

List of figures	xii
List of tables	xiv
Acknowledgments	xv

I PRICING AND TELECOMMUNICATIONS

1 Introduction	3
1.1 Telecommunications pricing	3
1.2 Theory and practice	4
1.3 Overview	6
2 Telecommunications production, costs, and pricing	7
2.1 Stylized telecommunications technology	7
2.2 The US context	15
2.3 Major tariff developments	17

II RECENT DEVELOPMENTS IN THE NORMATIVE ECONOMIC THEORY OF TARIFFS

3 Types of tariffs	23
3.1 The context	23
3.2 Normative framework	26
3.3 Overview of tariff types	34
4 Linear tariffs	38
4.1 Marginal-cost prices	38
4.2 Ramsey pricing (demand-oriented tariffs)	43
4.3 Ramsey pricing with competition	48
4.4 Ramsey pricing with consumption externalities	55
4.5 Definition of services	61
4.6 Customer-class pricing	64

4.7	Dynamic pricing	66
4.8	Conclusions	72
5	Nonlinear tariffs	73
5.1	The consumption framework	73
5.2	Two-part tariffs	77
5.3	Two-part tariffs with consumption externalities	81
5.4	Discriminatory two-part tariffs	83
5.5	Smooth nonlinear tariffs	85
5.6	Discrete multipart and optional two-part tariffs	95
5.7	Tying/bundling versus unbundling	105
5.8	Nonlinear tariffs in oligopoly	112
5.9	Second-best piecemeal policy	114
6	Cost-based tariffs	118
6.1	Subsidy-free pricing	118
6.2	Cost-axiomatic pricing	134
6.3	Fully distributed-cost pricing	137
6.4	Special issues of carrier rates	140
6.5	Second-best piecemeal policy revisited	143
III	TELEPHONE RATE STRUCTURES IN THE UNITED STATES	
7	Regulation and US retail rates	149
7.1	The impact of regulation on rate setting	149
7.2	Basic US retail rates	156
7.3	Price caps	167
8	Optional calling plans	176
8.1	Theory of optional tariffs reconsidered	176
8.2	Development of AT&T's optional calling plan	188

8.3	Nationwide optional calling plans	194
8.4	FCC guidelines for optional calling plans	199
9	Business bulk-rate tariffs	201
9.1	Local rates	201
9.2	WATS tariffs	202
9.3	800-number services	206
9.4	Virtual private networks	207
9.5	Discounts for bundling	208
9.6	Private lines	210
9.7	Custom tariffs	211
10	Pricing of carrier services	213
10.1	Carrier access rates	213
10.2	Bypass of the local exchange	216
10.3	Incentive effects	216
10.4	Nonlinear pricing of carrier access	221
11	Social tariffs	224
11.1	Telephone penetration	224
11.2	Goals of social tariffs	227
11.3	The history of social tariffs	228
11.4	Description of state programs	230
11.5	The costs of social tariffs	239
11.6	The welfare impact of social tariffs	243
IV	SYNTHESIS	
12	Synthesis of theory and practice	249
12.1	Lessons from pricing theory	249
12.2	Assessing practice in light of theory	252
12.3	Pricing and the future	258

A	US telephone price indexes	264
	Bibliography	287
	Index	301
	Selected list of RAND books	308

Figures

1.1	Innovation in theory and practice	4
2.1	Stylized telephone network	9
2.2	Local and trunk carriers	16
3.1	Average-cost and marginal-cost pricing	36
4.1	Ramsey pricing	46
4.2	Geometry of the Ramsey optimum	47
4.3	Equilibrium subscriber set	57
4.4	Access externality	58
4.5	Distance-related demand curves	62
5.1	Noncrossing demand curves	74
5.2	Fixed fee and three types of consumers	76
5.3	Subadditive outlay function	91
5.4	Block and smooth tariffs	96
5.5	Optional and multipart tariffs	101
5.6	Nonoptimality of marginal-cost price	104
6.1	Internal subsidization	120
6.2	Anonymous equity and support prices	123
6.3	Nonlinear tariff to avoid inefficient bypass	133
7.1	Rate structures and distance	157
7.2	Rate periods for AT&T area code calling plan	165
8.1	Linear and two-part tariffs	177
8.2	Optional and ex-post tariffs	178
8.3	Block-of-time tariff	182
8.4	Customer sizes under block-of-time tariff	184
8.5	Take rates for optional tariff	187

List of figures	xiii
9.1 AT&T bulk rates (1000 mi.)	206
10.1 Switched access and bypass arrangements	218
11.1 US telephone penetration	227
A.1 Interstate and state prices	265
A.2 CPI price indexes	267
A.3 MTS and WATS prices	269

Tables

2.1	Market shares, 1989	14
2.2	The US telephone market	17
7.1	Average monthly local rates	159
7.2	Average connection charges	160
7.3	Retail rates for cellular service in California	161
7.4	Average intrastate toll rates (5-minute daytime calls)	162
7.5	AT&T interstate MTS rate structure	164
7.6	AT&T tariff filings requiring remapping of base demand	171
7.7	Tariffs excluded from AT&T price cap regulation	172
7.8	Revenue shares for AT&T by price cap basket	174
7.9	AT&T price cap and BLS index values	175
8.1	AT&T experimental plans, 1983	190
8.2	Changes in usage and revenues under experimental rate plans	193
8.3	Growth in optional calling plans	194
8.4	Customer distribution by night/weekend usage, 1984-5	195
8.5	AT&T Reach-Out America plans	196
8.6	MCI optional calling plans	197
8.7	US Sprint optional calling plans	197
9.1	AT&T PRO WATS I, II, and III	203
9.2	AT&T PRO WATS tariff	204
9.3	High-volume AT&T WATS tariffs	205
9.4	AT&T 800-service rates	207
9.5	AT&T private line interoffice transport rates	210
10.1	Interstate carrier access charges (cents per minute)	215
10.2	Distribution of monthly usage	221
10.3	Two nonuniform-pricing access rates	222

11.1	Telephone penetration in US households (percent)	225
11.2	Eligibility in Lifeline and Link-up programs	231
11.3	Enrollment in social tariffs	240
11.4	Reimbursements to local exchange companies	242
11.5	Administrative costs of state programs, 1989	243
A.1	Differences between CPI and PPI telephone indexes	271
A.2	Consumer Price Index data	272
A.3	Producer Price Index data	273
A.4	Interstate and state share of total minutes	276
A.5	Consumer Price Index: annual growth rates (percent)	277
A.6	Producer Price Index: annual growth rates (percent)	278
A.7	Changes in AT&T price cap indexes and BLS indexes, July 1988 to July 1989	281