

# Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

## The Guadalajara Clause

TO THE EDITOR:

Antonin Scalia's "Guadalajara! A Case Study in Regulation by Munificence" in your March/April issue hits the nail on the head. I was assistant secretary for health, Department of Health, Education, and Welfare in 1976, and I recall how surprised we were when the "Guadalajara Clause" appeared in the version of the Health Professions Assistance Act that emerged from the House-Senate conference. I learned that the provision had originated on the House side and had then survived the conference committee because of House enthusiasm and Senate indifference. The Ford administration had not been consulted. I was so concerned about the provision that I immediately discussed it with then Secretary David Mathews. We had about ten days in which to consider the bill in its entirety and to advise President Ford about signature or veto. Because three years had passed without appropriate legislative authority for the programs on health professions education and because the bill did have some good features, the inclination to get a bill into law was strong. We decided to consult the medical schools through the Association of American Medical Colleges—which reported, I recall, that about 70 percent of its members favored accepting the bill. It should be clear, however, that most people did not have time to think the issue through. And the longing for a known dimension for capitation funds was great.

The contention expressed in the conference committee report—that "federal policy . . . is intended to

apply to all schools"—is the concept that most needs reexamination. Why, for example, should all medical schools be required—as they are under the capitation funding condition of the 1976 law—to allocate 50 percent of their residency positions to three primary-care specialties by the academic year 1980-81? The implication is that all schools have to do the same thing in the same way in order to contribute properly to the attainment of national goals. This issue, as pointed out by Professor Scalia, hits at the fundamental precepts of the American educational system.

Theodore Cooper, M.D.,  
Cornell University

## Telecommunications

TO THE EDITOR:

Stanley Besen has done a commendable job in summarizing recent changes in telecommunications regulation and the prospects for further deregulation ("Deregulating Telecommunications," *Regulation*, March/April). In the few pages allotted him, Besen understandably had to gloss over many issues to which he might have given much greater emphasis in a longer article. Unfortunately, I believe that readers unfamiliar with the complicated world of common-carrier technology might be misled by his article into believing that continued rate regulation of the multitude of services offered by AT&T and its rivals is both feasible and desirable.

It was inevitable that the FCC would have to open up the interstate communications markets to new competitors. With new technology developing in microwave transmission and satellite distribution and with AT&T locked into depreciating an increasingly obsolete plant over a very long accounting life, new competitors would be knocking at the door with a new generation of equipment that Bell would be unwilling or unable to offer. Specialized carriers of microwave signals offered digital service

for business data communications at a time when Bell's plant was incapable of providing the service. Increasingly sophisticated terminal equipment grew out of the electronics revolution, threatening to displace the old handsets, terminals, and PBXs offered by Bell. The Federal Communications Commission could hardly pursue "the public interest" by discouraging the use of such technology.

Yet when the commission began to offer limited entry into interstate transmission and terminal equipment markets, it faced several problems only one of which Besen addresses.

First, it faced the problem of ascertaining the appropriate price of each interstate service. In the past, it had simply examined AT&T's overall rate of return, allowing the company to dictate the rate structure. But once it opened up part of AT&T's world to competition, issues of rate structure became important, not simply for reasons of economic efficiency but because of competitors' howls.

The rate structure issues emerged in AT&T's responses to competition in everything from *Telpak* to high-low pricing, WATS service, and digital data service. In most of these cases, the commission took a dim view of that company's aggressive competitive responses. As a result (as Besen observes), the commission refused to allow it to base its charges on estimated incremental costs of competitive services, requiring it instead to charge on the basis of "fully allocated" costs. The reason for this decision, I believe, was simply distrust of how AT&T's management assessed the company's *future* incremental costs of service. The commission wanted something tangible to base the rates upon and it wanted the costs to add up to AT&T's total costs. It therefore asked management to allocate all *historical* costs in a fully allocated cost analysis. While deviations from the actual historical outlays were utilized in various versions of fully allocated cost calculations submitted by the company, management was not permitted to base rates on prospective incremental costs (the economically efficient choice).

In the rapidly changing world of electronics and communications technology, to tie AT&T to pricing rules that depend upon historical, imbedded costs is to require it to price inefficiently. Moreover, if entry is permitted while the existing firm is constrained to historical-cost

pricing, the existing firm must operate at an enormous disadvantage if more than one rate obtains for the same service in the same market.

The explosion of new technology has only begun to be felt in AT&T's markets, and entry has thus far been limited to some of the less exciting areas. The major threat to AT&T at this moment is not a service based upon a new, exotic technology, but one which exploits the mistakes of regulation. "Execunet," a long-distance business service, has simply taken advantage of (1) the poor methodology used by the FCC and state commissions in "separating" interstate and intrastate costs and (2) the absence of time-sensitive pricing for local exchange services. But this is not the major long-term threat facing AT&T.

