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Bell Entry into Long-Distance Service

by
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For over 15 years, federal regulation has prohibited the Bell companies from offering long-distance service. It is past time to "Just Do It"—that is, allow free entry into the long-distance market.

Background. When an antitrust consent decree broke up AT&T in 1984, local telephone service went to seven Regional Bell Operating Companies (RBOC). These were prohibited from engaging in three lines of business: information services, manufacturing, and long-distance telephone service. The restrictions were based on fear that an RBOC would be able to leverage its near-monopoly over local telephone service to gain power in the other markets, either by discriminating against competitors or by cross-subsidizing its own services.

As the telecommunications industry evolved, these restrictions came under criticism. With technologies changing and services converging, the costs of maintaining artificial distinctions (*i.e.*, distinctions not based on technological or market factors) between types of services grew because they prevented the Bells from gaining synergies from all aspects of communications. Moreover, evidence from competitive fields which the Bells were allowed to enter—such as the cellular-phone market—showed that it was much harder than previously thought to use discrimination and cross-subsidies to extend market power.

The information-services ban was repealed in 1991 by court order. Under the Telecommunications Act of 1996, the manufacturing ban was also eliminated. Section 271 of that act also authorized FCC to lift the final restriction on entry into long distance, but only on a state-by-state basis, and only if the RBOC were found to have effectively opened their local telephone market to competition. Specifically, the RBOC was required to have entered into an agreement with a competitor providing for interconnection of calls, or (in certain cases) show it was willing and able to do so. RBOCs were also required to satisfy an extensive 14-point "checklist" of market-opening measures, ranging from non-discrim-

inatory access, to provision of "unbundled" call-switching services. And the act established an elaborate mechanism to determine whether these conditions have been met, involving review by the state public-utility commissions and the US Department of Justice, and final approval by FCC.

In essence, the ban on Bell entry into long-distance became part of a carrot-and-stick scheme. The Telecommunications Act not only mandated that the Bells open their networks to competition, it also gave them an incentive by holding back long-distance entry until the opening-up was accomplished.

Opinion is mixed as to the success of section 271. Local competition has been growing—with competitors earning some 8 percent of the market at last count.[1] (Most of this has been in the business market; competition in residential markets has been disappointing). Despite this, however, Bell companies have gained approval to enter long-distance markets in only five states—New York, Massachusetts, Kansas, Oklahoma, and Texas.

Policy discussion. Whatever the success of section 271 so far, it may be reaching the point of diminishing returns. Four years ago, competition in most markets was only a theoretical idea. It was unclear from a technical point of view what could be done and how, in terms of opening networks. Can a particular service be offered separately? How can service orders be processed? Today, although competition may only be a limited success, those uncertainties have been vastly decreased. A basic road map has been established, showing regulators what can and cannot be done, and how to go about doing it. As a result, it is easier to enforce market-opening requirements directly, rather than relying upon indirect incentives such as section 271.[2]

Moreover, we may be reaching a stage where the incentive created by section 271 is no longer effective. If long-distance entry is stymied in most states, the incentive will be lost—just as a carrot too far away from the horse is ineffectual. Even worse, some argue that 271 is now providing the wrong incentive to potential competitors—in particular, to long-distance providers who might slow their entry into the local business out of fear that such entry would allow the Bell companies to enter the long-distance market as well.

Incentives aside, consumers would benefit directly from the additional competition created by Bell entry. Some evidence of this can be seen in

New York, where Verizon was allowed to begin long-distance service early last year. Because of bundling with other services and the widespread use of discount plans, specific data on rate trends are hard to come by. But Robert Crandall of the Brookings Institution has calculated that Verizon's entry caused long-distance usage to increase about 7 percent in New York in the first half of 2000, implying an effective reduction in rates of about 10 percent. He estimated the total savings to New York consumers to be at least $226 million per year.[3]

The long-distance restriction also could be hindering investment in high-speed, "broadband" communications. The ban makes no distinction between traditional "voice" services and Internet-based data services (which were a miniscule part of the market when the 1996 Telecommunications Act was adopted, and unheard of when the AT&T break-up occurred). As a result, even though the market for data transmission at a local level is intensely competitive,[4] RBOCs are still forbidden to transfer data across the boundaries between different Local Access and Transport Areas (LATA). This restriction keeps the Bells from investing in long-haul Internet backbone systems, which means not only decreased total backbone capacity, but less competition among backbone providers. Given the highly concentrated nature of the backbone market, the exclusion of potential additional competitors seems particularly unfortunate.

Policy recommendation. FCC should move quickly to review and approve additional applications to allow Bell companies to compete in long-distance markets. In addition, Congress should act to amend current rules to allow Bell companies to provide data services across LATA boundaries.

~ James Gattuso

For further reading:

Olbeter, Eric R., and Matt Robison. "Breaking the Backbone: The Impact of Regulation on Internet Infrastructure Deployment," *iAdvance Coalition*, 27 July 1999.

Thierer, Adam D. "Broadband Telecommunications in the 21st Century: Five Principles for Reform," *The Heritage Foundation Backgrounder*, no. 1317, 2 September 1999.

[1] Credit Suisse First Boston Corporation, "Telecom Services—CLECs," investors' report, 12 September 2000.

[2] This is not to say that "direct" regulation could not use some reforms itself. See generally, Robert W. Crandall, "Local and Long Distance Competition: Replacing Regulation With Competition," in *Communications Deregulation and FCC Reform: What Comes Next?* (Washington, DC: The Progress and Freedom Foundation, 2001).

[3] Reply declaration of Robert W. Crandall before the Federal Communications Commission, *In the Matter of Application by Verizon New England Inc., et al., for Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 00-176, 2 November 2000.

[4] See chapter 12, "High-Speed Internet Access Policy."