The Breakup of Ma Bell

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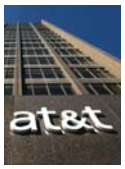

Ten years into the 20th century, the United States citizenry were still enjoying the afterglow of a remarkable generation of economic growth, innovation, and expansion.

Popular interests consisted of going to the movies, doing the Tango, and reading the *Saturday Evening Post*. A hands-off President, William Howard Taft, was in the White House, and people were enjoying clever inventions such as traffic lights, the refrigerator, and the telephone.

Alexander Graham Bell patented the telephone on March 7, 1876, but initially it was considered no more than a passing novelty. In fact, Western Union passed up the opportunity to purchase the Bell patents for $100,000. But when those patents held by American Telephone and Telegraph Company expired in 1894, competition entered the market and the availability of telephone service and the number of telephones exploded. The telephone moved from novelty to necessity. According to Adam Thierer of the Cato Institute, there were, at the time, more than 3,000 telephone companies vying for customers. Author G. W. Brock, in his book *The Telecommunications Industry*, pointed out the difference competition made:

> After seventeen years of monopoly [thanks to the patents held by AT&T from 1877 - 1894], the United States had a limited telephone system of 270,000 phones [mostly concentrated] in the centers of the cities, with service generally unavailable in the outlying areas. After thirteen years of competition [1907], the United States had an extensive system of *six million telephones*, almost evenly divided between Bell and [its competitors], with service available practically anywhere in the country. [Emphasis added.]

Writing in *The New Telecommunications Industry*, authors Leonard Hyman, Richard Toole, and Rosemary Avellis concluded that "competition helped to expand the market, bring down costs, and lower prices to consumers." Because of the negative impact upon AT&T by its competitors, the president of AT&T, Theodore Newton Vail, changed the focus of the company from competition to consolidation. As noted by Thierer, "Vail's most important goals upon taking over AT&T were the elimination of competitors, the befriending of policymakers and regulators, and the expansion of telephone service to the general public." Vail's belief in the superiority of a single monopolistic system was reflected in the company's new corporate slogan, "One Policy, One System, Universal Service." In the company's 1910 annual report, Vail wrote:

> It is believed that the telephone system should be universal, interdependent and intercommunicating, affording opportunity for any subscriber of any exchange to communicate with any other subscriber of any other exchange.... It is believed that some sort of a connection with the telephone system should be within reach of all....
>
> It is not believed that this can be accomplished by separately controlled or distinct systems *nor that there can be competition in the accepted sense of competition*.... [Emphasis added.]
>
> It is believed that all this can be accomplished to the reasonable satisfaction of the public with its acquiescence, under such control and regulation as will afford the public much better service *at less cost than any competition or government-owned monopoly* could permanently afford.... [Emphasis added.]
>
> Effective, aggressive competition and regulation and control are inconsistent with each other, and cannot be had at the same time.

Author R.H.K. Vietor, writing in *Contrived Competition*, said, "Vail chose at this time to put AT&T squarely behind government regulation, as the quid pro quo for avoiding competition. This was the only politically acceptable way for AT&T to monopolize telephony." In fact, without government regulations eliminating the competition, the reinstitution of the AT&T monopoly would have been impossible. The Kingsbury Commitment (named for one of Vail's employees) was an agreement with the Attorney General and the Interstate Commerce Commission in 1913 that essentially codified the playing field which allowed AT&T to regain monopoly control of the industry.

In 1934, the power to regulate the telephone industry under the ICC was transferred to the new Federal Communications Commission. Enacted by the Roosevelt Revolution during the Great Depression, the Communications Act of 1934 created the FCC "for the purpose of regulating interstate and foreign

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commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." In other words, according to Thierer, "every American was henceforth found to be entitled to the right to telephone service, specifically cheap telephone service." The FCC's powers included the power to regulate rates and restrict entry by competitors, all in the name of preventing "wasteful duplication" and "unneeded competition."

The Breakup

At the time of the Bell system breakup in 1984, the monopoly advantages enjoyed by the company (which were wrongly attributed to the free market, not government favoritism) had created an economic behemoth with $150 billion in assets, $70 billion in revenues, and a million employees. The Justice Department had determined that the company had grown too big, however, and filed suit under the Sherman Antitrust Act in 1974. The case, *United States v. AT&T*, was settled by a consent decree in January 1982, under which the company agreed to give up its 22 local exchange service companies, but keep its interests in Bell Labs and Western Electric. The 22 companies were divided into seven independent Regional Bell Operating Companies, RBOCs, or "Baby Bells." AT&T continued to operate its long-distance services.

