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Thanks to Greg Sidak, Bob Hahn, and the American Enterprise Institute for hosting this event. The future of our modern economy is inextricably linked to the telecommunications industry and, consequently, it is well worth bringing together serious students of the industry to offer their opinions regarding the best forward-going public policies for the industry. I especially appreciate the opportunity to participate in a forum with such distinguished co-panelists.

Let's be clear: the Telecommunications Act of 1996 seeks to open telecommunications markets to competition and to do so by opening the doors to new competitors as wide as is possible. No less than the Supreme Court of the United States has been unequivocal in its assessment of what Congress intended in crafting the Act. In its *Verizon* Opinion only two years ago, it stated that

Congress called for ratemaking different from any historical practice, to achieve *the entirely new objective of uprooting the monopolies*....For the first time, Congress passed a ratesetting statute with the aim not just to balance the interests between sellers and buyers, but *to reorganize markets by rendering regulated utilities' monopolies vulnerable to interlopers*....Thus, the Act appears to be an explicit disavowal of the familiar public-utility model...in favor of novel ratesetting designed *to give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbents' property*.<sup>1</sup>  
(emphasis added)

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<sup>1</sup> *Verizon Communications Inc., et al v. Federal Communications Commission et al*, Opinion, pp. 15-17.

The benefits of competition in long-distance markets were consummated through the divestiture and equal access policies of the 1980s, and benefits to wireless customers have emerged as a consequence of the allocation and auction of competition-enabling PSC spectrum. The golden prize of competition, however, lay at the time of the Act, and as it turns out, still lies, in the development of effective competition in local exchange telephone markets. The fact is that competition increases consumer welfare by creating consumer choice, placing downward cost pressure on firms, driving prices downward, and stimulating innovation and investment. The merits of the Telecommunications Act's vision of bringing competition to local exchange services are, then, or should be, incontrovertible. In this regard, I think we are hard pressed to do better than to remember the words of the famous American jurist Learned Hand in rendering the ALCOA antitrust decision almost 60 years ago when he stated that "Immunity from competition is a narcotic and rivalry a stimulant to industrial progress."<sup>2</sup>

So, it would seem that with such unanimity the matter of implementing the pro-competitive vision of the Act would have been straightforward. Unfortunately, to assume so would be to forget an important lesson from economic theory: that monopolists do not readily cede their monopoly power. So, it was no sooner than the ink had dried on the Act than the incumbent local exchange companies, the ILECs, began a quest to retain as much as possible of their monopoly grip on the last mile facilities that are vital to enabling local exchange competition. Importantly, as consumers increasingly demonstrate a desire for bundled telecommunications services, any retention of the ILECs monopoly grip on local exchange facilities translates not simply into monopoly in traditional local exchange markets but to a broader array of bundled services.

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<sup>2</sup> 148 F. 2d 416 (2d Cir. 1945).

Unlike previous situations in modern economic history, the assault by the ILECs on competition has not been direct. Nowhere will you find the sort of emboldened defense of monopoly that characterized the pre-divestiture AT&T. Rather the defense of the ILECs has largely played out indirectly. The indirect nature of the defense by the ILECs, however, bears striking parallels to arguments that have come to be routinely rejected in antitrust economics. Let me mention two:

1. The ILECs have argued that unbundled network element (UNE) competition is not “real” and, therefore, should be denied. Instead, they argue that the denial of access to unbundled elements will actually promote “real” competition by stimulating facilities-based competition. This argument is, however, both an affront to the Act, which most assuredly did not favor any one form of or platform for competition over any other, and is, as a practical matter, wrong. The proliferation of UNE lines in recent years has led to billions of dollars of cost saving to consumers as direct consequence of their ability to choose a wider array of competitors than if access to UNEs were denied.<sup>3</sup> Indeed, since the FCC and Administration’s decision to retreat from enabling UNE-based access in residential markets, the entry and expansion of competitors into those markets has withered to a fraction of its earlier pace. While one can hope that a technological remedy will be around the corner, the fact is that access to UNEs has been a demonstrable success in promoting rivalry and real consumer choices. It seems both inconsistent and the poor basis for policy to argue that today’s UNE-based rivalry is not real, but that the competition that some futurists can imagine is somehow real.

