Telecom Competition and the 1996 Act: Reflecting Back and Looking Forward

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- *There is strong consensus in the U.S. that telecom regulation should be reformed to allow a greater role for competition.*

  *It is important, however not to become euphoric but to hold realistic expectations.…The Act calls for implementation of many requirements. But calling for and actually implementing…are two different things.**

* Marius Schwartz, "Telecommunications Reform in the United States: Promises and Pitfalls" in Telecommunications and Energy in Systemic Transformation, Paul Welfens and George Yarrow eds., Springer 1997 (p. 260).

- This talk:
  - Reflects back on the premises underlying the 1996 Act, its key provisions — especially on network sharing — and the track record.
  - Summarizes briefly some of the lessons and their implications for policy going forward.

REFLECTING BACK

The 1996 Act: Underlying Premises and Key Local Competition Provisions

- **Status quo is highly inefficient**
  - Local access phone networks still predominantly a monopoly, with presumed inefficiencies
  - Monopoly invites costly and intrusive regulation: of rate Level (creating problems for incentives) and of rate Structure (inefficient cross subsidies)
  - Artificial separation of "local" from "long-distance" (LD) services to prevent leverage from monopoly local into potentially competitive LD

- **Competition should be encouraged by removing certain impediments**
  - "Natural Monopoly" should no longer be presumed — competition may be possible in some or even all segments of the local network; technological change (wireless, cable) can erode natural monopoly conditions
  - To foster local competition the Act seeks to remove perceived artificial impediments:
    - *State and local regulations* that limit telecom competition largely preempted
    - *Interconnection* by incumbents with entrants mandated at low reciprocal rates
    - More controversial: *Network Sharing* obligations on incumbents (resale; unbundled network elements — UNEs and UNE-P)

Network Sharing Requirements: Rationale & Risks

- **Requirements on Incumbent Local Exchange Carriers (ILECs)**
  - *Resale*: ILEC must offer competitors its retail services at wholesale discount reflecting its cost savings from delegating the retailing functions
  - *Unbundled Network Elements* (UNEs), including the Platform (UNE-P): must be offered to competitors at cost-based prices (TELRIC)
- **Rationale for resale or partial-facilities competition**
  - Price and variety benefits in the entered segments
  - Assists transition to full facilities competition by letting entrants economically share incumbent infrastructure until their customer base grows
- **Risks**
  - Discourage investment in the shared facilities if access prices set too low
  - Costs of implementing network sharing: technological costs and disputes, rise as number and complexity of unbundled elements increase
  - Perpetual regulation / no end game. Network sharing can create constituency of competitors dependent on ILEC.

The Record, from 50,000 Feet

- **Resale competition minimal**
  - Insufficient wholesale discounts, and / or little scope for entrants to add value
- **UNE competition**
  - UNE-P quite "successful" while rates were attractive: AT&T, MCI captured millions of local customers; collapsed once courts ended UNE-P
  - Facilities unbundling fairly minimal (e.g., few unbundled loops)
- **Integration of retail local & LD services, suggestive of efficiencies**
  - RBOCs very successful in capturing LD customers; little or no evidence of access discrimination against IXCs ("leverage").
  - RBOC advantage came mainly from offering both LD and local services
  - Some evidence of network-integration efficiencies post SBC / AT&T merger

- **Facilities based competition overall quite effective**
  - Business customers
    - Considerable competition, relying partly on established ILEC facilities (e.g., special access) that are relatively easy for regulators to police
  - Residential / mass market: mainly cable (also wireless)
    - Somewhat slow start for cable telephony
    - But accelerated with push into Internet broadband access — competition in bundled services (broadband access plus voice)
    - Accelerated dramatically of late with rise in VOIP

LOOKING FORWARD

Broad Lessons from the Record

- **Forced network sharing is quite problematic**
  - Technical obstacles considerable, whether contrived or inherent:
    - UNE-L: difficulties with hot cuts
    - Operations Support Systems (OSS): large costs and delays in developing these complex new systems for entrants to interface electronically with incumbents
    - Develop new performance measures; interpret reasons for "poor" performance
  - Pricing disputes — lengthy and costly:
    - Partly due to lack of specificity in the Act
    - Partly inherent in US system of shared jurisdictions (FCC, courts, states); if it *can* be litigated, it *will* (and in US, most things can...)

- **Facilities based competition is powerful, and requires much less intervention**

  - Cable broadband's central role in fostering competition in voice services highlights an additional point: regulators' "surprise" at direction of technology and mix of services

    - 1996 Act was largely voice centric, overlooked the growth of the Internet — and its implications for competition in multiple services over same facilities

Some Implications for Future Policy

- **Intrusive access regulation should not be the first resort — mainly a backstop if facilities competition is ineffective**
  - Act takes important philosophical step: expressed preference for relying on competition, and using regulation only to facilitate / protect competition
    - Heavy regulation, despite its costs, may be justified if faced with an enduring bottleneck; but there should be a healthy reluctance to go down that path if competition is feasible
    - Forbearance provisions in the Act are critical: regulatory obligations should be revisited as conditions change and competition develops

- **Net Neutrality debate: intrusive access regulation is premature at best**
  - *Different context* than local competition debate — protecting content and applications providers (CAPs), not assisting broadband competitors; but similar approach of requiring complex access regulation
  - *Costs of intervention* are likely to be substantial — "regulation lite" rarely is…
    - Technology of IP networks is complex and evolving; intrusive regulation into traffic management and network design threatens various integration efficiencies and network innovations. Hard to regulate new, complex arrangements, as post 1996 record shows.
    - "Non-discrimination" requirements are likely to produce excessive uniformity, or squabbles over price differentials for differently situated parties

– *Benefits from intervention* at this stage are dubious:

- Broadband providers are only minimally integrated into IP content / applications; no "dangerous probability" of monopolization

- Imposing charges on CAPs is not a core competition issue, and is neither presumptively inefficient nor harmful to consumers

- Perhaps most importantly, broadband access is not a blockaded monopoly: substantial competition between cable and DSL, and scope for further competitors; entirely premature to assume that heavy regulation is needed.