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## Refuting the New Anti-Competition Mantra

*By Terrence L. Barnich and Craig M. Clausen*

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It has always been fashionable to decry the state of competition in the local exchange. Its absence has been cited as evidence of the monopoly stranglehold maintained by the incumbent local exchange carriers (ILECs), and its desirability was justification for the passage of the Telecommunications Act of 1996. Curiously enough, today's newest fashion, most notably among certain Washington pundits, is to cite the lack of competition as evidence of inherent natural monopoly characteristics of the local exchange.

In short, the argument goes something like this: Congress passed a law whose intent was to foster competition in the local exchange and preserve and extend universal service. Two years later, full-blown, ubiquitous competition has not flowered and the fledgling competitive local exchange carrier (CLEC) industry is dangerously consolidating. Therefore, the law has failed and the prospect is that the local exchange will remain secure largely in the monopoly fold with only a few niche markets held by behemoths such as AT&T Corp. and WorldCom Inc., which will have swallowed or pushed out of business all the traditional CLECs.

Balderdash!

The implication inferred from the evidence is that the CLECs and local competition will prove to be anomalies, soon to fade from the radar screen. We, however, look at the same evidence relied upon by the naysayers and argue that, properly understood, it supports a rather encouraging CLEC future. Let's walk through the arguments and countervailing evidence.

**Argument #1: Competitors won't serve all customers.** This is a variation on the monopolist "obligation to serve," "cherry picking" siren song. You know, that's the one about how only the well-heeled businesses get competitors' juices flowing. It is indeed a truism that any market opening to competition will first address the most profitable segments. Perhaps surprisingly, CLECs have found this to be the small- and medium-sized businesses, which have been largely ignored and underserved by the ILECs. However, competition will spread to the large business market as well as to the residential consumer. As CLECs grow further, they will--driven by shameless capitalism--address each and every market.

The real implication behind the charge is that CLECs can't profitably serve the residential market. Well, that argument doesn't quite square with the likes of RCN Telecom Services, Inc., Conectiv Communications, Inc., 21st Century Telecom Group Inc. and McLeodUSA, all of whom are targeting residential customers. Even poor-credit residential customers are being targeted. For example, Texas Comm South, operating out of Dallas, offers prepay telecom services to high-risk, low-income residential customers--the stereotypical communications "have nots."

Giving lie to the myth about the burden of the obligation to serve is Section 102 of the Telecom Act, which essentially permits a carrier straining from the burdensome yoke of being the carrier of last resort to opt out in favor of another carrier, who then becomes a last-resort provider or eligible telecommunications carrier (ETC). Last time we looked, there weren't long lists of requests from ILECs seeking to offload underperforming exchanges. On the other hand, some state public utilities commissions (PUCs) are entertaining inquiries from competitive carriers to take over ETC status in some areas. Also, we note that the going price for recently sold rural telephone exchanges is now about \$3,000 per line--and climbing. The market isn't exactly finding these businesses burdensome or valueless.

**Argument #2: The policy of universal service undermines the efficiency of the competitive marketplace and can't be sustained.** Often heard from the economic libertarian think tanks, this argument posits the incompatibility of a pricing system half-free and half set by government decree. However offensive to the free market purists, there's no evidence to support the notion that the contradiction between a competitive market and subsidized services, or even averaged pricing, will ultimately frustrate the emergence of an open, competitive marketplace. Gayle Schwartz of Teleport Communications Group Inc. (TCG) has argued quite persuasively that targeted, competitively neutral subsidies such as "phone credits" can coexist in a competitive telecom world as long as they are explicit and targeted users. We would further note that the existence of food stamps has not been a detriment to a robustly competitive grocery store industry.

**Argument #3: Despite all our intentions and expectations, two years after the passage of the Telecom Act there is but a marginal increase in competition.** This argument says less about the failure of competition than it does about the parochialism of Washington, the lack of historical perspective regarding the time it takes to deregulate network-based monopoly industries and our era of "instant gratification."

Just because the politicians and their hangers-on decree, "Let there be competition," doesn't mean it will immediately come to pass. Some critics predict that widespread competition won't be a reality for five to 10 years, and to them, that's simply unacceptable. Excuse us for injecting some historical insight, but in deregulatory network industries such as airlines, railroads, natural gas and long

distance telephone service, five years is the blink of an eye. Divestiture began in 1984, yet AT&T's market share didn't dip below 50 percent until 1997. The natural gas pipeline industry was deregulated beginning in 1983, yet states are just now experimenting with offering residential customers a choice of suppliers. So, for the local exchange, open for only three years, what's the panic?

**Argument #4: The CLEC industry is consolidating and being subsumed by large long distance companies that are trying to reconstitute Ma Bell.** Sure, Brooks Fiber Properties Inc. ate City Signal, which in turn was eaten by WorldCom Inc., which then gobbled MFS Communications Inc., and TCG ate Diginet Inc., Eastern TeleLogic Corp. and BizTel Communications Inc. before merging with AT&T Corp. But this is an industry that counts among its members some 100 companies. Certainly, the question of how many is enough is a significant one, but we shouldn't confuse perfect competition with unlimited numbers. In any restructuring industry there will be some consolidation. Economists call this process "reaching equilibrium," which recognizes that the substantive objectives of the competitive market extend beyond mere nose-counting.

Furthermore, these latest consolidations have had a palpable fertilizer effect for a whole new crop of CLECs that have sprouted from their unions. From the ranks of MFS alone, for instance, come the founders or key executives for Allegiance Telecom Inc., Focal Communications Corp., Level 3 Communications Inc. and OCI Communications Inc. We fully expect to see similar seeds sown as other CLEC executives strike out on their own with innovative ideas for attacking new niche markets in the local exchange.

These consolidations also have fired up a significant amount of risk capital that is not content mingling with the "widows and orphans" motivations of investing in AT&T. And as Royce Holland, CEO of Allegiance, has previously pointed out, there are a good number of customers who prefer the small, upstart entrepreneurial companies, thus creating a demand-driven market for a proliferation of companies beyond AT&T, SonyCom, Citicorp, WorldCom and PacBell, Atlantic HealthCareCom, for example.

We believe the operational indices, and points of validation, in this industry--market share growth, movement toward profitability, line deployment, minutes of use--which are all growing at exponential rates, are reliable trendlines forecasting continued success. Facilities-based competition continues to grow, taking advantage of new niche opportunities and presenting consumers with new, enhanced choices. Companies such as Allegiance, Focal Communications Corp., Level 3 and NewSouth Communications LLC all represent new, viable opportunities for consumers. These opportunities include new and more reliable services, lower prices and continued technological developments that finally will bring us into the true information age. As has been the case in other markets opened to powers of competition, these benefits of competition will reach all telecom consumers. Five to 10 years is not an eternity to wait for competition to find its way to all end users.

All the teeth-gnashing and fevered naysaying really needs some cooling down and then to be recognized for what it is...propaganda for a political purpose.

*Terrence L. Barnich is president of New Paradigm Resources Group, Inc. (NPRG) and Craig M. Clausen is its senior vice president. NPRG is a Chicago-based consultancy focusing on CLEC developments and competitive issues. NPRG produces "The CLEC Report™" and can be reached at (312) 980-7848.*