible Investment in Telecom Networks* (January 2004) (unpublished draft, available at

non-facilities-based reselling, predominantly by AT&T and MCI — in effect, a betrayal of the CLECs that had made the mistake of constructing their own facilities¹⁷ and a discouragement to genuine competition at the “production” or wholesale level.¹⁸

III. THE IMPERFECTIONS OF THE ANALOGY: THE OVERWHELMING ROLE OF TECHNOLOGY IN TELECOMMUNICATIONS

I have already described the essential respect in which the analogy between commercial aviation and telecommunications is highly imperfect: The original rationale for regulation in the first case was a presumed inherent tendency of the industry to periodic bouts of destructive competition, requiring governmentally imposed price floors. In the second, the assumption was that the industry was a natural monopoly, requiring price ceilings to protect consumers from monopolistic exploitation.

This essential difference did not prevent both industries from suffering catastrophic losses in the last few years, a consequence of their heavy fixed costs and fluctuating demand. But there the analogy ends. While technological progress in commercial aviation, notably the jet and jumbo jet revolutions, did generate pressures in the 1970s and 1980s for greater freedom in pricing, specifically to offer discounted fares in order to fill all those empty seats, it did not play a significant role in undermining the rationale of continued regulation. In contrast, it has been technological progress that first undermined, then destroyed, the natural monopoly rationale in telecommunications,¹⁹ while at the same

<http://www.nber.org/papers/W10287>) (citing pioneering work by Jerry Hausman) .

17. See John Wohlstetter, *Telecom Madness*, AM. OUTLOOK, 33 (Fall 2003); See also Kahn, *supra* note 9, at 35-39.

18. See Robert W. Crandall et al., *Do Unbundling Policies Discourage CLEC Facilities-Based Investment?*, 4 TOPICS IN ECONOMIC ANALYSIS & POLICY 14 (2004), available at <http://www.bepress.com/cgi/viewcontent.cgi?article=1136&context=bejeap>; Thomas W. Hazlett & Arthur M. Havenner, *The Arbitrage Mirage: Regulated Access Prices with Free Entry in Local Telecommunications Markets*, 2 REVIEW OF NETWORK ECONOMICS 440 (Dec. 2003), available at http://www.rnejournal.com/articles/hazlett-havenner-RNE_8_dec_03final.pdf.

19. See GERALD R. FAULHABER, TELECOMMUNICATIONS IN TURMOIL: TECHNOLOGY AND PUBLIC POLICY (1987). I owe to Charles Jackson, an engineer and valued former colleague, the admonition that my expression of technological determinism is simplistic. He contends that, entirely apart from technological developments [the] modern era of competition in telecommunications began with terminal equipment. Terminal equipment competition was possible no later than 1930 and would have been beneficial then. Yet, real terminal equipment competition in the United States began only in 1968 with the FCC's Carterfone decision. Telephone Interview with Charles Jackson, Independent Telecommunications Consultant (Sept. 13, 2005). As an active participant in the deregulation of terminal equipment, going back to my scornful criticisms of the lamentable FCC Hush-a-Phone decision of 1956, as well as in the airline field, I happily acknowledge the oversimplification of attributing it all merely to technological change. See *Hush-A-Phone v.*

time increasing the industry's susceptibility to boom and bust.

The first example of the critical role of technological progress was the microwave revolution of a half-century ago, which imposed ultimately irresistible pressures on the Federal Communications Commission to permit, first, unregulated private, then MCI's common long-distance microwave carriage.²⁰ Similarly, a quarter-century later, fiber optics permitted direct facilities-based competition in metropolitan areas attracted by, and undermining, the distorted rate structures I have already described. Next came cellular telephony, subscribership to which has soared in just the last few years to levels comparable to those of traditional fixed-line service.

Finally — although history tells us there is no “finally” in this technology — broadband is destroying the distinctions among cable, wireless, and circuit-switched telephony, between local and long-distance, intra- and interLATA, voice and data, telecommunications and “information service.” Broadband cable companies have maintained a better than 1.6 to 1 lead over telephone companies and broadband wireless and electric power lines have already crossed the threshold of offering viable market alternatives.

