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PERSPECTIVE:

CONVERGENCE DOES NOT EQUAL POWER

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As all of us are painfully aware, the telecoms and information technology (IT) industries are in the process of a violent meltdown. Although the financial community funded many new entrants whose business plans (or management's inexperience) did not warrant the obscene amount of money invested in them, the total blame for the current meltdown cannot be laid at their pathetic feet.

Instead, as I have argued many times before, much of the blame must go to good old fashioned regulatory failure – that is, regulators have failed to promote entry aggressively for local access, and with the deliberate re-vertical integration of the telecoms industry, the current structure of most telecoms markets are not capable of sustaining competitive rivalry and achieving good economic market performance.

Notwithstanding the above, dominant incumbents continue to push for more deregulation. Their first argument is what I describe as the "tectonic plates are shifting" defense – *i.e.*, with all of this marvellous technological advancement, it is now appropriate to unshackle dominant incumbents from whatever residual regulation remains because advanced technology will automatically lead to Shumpeter's "creative destruction" and force Adam Smith's invisible hand to mitigate incumbents' market power by giving them a good thrashing.

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While such a utopian vision is nice, it does not square with economic first principles. Although competition is becoming increasingly "multi-dimensional," the hard reality is that, even with dramatic technological advancement, the majority of telecoms and IT services *are not close substitutes for each other*. Instead, consumers perceive them as *complements.* As such, we have yet to see widespread evidence that new technology – in whatever form – is having a contestable effect on dominant incumbents' strategic behavior.

Given the inherent flaw in this argument, dominant incumbents fall back on what I describe as the "relevant market" defense – *i.e.*, the issue is no longer about "narrow-band" local access for voice over the public switched telephone network or multichannel delivered programming over a coax cable network, but instead about the highly competitive, and ostensibly severable, market for "broadband" products and services.

Severability, however, is not as easy as it would seem. With the increasing digitalization of traffic right on up to the customer premises equipment, how do you distinguish between a data packet, a voice packet or even a video packet, especially when these packets go into an Internet cloud?

What technology does do, however, is make explicit exactly what this business is all about. Let's be quite clear here: the way you make money in telecoms always was, is, and always will be, about one central thing – having competitors terminate more traffic on your network than you do on theirs.

Accordingly, the real issue is not about "convergence", but about market power for termination of traffic. As such, the ostensibly severable market for broadband is just as ephemeral as the fictional regulatory constructs of "video dial tone" or "global seamless service." Indeed, the notion that everything will be swell because cable companies and the phone companies will duke it out for broadband (the "battling duopolists" argument), without any competition to their core businesses, is just another example of regulatory wealth reallocation, rather than public policies that should appropriately seek long-term consumer welfare maximization.

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Policy makers cannot continue to use the promise of technology as a smokescreen to avoid resolving the structural problems inherent to the telecoms industry. Instead, if consumer welfare is truly to be maximized in the long-run, then, for structural problems, final structural solutions are required.