At the time it appeared that although the company was less than half its former size, it had retained three very profitable businesses. Bell Labs was the world's foremost research and development operation. Its scientists had won seven Nobel Prizes, and it was responsible for the development of the transistor, the laser, the semiconductor, and the microchip. AT&T's long-distance service was highly profitable, and its Western Electric facility employed thousands of people making handsets.

But the competition that AT&T had been successfully avoiding for so many years very quickly took its toll on a company not used to competition. AT&T's Computer Systems venture failed; its purchase of NCR was a notable failure as well; and Bell Labs and Western Electric were sold to Lucent. The Western Electric manufacturing plant was eventually closed in the face of foreign competition. AT&T wound up being purchased by one of the RBOCs, Southwestern Bell, now SBC Communications, in 2005.

In the midst of "Ma Bell's" troubles came the Telecommunications Act (TCA) of 1996, which was designed to open up the long-distance telephone service markets that had been closed to competitors since the consent decree. The act also forced incumbents to allow newcomers to enter their markets by giving them access to their own infrastructure, which was meant to allow competition. But the TCA didn't lead to multiple companies working to improve existing long-distance service. What the TCA did, instead, was allow the free market to provide lower rates and better service to customers while resulting in the consolidation of the seven Baby Bells to the point now where there are essentially only two competing companies providing traditional hard-wire, plain old telephone service (POTS): AT&T and Verizon.

Because regulations and regulators are always behind the technological curve, while the government was looking toward expanding the competitive market in the area of POTS, entrepreneurs were innovating and moving in a different direction. As Mary Bennett Peterson noted in her book *The Regulated Consumer*, such a regulatory disconnect is commonplace: The "widening gap between the normative world of the regulator and the real world of the regulated industry [has always been] a problem [ever] since 1887, the year of the birth of the ICC."

While government was regulating the "communications" industry, entrepreneurs were taking advantage of unregulated Wi-Fi bandwidth to connect to the Internet wirelessly and develop new information systems that could also be used as communications services and could be used to take the place of land lines. Michael Powell, former chairman of the FCC, noted that his agency "made an interesting error [sic] many years ago and issued the unlicensed [Wi-Fi] band because they thought the spectrum was junk … suddenly people were bringing very interesting products to consumers at very low cost."

The "inter-modal" competition that subsequently developed (such as wireless service, VoIP, and IP video) now means that communications service providers must compete with informational service providers, causing regulatory headaches for the FCC and leaving them once again behind the curve.

In January, AT&T and Verizon joined together in a statement to the FCC predicting the imminent demise of Ma Bell's classic telephone network. In their 30-page commentary, AT&T says that "with each passing day, more and more communications services migrate to broadband and Internet Protocol (IP)-based services, leaving the public switched telephone network [PSTN] and plain-old telephone service as relics of a by-gone era." The statement explained:

> While broadband usage — and the importance of broadband to Americans' lives — is growing every day, the business model for legacy phone services is in a death spiral. Revenues from POTS are plummeting as customers cut their landlines in favor of the convenience and advanced features of wireless and VoIP services. At the same time, due to the high costs of providing POTS, every customer who abandons this service raises the average cost-per-line to serve the remaining customers [as required under the FCC's rules]. With an outdated product, falling revenues, and rising costs, the POTS business is unsustainable.

AT&T and Verizon are undoubtedly correct. Craig Moffett from Bernstein Research estimates that nearly one million phone lines are being disconnected every month. AT&T itself estimates that total industry revenue for basic wired phone service has dropped from $178 billion in 2000 to $130 billion in 2007, and continues to decline.

Enter the Internet

The big problem now plaguing AT&T is the Internet. In 2009, it was estimated that one-quarter of the entire world's population is connected via the Internet. Interestingly, the Internet has no centralized governance in either technological implementation or policies for access and usage — each constituent network sets its own standards. The only real regulatory power over the Internet is held by non-profit organizations of

loosely affiliated international participants that anyone may associate with simply by contributing their own expertise: the Internet Corporation for Assigned Names and Numbers (ICANN) and the Internet Engineering Task Force (IETF). ICANN is the maintainer organization, while the technical underpinning and standardization of the core protocols are the responsibility of the IETF. In other words, *the Internet is a free market*. The size and the growth rate of this medium, as estimated by AT&T Labs and Internet World Stats, may be safely attributed to the lack of central administration. As Wikipedia summarizes, this "allows organic growth of the network [and] encourages vendor interoperability and prevents any one company from exerting too much control over the network."