Observe that the first of these developments, dating back a half-century, undermined the putative natural monopoly only in long-distance carriage. The lingering conception that the local part of the telephone business retained the characteristics of a natural monopoly seemed to make simple deregulation inadvisable. In these circumstances, the FCC became understandably preoccupied with the need to prevent AT&T from “cross-subsidizing” its newly competitive long-distance operations at the expense of its local rates. The line of battle shifted to the proper measure or test of such cross-subsidization, with the Commission holding out for fully distributed and the Bell Company for long-run incremental costs. How many of you remember the infamous Seven-Way Cost Study — the FCC's last-gasp effort to preserve the historical cross-subsidization by cost prestidigitiation?²¹ Later, the Department of Justice became convinced and, in turn, evidently convinced Judge Greene that AT&T was using its control over the local bottleneck to handicap MCI and its other long-distance competitors.

The result was, of course, the Consent Decree that broke up

United States, 238 F.2d 266 (D.C. Cir. 1956); ALFRED E. KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTION* 140-45 (John Wiley ed., MIT Press 1988) (1970).

20. See, e.g., Gerald Brock, *Dynamic Market Structure and Technical Innovation*, in *TELECOMMUNICATIONS ACCESS AND PUBLIC POLICY* (Alan Baughcum & Jerald R. Faulhaber eds., 1982); see also KAHN, *supra* note 19, at 126-39.

21. KAHN, *supra* note 19, at 156-58. On the fallacies of such fully distributed costs exercises, see *id.* at 150-56.

AT&T, separating the competitive long-distance from the putatively still monopolistic and therefore tightly regulated local services. Following this — to skip the twelve years in which Judge Greene effectively oversaw the industry²² — came the grand and in some ways impressive compromise of the 1996 Act. The Act required the incumbent local Bell companies to open their local networks to competitors, primarily by leasing to them putatively naturally monopolistic unbundled network elements²³ at “cost,” in exchange for removal of the 1982 MFJ’s prohibition of their offering interLATA services. It is worth reminding ourselves at the outset that, whatever the merits of the continuing claims that the ILECs have not fully cooperated in providing the promised *quid*, their receipt of the *quo* has proved to be a total success for consumers: long-distance service has become much more broadly and effectively competitive and cheaper than ever. Whether it is any longer capable of supporting an independent AT&T or MCI will presumably be a consideration in the antitrust agencies’ appraisal of their mergers with SBC and Verizon, respectively.

It is only because the sufficiency of competition in “local” service to the great bulk of residential customers remains the subject of intense controversy that I am constrained to remind you of the dreary history of the last decade, during which the FCC and state commissions (1) progressively defined those “necessary” network elements as *all* elements capable of being unbundled and, eventually, *complete services* — the afore-mentioned UNE-P — and (2) prescribed rental charges equated to the equally ineffable TELRIC — set deliberately below the costs, both historical and incremental, of the incumbents themselves, enabling competitors such as AT&T and MCI simply to re-label the service with their own brands and sell them at attractive retail rates. And it was only after having been thoroughly rebuffed by the Supreme Court in 1999 and on two subsequent separate occasions by the Federal Circuit of Appeals for the District of Columbia that the Commission announced its abandonment of this last *reductio ad absurdum*. This was a victory, finally, for the now-former chairman Michael Powell and his colleague, Commissioner Kathleen Abernathy,²⁴ and a defeat — perhaps final —

22. This was the period between the effectuation of the Modified Final Judgment in the Department of Justice’s antitrust suit against AT&T and its replacement by the Telecommunications Act of 1996.

