

Winning Ugly

The 1996 Telecommunications Act was not pretty.
But its obvious flaws should not hide the lessons behind its subtle successes.

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It is not news that the Telecommunications Act of 1996 was less than a miracle cure for the dual maladies of monopoly and over-regulation in telecommunications markets. That story should have been written before the Act was signed into law, when special interests were defending their turf against more aggressive reforms. What is newsworthy in the five years since enactment is that some aspects of the law have actually worked pretty well, and that we can learn a lot from comparing these successes to the flops.

Five years out, these look to be the big-ticket economic achievements of the Telecom Act: abolition of monopoly state telephone franchises; striking down the ban on telephone company provision of video service; and cable rate deregulation. And here are the apparent failures: using permission to compete in long-distance as a carrot to entice Regional Bell Operating Companies (RBOCs) to open local markets; “unbundling” local telephone networks at any feasible point for resale to competitors; and Open Video Systems, a common carrier approach for new cable television competitors.

While long distance telephone rates have fallen sharply in the last five years, consumers would clearly enjoy additional competition. Indeed, 20% of New York households subscribe to Verizon after just one year of providing long distance service and one million households have rushed to SBC long distance in the Lone Star State in just four months. But RBOCs offer long distance service nowhere else – banned by law. The Telecommunications Act erected a 5-year-plus

obstacle course for the Bells to traverse to gain entry rights. We do not know if this is helping speed local competition, as it ostensibly aimed to do, but we can be certain it has retarded long distance rivalry. Prices would fall even faster were RBOC entry permitted.

In local phone markets, the elimination of state monopoly telephone franchises has been a very positive development. Yet, the unbundling procedure, crafted to speed new competitors into the market by allowing use of the incumbent phone company's network at regulated (cost-based) rates, is a shambles. Competitive local exchange carriers have made a courageous run at the market, and invested billions. But equity values in Year 2000 plummeted (absolutely and relative to even the poorly performing Nasdaq). Financial markets have learned that businesses based on renting key infrastructure from one's rivals are difficult propositions. Capital investments will not be optimized for the reseller, and coordination problems abound. Most fundamentally, entry is completely free – an appealing textbook notion actually destructive of investment incentives. When a firm's business model can be duplicated by simply leasing the same infrastructure at equal (open access) terms, long-term capital gains are elusive.

Facilities-based competition, however, is alive and well. Firms building competitive delivery systems had a bad 2000, but not a disastrous one. Wireless access providers Winstar and XO remain healthy, as are fiber-link owners Level 3, Metropolitan Fiber Systems, Williams, and Time

Warner Telecom. Compared to the virtually universal financial devastation wreaked on the resellers of digital subscriber lines (the four leading DSL wholesalers, Covad, Rhythms, Network Access, and NorthPoint all lost over 95% of their market value in the last few months of 2000, and NorthPoint is now in bankruptcy), constructing a rival network appears the more protean route to competitive success.

Cable television rate controls were eliminated by the Act as of March 31, 1999. Incredibly, rates have risen far less in the 21 months since (using the most recent CPI data) than they did during the six and a half years they were regulated following the 1992 Cable Act (annualizing and subtracting the overall rate of inflation). The controls were not merely ineffective, however, as they also discouraged investment in cable systems, programming, and service upgrades. Now, with controls moot, cable operators are expanding into digital services and providing broadband Internet access to millions of households.

In some markets, cable companies are getting competition from new rivals. The Telecommunications Act eliminated the telco-cable cross-ownership ban, allowing phone companies to provide cable TV service to local customers. This has had a surprising effect. While Ameritech (now part of SBC) took advantage of the reform to provide cable TV to about 250,000 households, the big impact has been to welcome over a half-dozen well-financed new "overbuilders" into the market. Firms like RCN and Western Integrated have invested several billions of dollars to provide head-to-head competition to both phone and cable monopolists in cities such as Washington, DC, Boston, Philadelphia, Los Angeles, Denver, Dallas, and Chicago. It will take several years before these build-outs near completion; recall that the initial cabling of America took decades. But the competitive pressure that these upstarts, with modern systems and bundled voice/video/data services, bring to erstwhile monopolists far

surpasses the trivial – or counter-productive – impacts of either the 1984 Cable Act or the 1992 Cable Act, both of which promised to promote new rivalry.

Meanwhile, Open Video Systems – the "unbundled" approach to cable competition – has lagged behind. Just 60,000 customers nationwide are served by this method of programming delivery. Compared to the millions of households offered competitive cable service by plain old cable franchises, the experiment in separating conduit from content in video has once again, as in the nine years of "video dial-tone" rule makings that produced lots of paper but few subscribers, proven a failure.

The success of the Telecommunications Act is in encouraging facilities-based rivals. That more competition has yet to materialize is attributable to the Act's restrictions on long distance entry, its timidity in opening local cable markets (still restricted by anti-competitive municipal rules and state "level playing field" statutes that protect incumbents), and its primary omission: not unleashing wireless. A phalanx of new fixed and mobile wireless providers could energize market rivalry if only the spectrum hoarding of the Federal Communications Commission were quashed. That bold step, however, awaits the Telecommunications Act of 200x.

