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Telecom Investment Bonanza

By Bruce Fein 07/11/2003

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The Federal Communications Commission should not quarrel with success.

Telecommunications investments -- a sparkplug of economic growth and prosperity -- have boomed since the inauguration of competition for local exchange service under the umbrella of the 1996 Telecommunications Act. Pivotal to incubating competitive local exchange carriers (CLECs) tasked with breaking down the monopoly market shares of incumbent local exchange carriers (ILECs) has been the unbundling of local network elements (UNEs) for leasing to newcomers at just and reasonable rates. The unbundling enables CLECs to enjoy the same enormous economies of scale in the construction of local loops, switches, and transport lines as is enjoyed by the ILECs. Unbundling also avoids a glut of excess capacity that has destroyed the likes of many start-up firms. And, UNEs and UNE rates have unleashed a surge of telecommunications investments by the spur of unprecedented local exchange competition.

The Phoenix Center Policy Center Bulletin No. 4 (June 24, 2003) meticulously surveys telecommunications investment since the 1996 Act. According to its study, from 1980 through 1995, investment by telecommunications firms grew at 2.8% annually, with an average investment level approximating \$38.8 billion. After the Act through 2001, the corresponding figures rocketed to 22.3% and \$95.3 billion, respectively, yielding a gross telecommunications investment figure of \$572 billion. Extrapolating from the forecasted investment level (\$305 billion) and the actual level, the 1996 Act is associated with a boost of \$267 billion in investment over a 5-year period.

Lawrence J. Spiwak, President of the Phoenix Center, explained the nexus between newly inaugurated competition and climbs in investment as follows: "The data shows clearly that the mere prospect of competition unleashed a wave of new investment. The investment growth verifies basic economics -- companies that have to compete for customers invest more than monopolists who, by definition, never cut costs or innovate."

A few charge, nevertheless, that the CLECs are artificial creations that survive only because UNE prices are below market and enable CLECs to prosper at the expense of the Baby Bell quadrumvirate: SBC, Qwest, BellSouth, and Verizon. If that were true, it would be expected that the Baby Bells would poach on each other's local exchange markets through UNE-P entry. But no poaching has occurred. The Baby Bells have scrupulously honored each other's local exchange monopolies, which would be senseless if poaching by piecemeal leasing of network elements entry guaranteed rich profits. Indeed, to neglect to poach in such circumstances would expose Baby Bell directors and officers to shareholder liability for gross mismanagement. In sum, the marketplace behavior of the Baby Bells convincingly discredits the theory of below-cost pricing of UNEs.

The rates of return on investments by the Baby Bells reinforce that conclusion.



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Yale Braunstein, a professor at the University of California, Berkeley, examined UNE pricing in California where SBC is dominant. Among other things, Braunstein found: "An analysis of the new UNE-P rates ordered by [the California Public Utilities Commission] in 2002 shows that when earnings and costs of retailing local phone service are subtracted from retail revenues, the remaining embedded costs appear to be covered by the current UNE-P rates. In fact, they still leave room for a profit in this wholesale business of between 9% and 42%."

The Baby Bells' complaint to the United States Supreme Court that UNE rates were confiscatory was denied in Verizon v. Federal Communication Commission (2002). CLECs have invested more than \$100 billion in new facilities since the deregulation mandated by the 1996 Telecommunications Act. Those investments would have been economically ruinous if CLECs could have entered local exchange service more cheaply through UNE-P leasing.

Baby Bell promises of an investment surge if UNE-P were abandoned and CLECs withered command little credibility. Consider the parallel case of new fiber in which the Baby Bells pledged an investment bonanzas if unbundling obligations for new fiber construction were lifted. Their wish was granted by the FCC last February 20. New fiber was deregulated. But the Baby Bells immediately renounced their investment lyrics. They demanded that UNEs for local phone service must also be ended before fiber investments would be forthcoming; and, even those new promises were hedged.

Contrary to some voices, leasing network elements to CLECs is neither economically sinister nor dubious. The Baby Bells themselves recognize that building new facilities in lieu of leased lines may be economic folly. Verizon, for instance, rents access to the networks of the facilities-based long distance carriers such as AT&T, Sprint, Worldcom and Wiltel; it has not constructed its own complete long distance network.

Critics who argue that UNEs and CLECs are economically harming consumers are unconvincing. If that assertion were true, consumer groups like the AARP would be shouting at the FCC to abandon UNEs or hike UNE prices. But the opposite has been the case. Consumer representatives uniformly urged the FCC in its UNE rulemaking that culminated last February 20 to retain obligations to unbundle local networks. Not a single consumer voiced alarm that UNE prices were too low.

In sum, marketplace behavior is the best test of government regulatory wisdom. On that score, the FCC's nurturing of CLECs under the aegis of the 1996 Act to compete with the monopoly Baby Bells through the option of entry by UNE-P deserves accolades. Prices have fallen. Service has improved. Baby Bell market shares have inched downward. And telecommunications investment has soared. To jettison the winning UNE formula would smack of regulatory irresponsibility.

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