23. Archetypically, their ubiquitous copper subscriber lines.

24. See their eloquent explanations of their dissents from the majority opinion, attached to the press release from the FCC, *FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers* (Feb. 20, 2003), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A3.pdf and available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-231344A4.pdf and reproduced in part in KAHN, *supra* note 9, at 33, 73-74.

for a stand-alone AT&T and MCI. Such worthies as the *New York Times* editorially criticized Chairman Powell on the occasion of his announced departure for his ultimately successful effort:

Mr. Powell should have been an advocate for reasonable regulations that protect consumers and promote competition. Instead, he brought to his position an extreme commitment to deregulation that seemed to serve big business's interests most of all. One high-profile example was his attempt to remove regulations on the Baby Bells that were designed to make local telephone service more competitive.²⁵

It is worth reemphasizing, in response, that those policies constituted the simplest and most glaring illustration of the error of protecting or subsidizing competitors — “Potemkin competition,” as John Wohlstetter characterized it²⁶ — at the expense of efficient competition.

In fact, the competition and consumer protection that the *Times* criticized Mr. Powell for abandoning was competition *at the retail level exclusively* — and subsidized competition at that. Moreover, as I have pointed out, the increased recourse to that mere reselling option on increasingly favorable terms after 2000 was a betrayal of the competitive carriers that had previously challenged the incumbent monopolists by constructing their own access lines, installing their own switches, and suffering losses totaling in the sixty to eighty billion dollar range²⁷ when the boom collapsed.

This returns us to the respect in which telecommunications offers, almost uniquely, the opportunities for the most effective kind of competition conceivable — competition among burgeoning technologies employing copper, fiber, cable, wireless — all already deployed on a massive scale — and, on the horizon, electric power lines, all of which

25. Editorial, *Another Powell Departs*, N.Y.TIMES, Jan. 24, 2005, at A16. A Times reporter later characterized those policies more accurately: “over the last four years, the Commission has moved away from trying to manage competition among the phone companies intended to encourage—and subsidize—smaller rivals [most prominently AT&T and MCI] to the Bell companies,” Stephen Labaton, *Reshaping Telecommunications: The Regulators: With Huge Proposed Mergers, the Regulatory Maze Ahead for a Recast F.C.C.*, N.Y.TIMES, Feb. 15, 2005 at C6.

26. John Wohlstetter, *Cleaning Kevin's Clock: The White House Wakes Up, Telecom Shakes Up*, BANDWIDTH, (July 12, 2004), available at <http://www.discovery.org/scripts/viewDB/filesDB-download.php?id=114> (commenting on the decision of the White House not to appeal the February 28th decision of the Circuit Court of Appeals for the District of Columbia throwing out those rules).

27. James L. Gattuso, *The FCC's Local Competition Report: Surprise!/C:/SPIN* (Jan. 31, 2003), available at <http://www.cei.org/gencon/016,03346.cfm>.; see also Larry F. Darby et al., *The CLEC Experiment: Anatomy of a Meltdown*, WASHINGTON PROGRESS AND FREEDOM FOUNDATION (Sep. 23, 2002), available at <http://www.pff.org/issues-pubs/pops/pop9.23clecexperiment.pdf>.

were not merely ignored but actually repressed by the FCC's opportunistic subsidization of mere resale of existing switched wireline services. One would scarcely know from its critics about the effect of the FCC's wise deregulation of wireless and its decision to free up enough of the spectrum to permit as many as six facilities-based cell phone or "personal communications service" providers in each market.²⁸ Nor would one know about the revolutionary unregulated occurrence and prospect for competition at the local and long-distance levels (a distinction already technologically, though not regulatorily, meaningless) between unregulated cable and telephony — terrestrial, wireless, narrowband, and broadband VoIP.

This technological revolution recommends deregulation or something like it for reasons relating to both the demand and the supply side of these burgeoning services. On the demand side, the industry, however it is defined, is clearly universally offering or close to offering to consumers the range of competing options — at least three, generally — that makes exploitation of them difficult to impossible. First, of course, there are the ubiquitous incumbent wireline telephone companies. Second, are the wireless services: according to the FCC's 2004 wireless report about 97 percent of the U.S. population lives in counties with three or more providers of that service and about 30 percent in counties with seven or more.²⁹ The report explicitly concluded that competition amongst wireless providers and between them and providers of wired service³⁰ is highly effective.³¹