What we will see in the near future is an explosion of new services based upon new technologies. If the commission persists in requiring AT&T to meet this prospective competition on the basis of rates calculated by historical, embedded (average) costs, it will be giving new competitors an unfair advantage since AT&T will be required to charge prices high enough to cover the costs of using an old technology. Yet the commission can never know AT&T's true incremental costs. In fact, it is now discovering that it cannot even ascertain the existing embedded costs for each service, whatever the accounting method used.

The FCC is now faced with the task of drawing boundaries between potentially competitive markets and "natural monopolies," allowing entry into the former but not the latter. Besen apparently believes that such a distinction is possible. I am not convinced. Where does "local distribution" begin and end? Is my home rooftop satellite antenna to be considered part of an interstate-transmission system or part of a local distribution system? What if my next-door neighbor has the same equipment and uses it to communicate with me? What is my CB radio? What if, say, Carterfone discovers a method of allowing me to tie in to the satellite system through my CB radio? I doubt that there is a true "natural monopoly" left in communications, only monopolies protected by regulation. Why not ask the commission simply to open up the world to competition? But then who would repay AT&T stockholders if deregulation led us to discover that their assets are overvalued because of

decades of slow depreciation required by the commission's rate-setting policy?

In short, I think that the opening of communications markets to competition has created a much more difficult situation for the FCC than Besen portrays. It can never know the costs of providing each of a multitude of services that share common facilities. It must, therefore, set prices on the basis of informed guesses and the pleadings of competitors. How can any of us argue that this type of regulation serves the "public interest"?

Robert Crandall,  
Brookings Institution

STANLEY BESEN responds:

Robert Crandall's letter highlights the dilemma faced by the FCC as it attempted to deal with "competition" in the telephone industry. The commission had three broad alternatives. First, it could have argued that the public interest would best be served by maintaining, and perhaps extending, the legal monopolies possessed by the existing carriers. Second, it could have thrown open the entire telecommunications market to unfettered competition between the incumbents and the would-be entrants. This would have entailed giving AT&T and other telephone companies complete freedom to set rates. The FCC chose neither of these alternatives but rather a third: it allowed "competitors" to enter certain selected markets—those in which the commission had concluded that natural monopoly elements were relatively unimportant or that rapid technological change would best be promoted by a multitude of firms—and it limited the competitive responses of the existing carriers.

This policy has created a fundamental problem. As Crandall notes, it places a heavy burden on the commission to determine into which markets entry should be permitted and what prices AT&T and others can charge. This burden may be too much for the commission to bear. Moreover, as I argued in my article, the FCC has adopted a criterion for judging the competitive response—namely, existing carriers must price so as to cover "fully distributed costs"—that may lead to a worse outcome than if entry had not been permitted. (One of the reasons given for using this criterion is that it is easier to monitor than one based on the more appropriate incremental cost concept.)

I take the thrust of Crandall's let-

ter to be that "full and fair" competition (which the FCC says it seeks to promote) should involve limitations neither on entry nor on the permitted responses of the existing carriers. The alternative I suggested was a possible restructuring of the industry so that at least some parts of it could be left unregulated. But neither of us is likely to get his wish, and I suspect that each of us would prefer the other's first choice to the "regulated competition" the commission seems to prefer.

## Welfare and Voting

TO THE EDITOR:

American conservatism has, to the surprise of many of us, recently come forward with a body of argument that is thoughtful and challenging, and has begun to rebuild a position in the debate over public policy issues that has been missing for over a generation. Professor Ralph K. Winter's lively article ("The Welfare State and Electoral Politics") in the March/April issue of *Regulation* embodies some of the strengths of this position, but also illustrates some foibles that could prove to be its undoing.

John Stuart Mill once wrote that the prayer of every serious liberal should be, "Lord, enlighten thou our enemies. . . . We are in danger from their folly, not from their wisdom. . . ." Perhaps those of us who have suffered from the embarrassments of the New Left can offer some worthwhile advice to those whose conservatism is tempted toward habits of mind that are strikingly reminiscent of the presumptions and ideology that we battled for so long at the Left-of-Center.

Professor Winter, in the vein of the late-lamented new populists of the Democratic party, sees a sullen protest against big government and high taxes in the decline of voter participation in our national elections. He concludes that we are caught in a "drift away from democracy" which can only be ended by strapping government into a Procrustean bed of fixed taxing and spending limitations. (Procrustes, I am told, was a Greek bandit who placed his victims on a bed and chopped off whatever—head, arms, feet—stuck out over the edges. This treatment did affect the victims' size, but hardly at the places that are most likely to grow to flab.)

There have been some careful studies of our nonvoters (see, for example, the work of Jack Citrin and

Warren E. and Arthur H. Miller), and they do not provide any support for Professor Winter's assumption that these citizens are disgusted by their inability to impose limits on the size and spending of government. The nonvoter is not always the alienated citizen, but may just as well be the satisfied citizen, who assumes that elections bring little change and who therefore does not trouble to go to the polls. And, among those nonvoters who could be described as frustrated to the point of cynicism, such frustrations may be the result of many causes other than big government and big spending. Indeed, they may arise from the opinion that government is not doing enough or spending enough to make much difference in their affairs.

