



Telecom Crisis

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Outline

- Problem
- Current Situation
- Possible Resolutions
- Conclusion



Problem: supply side

- Excessive investment during late 1990s
 - New entrants
 - Just as cheap to install 266 strands as 24
 - WDM technology increased supply of bandwidth
 - Glut in long haul fiber capacity, though some other aspects are poorly served
 - Metro fiber is still in short supply in some places



Problem: demand side

- Much less demand than forecast
- “Internet traffic doubling in 90 days”
 - Not true, though probably doubling every year (*not* 16-fold growth!)
- Video on demand, broadband to the home, ubiquitous teleconferencing, etc. never materialized



Resolutions?

- For many firms total cost $>$ revenue which is not viable
- So must either increase revenue or decrease costs...



Enhance revenue?

- Unattractive options
 - Price supports?
 - Change merger guidelines to allow sufficient oligopoly power to push prices up?
- Attractive options
 - Encourage new services to cross subsidize losses on legacy investment
 - Example: camera equipped cell phones



Residential broadband won't bail us out

- INDEX project (1998): measured how much users were WTP for 128 Kbs service
 - Small WTP for broadband with current apps,
 - Except for home office workers and telecommuters
 - This was pre-Napster, pre-KaZaA, but point still holds...
- Some demand, but saturates at 15% of households at current prices...



What residential broadband needs

- Compelling applications
 - Copyright violations are killer app, but...
- Lower price
 - \$25 is good price point, more than \$30 won't work
 - Look at rest of world...
 - Prices in US have been going up!



Reduce costs?

- Cost reduction
 - Reduce operating costs? Great, but how?
 - Reduce fixed costs?
 - Mark fixed assets to market (aka bankruptcy)
 - Shareholders lose, bondholders lose, public gets cheap telecom



Problem with bankruptcy

- Competitive bankruptcy
 - If competitors cut costs by going bankrupt, I want to as well
 - This was endemic in 1890 railroads
 - Could easily happen in telecom...
 - Interaction with corporate organization?
 - Bundle losers into subsidiary, and go bankrupt?



What can FCC do?

- Try to reduce transactions costs of financial reorganization
 - Clear guidelines for asset transfer
 - Perhaps even explicate process (auctions?)
 - But be warned about competitive bankruptcy!
- Better to reorganize losses sooner than later
 - S&L v Japanese banks
- Encourage development of complementary services as new profit centers



Summary

- No easy answers
- Better to recognize losses sooner than later
- Should not relax antitrust/merger guidelines
- May be able to facilitate financial reorg
 - Be aware of competitive bankruptcy