Finally, even more directly replicating familiar "telephone" service, almost ubiquitously and with a distinct cost advantage, are the cable companies. Their share of the broadband market remains much larger than that of the phone companies. Even more directly in point, cable companies are in a position to offer telephone service at very low incremental cost, as Neuchterlein and Weiser point out — quoting Comcast Cable President Burke to the effect that:

Whereas a phone company has to go out and spend tens of billions of dollars to put in place an infrastructure that can

28. Amendment of the Commission's Rules to Establish New Personal Communications Services, *Notice of Proposed Rule Making & Tentative Decision*, 7 FCC Red. 5676 (1992).

29. Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993, *Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, 19 FCC Red. 20,597 (2004) (including resellers with facilities-based suppliers).

30. *See id.* Usually, at least one wired provider is a holder of a cellular license.

31. *See id.* According to John Kneuer, Deputy Assistant Secretary of Commerce, NTIA, however, we do not have precise data on how much competitive service is actually available in all markets, large and small across the country. *See* ROBERT M. ENTMAN, REFORMING TELECOMMUNICATIONS REGULATION: A REPORT OF THE NINETEENTH ANNUAL ASPEN INSTITUTE CONFERENCE ON TELECOMMUNICATIONS POLICY 25 (2005).

deliver video in addition to voice and data, we've already made the investment. So for us to sell a Verizon customer phone service costs under \$300. For Verizon to offer a customer fiber to the home costs in the thousands.³²

Confirming that boast, Cablevision in June 2004 offered its customers cable modem service, digital TV, and unlimited local and long-distance calling for \$90 a month. As the *Wall Street Journal* observed, "Cablevision is effectively giving away phone service."³³

Since, however, the availability of those choices inevitably varies between sparsely and densely populated areas and between business and residential consumers, the possibility remains that some continued, residual protections or subsidization may continue to be either desirable or politically unavoidable. In that event, the anomaly and competition-distorting effect of raising those subsidies by taxing only switched terrestrial services offered by the incumbent telephone companies must clearly be corrected.

As to the supply side, these revolutionary developments underscore the wisdom in these circumstances of three members of the FCC, led by former Chairman Powell, in exempting from mandatory sharing the huge, risky investments the ILECs are making in fiber to the premises, with its promise of much-needed competition with the video services of local cable companies. Any mandatory sharing obligations imposed on them, at regulatorily imposed rates, would inevitably discourage those investments, and by so doing, inhibit the inter-platform competition that makes deregulation conceivable, if not mandatory. Whether these considerations apply equally to the investments of the cable companies in broadband facilities, and the associated issue of whether they should be subjected to open access or common carrier obligations *vis-à-vis* independent providers of content, are questions about which I have as yet no informed opinion.

IV. THE RETURNED RELEVANCE OF ANTITRUST

This burgeoning, dynamic technological competition among platforms undermines the need for continuing regulation and argues positively for deregulation. It is important to remind ourselves, however, that deregulation in turn shifts responsibility for preserving that

32. JONATHAN E. NEUCHTERLEIN & PHILIP J. WEISER, DIGITAL CROSSROADS: AMERICAN TELECOMMUNICATIONS AND POLICY IN THE INTERNET AGE 196 (2005) (quoting George Mannes, *Comcast Faces Long Haul on Phone Push*, TheStreet.com, July 6, 2004, available at <http://www.thestreet.com/pf/tech/georgemannes/10169214.html>).

33. *Id.* (quoting Ken Brown, *Cablevision to Offer Internet Phone-Call Bundle*, WALL ST. J., June 21, 2004, at B5, available at http://online.wsj.com/article_print/0,,SB108777034073042332,00.html).

competition against threatened private suppressions by collusion, mergers, or unfair exclusionary tactics to the agencies charged with enforcement of the antitrust laws.³⁴ At the same time, it clearly suggests that such assessments of the prospective effect on competition must take into account the broadening of the relevant market to incorporate those competing platforms. By far the most effective competition in the industry, arguing strongly for deregulation, is precisely the competition among companies that had previously seemed to be totally noncompetitive.