2. The ILECs argue that the Act contradicts itself by espousing pro-deregulatory goals but instead has increased regulatory burdens on ILECs. This argument, however,

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<sup>3</sup> See for instance, <http://www.comptelascent.org/news/recent-news/031504.html>

curiously omits the fact that the vast majority of regulatory and legal burdens faced by the ILECs have been self-imposed. The ILECs have challenged virtually every effort in regulatory proceedings to open local exchange markets to competition and have faced numerous regulatory decisions and millions of dollars of fines for non-compliance with the competition enabling features of the Act. Ironically, the one exception to the ILECs intransigence was the brief period of cooperation in the effort to open local exchange facilities when the Bell operating companies were seeking regulatory approval to re-enter the long-distance market. The “carrot” of entry into the long distance market was sufficiently powerful to create cooperative behavior by the Bells. Now that the Bell companies have received regulatory approval to re-integrate, they have retreated to a hard-line regulatory resistance to competition-enabling policies.<sup>4</sup> Having devoured the regulatory carrot of long distance -- an arena in which they are rapidly reasserting their dominance -- the Bells have little incentive to allow the pro-competitive, de-regulatory features of the Act to play out. Rather, the ILECs have been the principal spur to increased regulatory activity in telecommunications. In light of the behavior of the Bell operating companies in the post-Act period, it is both ironic and fallacious for these same companies to argue that the Act has failed to meet its de-regulatory goals.

In summary, each of these arguments raised by the ILECs remains highly contentious and, I believe each is wrong in part or in toto. Of course, a full debate on these must play out in the larger literature and in public policy proceedings. The important point for today is that, as we look forward, it is the fact that each of these

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<sup>4</sup> This legal and regulatory resistance might have reasonably been expected given the observed intransigence of (already vertically integrated) GTE in the wake of passage of the Telecommunications Act. For a thorough discussion, see Federico Mini “The Role of Incentives for Opening Monopoly Markets: Comparing GTE and BOC Cooperation with Local Entrants,” Journal of Industrial Economics Vol. 49, September 2001, p. 379 ff.

arguments has found a sympathetic audience in certain circles within the FCC and Administration. The consequence is that a dispassionate assessment of the likely future is that the regulatory sympathy toward protecting the ILECs from competition will continue under the existing legislative framework. Moreover, this expected forward-going sympathy can be expected to further embolden efforts by the ILEC to use their regulatory clout to maintain control of last mile facilities and to erect barriers to entry from alternative providers and technologies.

So while I may disagree with my fellow panelists about the reasons for the policy failures under the Telecommunications Act, I must reluctantly agree that the current process is broken. The Act has been shown to be insufficiently robust to withstand the predictable efforts by the incumbents to cling to their monopoly positions. So what can be done in terms of legislative remedies on a forward-going basis? In this regard, several areas of potential legislative reform hold significant promise. Let me mention three.

1. While the goal of universal telephone service has both a theoretical and social welfare justification, the practical implementation of universal service policies in this country have been atrocious. Virtually every economic principal for establishing an efficient universal service policy has been turned on its head. For instance, economic theory indicates that the funds for universal service should be collected very broadly and targeted more narrowly to those households that would, but for the policy, fail to subscribe to the public switched (or, in the future, broadband) network. Instead, regulatory policies have perpetuated the very narrow collection of universal service funds and the very broad, virtually ineffective, distribution of universal service benefits. The results have been both huge economic welfare losses and significant distortions to

competition. On a forward-going basis, as we look toward a broader concept of universal service that may include broadband services, it is absolutely vital that these regulatory policies that have been so detrimental in the narrowband world not be extended to the broadband world. Elsewhere, my co-authors and I have described the principles that form the core for an efficient universal service policy as we move forward.<sup>5</sup>

2. It was recognized at the time of the passage of the Telecommunications Act that access pricing was absolutely laden with subsidies and competitive distortions. While significant progress has been made in certain features of the pricing of access to the local exchange network, there are still today a variety of different, non-cost based prices for this access depending on whether the access provided is to is another local exchange company, a long-distance company, a wireless company, an ISP or an Internet telephone provider. It is absolutely essential that this access, which costs the same in virtually all these different cases, be priced at the same, competition-enabling levels at rates that exclude either explicit or implicit subsidy flows.

