

Dealing with the Telecommunications Industry's Difficulties

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Overview

- Many parts of the telecommunications industry face serious financial difficulties, as a result of
 - Large expansion of fiber-optic cable capacity and complementary components
 - Rapid technological improvements in the use of that capacity
 - Much slower growth in demand
 - Slowing of U.S. economy
 - Corp. governance & accounting revelations

No magical, painless solutions; but three important principles

- Acknowledge and recognize losses and the pain – and move on
- Follow good antitrust principles
- Do not delay efficiency-increasing developments in spectrum allocation and usage

Acknowledge losses (1)

- The losses are unavoidable; *they must be absorbed by someone*
- Owners-shareholders first; then lenders-creditors
- Sooner and faster is better
 - Companies and markets can then recognize true prospective marginal costs
 - Lower prices, expanded demand, greater utilization, greater economic efficiency

Acknowledge losses (2)

- Delay will stretch out pain but not avoid it
- Investors do not “deserve” a return
 - They make risky investments; often they succeed; sometimes they lose; that’s the way a market economy should function
- *To prop up losing investors is to “privatize the gains, socialize the losses”*; this is a recipe for inefficient decisions and inequitable outcomes

Acknowledge losses (3)

- Sizable bankruptcies already; possibly more to come
 - Bankruptcies need not mean the shuttering of a company, so long as the company has prospective value
 - Bankruptcies provide resolution – moving on

A past example: late 19th century railroads

- Overbuilding, and slower demand
- Bankruptcies
- Surviving railroads
- Rail sector became the core of passenger and freight transportation in the U.S. for the next half century, and remains central to freight transportation today

A recent example: S&L debacle

- Excessive commercial real estate investments, and inadequate safety-and-soundness regulation in the early 1980s, resulting in
 - Overbuilt, overpriced commercial real estate
 - “See through office buildings” in the sun belt, circa 1986
 - Hundreds of insolvent S&Ls

S&L debacle (2)

- Political pressures to go slow, permit time for conditions to turn around
 - Fears that selling commercial real estate would only depress prices further
- But markets already knew that there was a commercial real estate overhang
- Delay would have allowed more risk-taking by insolvent S&Ls and a continued overhang of real estate

S&L debacle (3)

- The clean-up of insolvent S&Ls took longer than it should have, but it finally did proceed expeditiously
- The RTC moved expeditiously to dispose of the commercial real estate that it inherited from insolvent S&Ls
- Rapid actions helped both sectors emerge stronger and sooner

A current example: Japanese banks

- After the Japanese stock market and real estate market bubbles popped in early 1990s, Government of Japan should have
 - Forced banks to acknowledge losses
 - Dealt expeditiously with insolvent banks
 - Found new owners for insolvent banks
- Japanese banks could then have resumed their lending role to the Japanese economy

Japanese banks (2)

- Instead, the Japanese Government dithered
- When actions have been taken, they have been too little and too late
- Japanese banks remain saddled with bad loans on which they have not yet fully recognized losses
- Banks remain moribund and reluctant to lend
- Japanese economy remains stagnant

Follow good antitrust principles

- Some consolidation is warranted
- Financial difficulties are not a good excuse to abandon sound antitrust principles
- The DOJ-FTC “Horizontal Merger Guidelines” provide sensible guidance to permit efficient combinations and avoid the creation of market power
- Slack antitrust standards for railroad and airline mergers have had unfortunate outcomes

Don't delay efficiency- increasing developments for spectrum

- Substantial improvements continue to be possible
 - Improved technologies
 - Improved regulation and deregulation
- Don't delay because of feared effects on fiber-optic cable
- Spectrum auctions are a good start
- “Propertyze” the spectrum

Conclusion

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- Follow good antitrust principles
- Do not delay efficiency-increasing developments in spectrum allocation and usage