In such assessments, I find persuasive the perceptive statement of the FCC's former chairman Powell, as quoted by Neuchterlein and Weiser in their monumental *Digital Crossroads*, that “[m]agical things happen in competitive markets when there are at least three viable, facilities-based competitors.”³⁵ A threshold question must surely be whether that standard — a sensible one, even in industries characterized by such turbulent technology — is or will be met.

I should like to know how the recent consolidations in the industry, both intra- and inter-modal, meet this rule-of-thumb test. Among the former, I lack a feel for the likely effects on competition of combining the wireless operations of Vodaphone and Bell Atlantic, Cingular and AT&T (#2 and #3), and Sprint and Nextel (#4 and #6). Most prominent among the latter would be the recent acquisitions of AT&T by SBC and of MCI by Verizon, the dominant Bell-successor ILECs in their respective market territories. While the last two mergers may merely demonstrate that independent long-distance carriers are no longer viable in the digital age, which has obliterated the distinction between the two kinds of business, I would still want to be satisfied about the likely effects of combining their previously directly competitive operations. Prominent among these, it seems to me, would be the likely effect on the retail business market in metropolitan areas, where the acquired companies had, by virtue of their previous respective purchases of Teleport and MFS, become important competitors of the incumbent Bells, where the penetration by cable companies is low and the substitutability of wireless uncertain. This concern should presumably be mitigated by the unlikelihood of either of these once-dominating long-distance carriers being able to survive as an independent entity and the dynamic competition that has taken over the industry and obliterated such historical distinctions as between “local” and “long-distance” service.³⁶ It is still an important question, however, whether the

34. I do not necessarily exclude involvement by the FCC itself.

35. NEUCHTERLEIN & WEISER, *supra* note 32, at 409.

36. As Professor Philip Weiser testified before Congress:

It is very important for policymakers to get past the “emotional logic” against a

acquisition of AT&T and MCI by their most powerful competitors in their respective local markets is the least anticompetitive available resolution of their arguably failing firm status.³⁷

V. POLITICALLY MANDATED CROSS-SUBSIDIZATIONS AND THE COSTS OF CONSUMER SOVEREIGNTY

In all of this, I have studiously avoided what we used to refer to as the \$64,000 question (before I was given the job of controlling inflation): What of the massive politically dictated cross-subsidies embedded in still-regulated rate structures? I am strongly tempted to give the same reply as one gets upon asking a waiter in a restaurant in Israel the time of day: “*You’re not my table!*”

In the case of the airlines, Congress adopted an explicit subsidy program designed to ensure that no community that had previously enjoyed certificated service would lose it — a program that was almost universally effective in achieving that goal when last I checked some 15 years ago. A similar scheme, such as was adopted in the 1930s to subsidize rural telephone service, or the telephone equivalent of food stamps, would be infinitely more cost-effective than the present cumbersome and increasingly unsustainable cross-subsidization. It would be entertaining if such sensible suggestions confronted the present administration in Washington with a conflict between its policy of “starving the beast” on the one side, and its commitment to economic deregulation on the other.

I feel only relief that I am not compelled to offer an integrated reform package at this point. The ultimate goal, however, must surely be the same as the one we adopted for surface and air transportation some

merger of AT&T (or MCI) and a Bell company. Notably, AT&T and MCI were the firms who were supposed to be the main competition to the Bell companies and thus a merger between them strikes many as antithetical to the goals of the Telecom Act. This “supposed to,” however, is increasingly at odds with reality, as AT&T and MCI’s base of long distance customers is eroding and their future is increasingly cloudy.

Philip J. Weiser, Testimony before the U.S. House of Representatives Committee on Energy and Commerce at its hearing on Competition, *in* THE COMMUNICATIONS MARKETPLACE: HOW TECHNOLOGY IS CHANGING THE STRUCTURE OF THE INDUSTRY 7, *available at* <http://energyccommerce.house.gov/108/Hearings/03022005hearing1443/Weiser.pdf>.