3. The experience with the implementation of the Telecommunications Act points, I believe unequivocally, to the need for legislators to sharpen and elevate the prospects for antitrust liability as a tool to promote competition in the telecommunications industry. As the Supreme Court has stated, the role of the Act was to “uproot the incumbent LECs’ monopoly and to introduce competition in its place.”<sup>6</sup> My own observation of the developments over the last eight years leads me to the same conclusion that was reached by Assistant Attorney General William Baxter when, in the Ford and Reagan

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<sup>5</sup> "The Quest for Universal Service: The Misfortunes of a Misshapen Policy," (with David L. Kaserman) in Telecommunications Policy: Have Regulators Dialed the Wrong Number?, Donald L. Alexander, Editor, Praeger Publishing Group, Westport, CT, 1997, pp.131-144

<sup>6</sup> *Verizon Communications Inc. v. Law Offices of Custis V. Trinko, LLP*, decided January 13, 2004..

Administrations, he prosecuted the antitrust case against AT&T. Specifically, he concluded then, as I do now, that absent a visible and credible antitrust liability, regulation proves ineffective in advancing competition in telecommunications. The present situation, created by the Telecommunications Act's desire to see that ubiquitous spread of competition, is, as the Supreme Court has noted, an even more ambitious task than standard goals of antitrust of maintaining competition. In the present case, Congress seeks not only to maintain competition, but to advance it and to do so without any ex ante structure remedy that would be imposed by Congress. Ironically, members of the very same school of thought that have for years argued that regulation is ineffective and can safely be removed given the presence of an antitrust backstop seem in some circles today to be arguing that that we don't need to have an active antitrust threat because of the existence of regulation. But if regulation is, in fact, ineffective as they have argued, then we can ill afford to eliminate or downgrade the prospects for antitrust liability in this industry at the very moment when we are deregulating. Indeed, I believe that removing or even giving only a passive role to antitrust as a pro-competitive tool in this industry stands in the way of advancing competition. While one might have hoped that the nominal inclusion of an antitrust role in the language of the Telecommunications Act would have been seen as a stimulant to competition in this industry, those hopes were dashed in the Supreme Court's *Trinko* decision. Thus, we are left with a significant incongruity caused by the simultaneous presence of continued market power of the ILECs, ineffective regulation, an absent antitrust threat and an established goal of effective competition.

As a matter of both economic theory and economic history this lacuna is unwarranted. First, as matter of economic theory, we know that incumbent regulated monopolists facing a requirement to interconnect will, in a variety of circumstances, have incentives to: (1) refuse to interconnect; or, if required to interconnect, (2) do so only at uneconomic rates for new entrants; or, given requirements to interconnect at economic rates, (3) engage in sabotage (i.e., non-price discrimination) of vital network elements to competitors. All of these actions are perfectly isomorphic with the Sherman Act's condemnations against "willful acquisition or maintenance of monopoly power."<sup>7</sup> To, therefore exclude the Sherman Act as an enforcement tool in this instance fails to take advantage of an opportunity for advancing competition through the threat of antitrust liability.<sup>8</sup> Even more frightening is the prospect that, absent the threat of an effective and credible antitrust policy with the meaningful threat of liability, the industry will, despite the nominal presence of interconnection requirements, simply re-monopolize. Second, economic history is not kind to the position that regulation, acting alone, can effectively reign in the anticompetitive efforts of the incumbent LECs to maintain their existing monopoly power. Indeed, as I noted it was under a system of pervasive regulation of AT&T that the company was found guilty of monopolization.

In closing, let me again thank the AEI for hosting this event and I look forward to your questions and comments.

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<sup>7</sup> See *United States v. Grinnell Corp.*, 384 U.S. 563, 570-571 (1966).

<sup>8</sup> Moreover, it is no defense of the argument to exclude antitrust liability to observe that antitrust courts should not put themselves in a position that requires ongoing oversight that is best performed by regulators. Such a defense ignores the very potential for structural remedies that hold the promise of eliminating the economic incentives for discriminatory conduct, thereby promoting *both* competition and deregulation.