This lack of control is currently driving the FCC in its quest to regulate this medium. For people with a statist mentality who feel that the government must protect the people, the absence of central control and the benevolent hand of government is a recipe for failure or abuse. As Ronald Reagan put it of the statist mentality: "If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

Statist commentators want the FCC to step up the regulation of the Internet, despite a recent court ruling preventing it from doing just that. According to the *New York Times*, "It is untenable for the United States not to have a regulator to ensure nondiscriminatory access, guarantee interconnectivity among rival networks and protect consumers from potential abuse." It is clear that to statists no roadblock should stand in the way of ever-increasing government regulatory powers — not even court orders against assuming such powers.

So that the FCC can become *the* Internet regulator despite a court order against it, the author of the *New York Times*' article suggests brushing aside the court order by changing official definitions regarding the Internet to define it so that the Internet is a "communications" venue: "The Commission has the tools to fix this problem. It can … [re]define broadband Internet access [from an information service] to a communications service, like a phone company, over which the commission has indisputable authority." The writer concludes: "Broadband access is probably the most important communication service of our time. One that needs a robust regulator."

Though it is likely the FCC will follow a path similar to that suggested by the *New York Times*, some influential people are pointing out both the fallacy that government regulations improve service and the errant belief that better service is what the regulations are intended to accomplish. Michael Powell, former FCC chairman, responded to this incessant drumbeat for more regulation in a presentation he made at the Freedom Forum in Arlington, Virginia, in 1998. He said, "There are only three branches of government set out in the Constitution, and we are not one of them…. Technology makes ever more efficient use of spectrum. Broadcast channels are continually increasing. Cable [and the] internet provide an untold number of outlets for free speech. We must admit to these realities and quit subverting the Constitution in order for the government to be free to impose its speech preferences on the public." In another speech, this one before the Media Institute, Powell said, "One is left with the undeniable conclusion that the government has been engaged for too long in willful denial in order to subvert the Constitution so that it can impose its speech preferences on the public — exactly the sort of infringement of individual freedom the Constitution was masterfully designed to prevent." In an interview with *Reason* magazine, Powell points out that "every day the Internet becomes an increasingly effective tool for democracy [sic] and political organization."

If regulations on the Internet are put in place, they will fall under the purview of people like Mark Lloyd, the chief diversity officer of the FCC who complained that he was the target of attacks from the "vast right-wing conspiracy," namely, blogs, Facebook, Twitter, and other Internet-enabled communication users.

Increasing numbers of Americans seem to realize that Powell is correct about the intent of the regulation: to control free speech. According to a recent Rasmussen poll, 53 percent of Americans oppose FCC regulation of the Internet, and among those who use the Internet every or nearly every day, opposition to FCC regulation rises to 63 percent.

What intended or unintended impact will the regulations have if enacted? Consider again the impact of the consent decree in 1982. As author Tara Seals notes: "Ma Bell gave birth to seven regional Baby Bells in 1984, and the good news is that an era of competitive innovation began that eclipsed the sum total of the previous 108 years since Alexander Graham Bell completed the first telephone call [including]: mobile wireless voice, fiber optics, microprocessors, IPTV and IP video, VoIP, back office and equipment vendor landscapes that are light-years ahead, Wi-Fi, increasing demand for wireless broadband, and mobile broadband services and products like the new IPad from Apple."

Robert Crandall of the Brookings Institute, taking a slightly different tack, says, "The world that existed in 1984 no longer exists because of [these] changes in technology. The [FCC] had originally wanted to set up long-distance companies that would have provided us with lower long-distance rates. But separate long-distance companies are simply not viable now because of the advent of wireless and VoIP…. Whether we could have gotten to this place today without breaking up AT&T is an interesting question, but it's largely irrelevant." What is still very much relevant is the continuing and never-ending battle between the regulators who want to control freedom of speech and the increasing number of free citizens who understand and support their right to freedom of speech guaranteed to them under the First Amendment.

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