37. *See id.*; Letter from the American Antitrust Institute to the Senate Judiciary Committee *available at* <http://www.antitrustinstitute.org/recent2/394.pdf> (expressing the opinion that acquisition of MCI by the competitive unsuccessful bidder, Qwest, would not only be less objectionable because of the smaller overlap of direct competition between the two carriers in their metropolitan area business markets but also more likely to be beneficial, by creating a third competitor capable of challenging Verizon and SBC/AT&T in those markets). *See also* Jonathan Rubin, *The Competitive Threat of the Telecommunications Mergers*, AMERICAN ANTITRUST INSTITUTE (Mar. 24, 2005), *available at* <http://www.antitrustinstitute.org/recent2/398.pdf>.

25 years ago.

One inefficiency of the emerging deregulated system—a true cost of deregulation—is rarely weighed in the balance. Oscar Wilde is fabled to have said, “the trouble with Socialism is that it takes up too many evenings.”³⁸ The same is true of the dazzling proliferation of communications service varieties, combinations and packages encouraged by deregulation. It has surely become a problem of increasing dimensions, making even me nostalgic about the time when AT&T offered its subscribers their choice of any color phone they wanted, so long as it was black. Rational choosing among product and service innovations and price packages has become a major cost of the deregulated competitive process.³⁹ Consumer organizations are doubtless making every effort to help; but availing oneself of their services likewise “uses up too many evenings.”

Having dutifully thrown these last costs onto the regulation/deregulation scale, I now delicately remove them, because they seem to me truly inescapable in a consumer-sovereign economy — an external consequence of free consumer choice itself. It is because when confronted, for example, with the availability of wireless telephony along with packaged local/long-distance and a host of other attached services, consumers have opted for them in sufficient quantity that the costs of wise choosing has been forced on all of us thereafter — costs in a sense external to those original decisions. To the extent that the market does not itself fill the new gap,⁴⁰ I know of no way of sensibly weighing them in the regulation/deregulation balance — all the more so in view of the manifest enormous benefits of unregulated competition and, particularly, of the kind of technological competition that is the most important source of those costs.

CONCLUSION

In the case of the airlines, deregulation was concentrated in a one- or two-year period and, once sanctioned by Congress, universal (within the United States) and complete. Small wonder then that it began within a very short number of years to confer benefits on travelers to the

38. While this quote is widely used, no one seems to really know in which context or where Wilde said this.

39. One intriguing recent exposition and treatment of this problem is Jeff Sovern, *Towards a New Model of Consumer Protection: The Problem of Inflated Transaction Costs* (Jan. 2005), available at <http://ssrn.com/abstract=648052>.

40. The market's response to the predictably increased difficulty of shippers making least-cost choices among competitive truckers and rail carriers, freed by deregulation from the legal obligation to adhere to posted tariffs, was the emergence of thousands of freight bookers; in the case of airline service it was travel agents, computerized reservations systems, and such Internet services as Expedia, Orbitz and Travelocity.

tune of billions upon billions of dollars a year. Perhaps small wonder as well, that deregulation eventually exposed the once-dominant incumbent carriers to catastrophic losses.

In telecommunications, the process has been much more gradual. Over a period of more than 45 years, each step brought very large benefits to consumers in the markets affected. The process is by now virtually complete, except for the incumbent former monopolists remaining subject to direct regulation including the obligations of common carriage and provider of last resort. The obligation to offer UNE-Ps is long phased out, and they have over time succeeded in varying degrees in obtaining regulatory forbearance on the ground that sufficient competition prevailed to remove the threat of monopolistic exploitation of consumers. Understandably, while the benefits of these successive deregulations over decades have been huge, it is hardly to be expected that the mere removal of restraints on the incumbent former monopolists can produce comparably large benefits, since it is now only they who have been limited in their ability to compete.

The fact remains that the incumbent former monopolists' resources continue to be capable of making a huge contribution to inter-modal competition — and particularly competition with the video offerings of the still-dominating cable companies. It is clearly time to consider when, where, and how to complete the fifty-year process of deregulation.