Nor is it precisely correct to assert, as Professor Winter does, that "most voters want less government, less taxes, less inflation, along with the maintenance of a decent level of support for the genuinely poor." The problem seems to be that while voters do want less inflation and less taxes, they also want to keep many costly government services, and even to expand government in a number of areas—job creation, health security, drug abuse, crime control, education, and national defense—that will inevitably require a large bureaucracy and higher taxes. (Professor Everett Carll Ladd, Jr., provided a good summary of these public desires in last October's *Fortune* magazine and keeps a running account of them in AEI's *Public Opinion*.) The voters want a great deal from government, but they don't want to pay a high price for it, or lose their liberty to it. Some commentators seem to believe that this is deranged thinking. But is it really so abnormal? Who doesn't want something for nothing?

Professor Winter comes closer to a vulnerable target in his complaints against those who, while supposedly helping the poor, have really been helping themselves, often at a handsome cost to the taxpayer. He is also on sound ground in his criticism of legislative log-rolling: spreading the benefits of a program to groups whose needs are not at all pressing in order to win legislative support for it. But his solution for these abuses leans more toward an attack upon government than toward an attack upon the abuses of government.

His despair over the normal processes which govern taxing and spending leads Professor Winter toward the schemes of the tax re-

volt movement, which seeks to impose inflexible limits on the taxing powers of government. (These seem to be for the New Right what such things as the congressional War Powers Act and the cutoff of aid to the South Vietnamese were for the peace movement.) There are a number of strong economic arguments against this approach. But the political arguments are equally important and fill out the comparison between the New Conservatives and the New Left—a movement which had a similar mistrust of the capacities of representative government.

There are good grounds for assuming that the voters want efficient delivery of government services, dislike bureaucratic intrusiveness and red tape, prefer economic growth to welfarism as a means of ending poverty, and resent the "poverticians" and purveyors who have captured such a high proportion of the money intended to alleviate real poverty. It is equally true that today these sentiments are not very effectively brought to bear in the give-and-take of representative government. But an attack upon government itself by the New Conservatives—a revival of the old hatred of the New Deal will not, even if it should partially succeed, root out the ideologues, malfeasants, and incompetents who are responsible for government abuses. Moreover, there are those in liberal and labor circles who, while they strongly favor some aspects of big government, are also dismayed by its excesses. If, rather than opting out in disgust to attack the "establishment," the New Conservatives mounted a patient and vigorous attack on these abuses within the legislative system, they might not achieve their libertarian utopia, but they would certainly contribute a great deal to the effectiveness and vitality of modern government.

If they indulge the illusions and the strategy suggested by Professor Winter, they may very well discredit themselves and drive many of those who are discovering some merits in their critique back toward a reluctant alliance with those who favor big government for big government's sake—and for their own.

*Penn Kemble,  
American Enterprise Institute*

RALPH WINTER responds:

One could hardly argue with Mr. Kemble's proposition that we avoid Draconian measures and focus on specific abuses of the welfare state

if he accompanied his comments with realistic proposals on how that might be accomplished. The burden of my argument, after all, was that specific abuses are very unlikely to be eliminated on any widespread scale, given the present nature of our electoral politics. Voters will not vote to eliminate "abuses" which benefit them unless they are assured in advance that enough "abuses" which benefit others will also be eliminated so as to bring about a net gain in their welfare through the reduction of taxes and of bureaucratic control. I argued that candidate-versus-candidate politics does not realistically offer this kind of option to the voters, since such a result depends upon the behavior of numerous candidates representing other constituents. Voters thus take an "after you" approach and insist that they retain and increase their benefits in the absence of a general reduction of government services. As a consequence, the growth of government continues even though voters would prefer otherwise.

Mr. Kemble does not address this argument but focuses rather on one of a number of remedies I mention and rightly criticizes it as drastic. He does not, however, suggest realistic and less drastic alternatives to that or even to my more modest proposals such as indexing the progressive income tax. The spiraling size of government and the inflation that accompanies it are themselves drastic, and something more than criticism of "abuses" of the welfare state is necessary to stop it.

So far as his observation that voter apathy has many sources is concerned, again I do not quarrel with his general proposition. Nevertheless, I remain convinced that my analysis is a valid partial explanation of voter indifference. In no way does my analysis require that voters consciously perceive that the inability of candidates to make credible promises to reduce taxes and government controls is the reason for their nonparticipation. I would not expect, therefore, that public opinion research would necessarily conclude that this inability is a major source of voter indifference. I would rely rather on the fact that, in the most recent primaries, the "after you" candidate-versus-candidate politics produced yawns among voters everywhere, while the "all together" approach of Proposition 13 (however poorly drafted or misdirected that proposition may have been) generated the only voter interest. ■