

The Rise of Globalism in Communications

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## **The Rise of Globalism in Communications:**

*"Don't get stuck with the Old Kent road".*

*"Two Lessons from Europe"*

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## INTRODUCTION.

When I was young, there was a very popular game call Monopoly. Now even as a child you very quickly learnt that the person who normally won was the one who bought the two dark blue ones at the end of the fourth side of the board just before "Pass Go, collect £200".

On the English version these two properties are called Park Lane and Mayfair, on the American version I think they are called Boardwalk and Park Place from Atlantic City. But what was interesting was the reaction of the player who landed on them. There was no hesitation. You simply yelled out "BUY IT". Moreover if you then sold it, you sold it for a song.

Now, I think that something like that is going on in the Communications sector, not just in the US but in Europe too, although for the moment there is less to buy in Europe.

What is driving this is the expectation of regulatory constraints being lifted; in the US the constraints are the divisions between telephony and entertainment and between local or regional and long distance; in Europe the constraints to be lifted are the geographical divisions on the provision of telephony service but with the prospect also of a loosening of the rules on infrastructure in Germany, Holland, perhaps France, increasing competition on mobile or personal communications and with a Competition Commissioner in Brussels who is sympathetic to the views put by the Cable TV companies, who wish to supply telecommunications services.

No-one knows exactly where they want to go or what business they want to be in but no-one wants to get caught with the Old Kent Road. In other words no-one wants to stick with what they have at the moment or even worse, a share of what they have at the moment.

## THE STAKES ARE HIGH

The stakes are clearly very high. They can be measured in a number of ways, in terms of service revenues, in terms of company turnover, in terms of earnings, in terms of traffic carried or traffic shares or in terms of the amounts required to buy a shareholding or merge - see Annex tables.

In Europe we are still in single billion figures. The sale of a third of the Hungarian PTO was expected to raise about \$1 billion, now estimated to be just over half a billion dollars. The sale of a 30% strategic share of OTE, the Greek TO, now on hold after

the elections, was expected to generate \$1,5 billion. But these are small operators. On a grander scale the last tranche of BT raised about £5 billion. The partnership between BT and MCI involves BT paying \$4,3 billion for 20 per cent of MCI and an investment of \$1 billion in a joint global services company. And there are bigger fish to come. Injections of 50 per cent private capital in Germany, France, Holland, Belgium and Denmark and increases of private shareholdings in Italy, Spain and Portugal would raise in the region of 50 billion dollars.

In the US, you are already in to tens of billions; AT and T - McCaw, Paramount and now Bell Atlantic - TCL. And we are clearly not finished yet. But I think one of the more interesting recent ones is George Soros buying a stake in the resale operator, Viatel. In Europe, we always watch very carefully when George Soros starts selling something. So I think we should also watch when he starts buying something.

As a policy-maker or a sector analyst, there is clearly no point in swimming against the current. In fact, much of this is happening because of policy changes or in anticipation of policy changes even if some of the activity and interests are forcing the changes.

#### PRIVATISATIONS, RESTRUCTURING AND COMPETITION POLICY

What is interesting in the telecommunications sector is that a number of forces are underway at the same time. Some of the traditional ties between operators and equipment suppliers are loosening. There is the beginning of geographical diversification and in Europe of privatisation to respond to multinational customers and financial requirements respectively. The technological changes are also forcing operators and suppliers into each others territory. And finally there is the prospect of substantial facilities based competition.

In Europe we eagerly await the privatisations or partial privatisations. This is an important complement to the separation of operational and regulatory activities in Europe. Both are indispensable for integrating the sector into normal commercial activities, in allowing adjustment, flexibility and independent management and injecting private finance where it is needed.

At the same time the forces involved are overwhelming from a regulators point of view. And they risk clogging or even rupturing the competition or anti-trust machinery.

The first big challenge in the Community has been the BT-MCI notification, numbers 4 and 5 with respect to world international traffic, but subject nevertheless to significant competition in their domestic markets and free of any vertical integration. Now a more difficult possible question looms with talks between numbers 1, 2 and 3 - number 1

being a well known US operator and numbers 2 and 3 being well known TOs from continental Europe. The Community anti-trust machinery, sophisticated as it may be, is not ideally designed to deal with such a situation. There are no easy rules or algorithms to apply.

It may be that the joint venture interests of these companies will be restricted to certain international service areas where the competition though thin does nevertheless exist and companies do have alternatives. However, on a more basic level a possible link-up is almost unprecedented in any sector. These three companies together account for a third of the world's international outgoing traffic and fifty per cent of combined North American and European Community traffic. The five operators together account for two thirds of combined outgoing North American and European traffic.

That really makes Tom McCabe's activities with Swiftcall look like a drop in the ocean. Or to put it another way, you still can't yet get call divert or call waiting in most of Europe and yet there is the prospect of the three biggest operators joining forces.

#### A MORE RIGOUROUS EXAMINATION OF GLOBAL SERVICES.

As the authors Kramer and Ní Shuilleabhain point out, the genuine global services market is still underdeveloped; 5 billion dollars or 1 per cent of the world telecommunications services market would be a reasonable assessment.

But surely this begs the question of how non-domestic or extra-territorial turnover is measured. Are the 50-60 billion dollars of international telephone services domestic or global or something in between.

We have encountered this problem in the Community in connection with the merger rules. Mergers escape scrutiny by the Community merger rules unless at least two parties have Community turnover in excess of 250 million ecu. Thus a venture which is construed as a merger between BT and MCI or between AT and T and France Telecom escapes the merger rules, except to the extent that AT and T's equipment operations in Europe are included. However, a merger between two small Community TOs would fall under the merger rules.

But let me return to genuine global services. During the recent Telecom Review on telephone liberalisation, we had an interesting submission by Reuters which some of you may have seen. They gave an estimate of what their private network cost in

Europe relative to that of an equivalent N. American network. The answer was that the European network cost 10 times the N. American one.

What was interesting was that the excessive price did not seem to be their main concern. I presume this is because they felt, perhaps quite rightly that no-one else could do any better than them. What they did seem more concerned about was reliability because their capacity to run their business effectively depended on a network performing reliably and predictably.

I think this gets at the necessary or even the sufficient conditions for what is required to see a growth of genuine global services. A given communications demand is no more than a mixture of voice, data and image transmissions in real time or not in real time. To achieve this there are a number of substitutable products. It can be sent over the public switched network or over private circuits. It can be managed by the operator or operators or by the company itself or by someone else. And there can be some tailor-made bits depending on, for example, the terminals that you use or your requirements for data transmission.

Now what is hampering this in a cross-border or non-domestic or global situation is that it is only rarely that someone can offer a very good price or very good reliability and it is not yet the case that anyone can offer both.

#### PRICING BANDWIDTH

So clearly reliability or control over facilities is important. But surely price matters as well. If Bandwidth was priced more aggressively, then would not applications multiply and not simply be confined to demands from research programmes in theoretical physics and chemistry.

If the UK police who spend 30 million dollars per year on communications can move to 34 Mb LAN interconnect then why don't a considerable number of private sector companies do likewise.

(At the moment the pace of migration is relatively slow. Club Med have just announced a contract with SITA for managed voice and data but for their constant spend of 145,000 dollars a year they simply get twice the capacity that they had on their leased lines.)

What I suspect is necessary, therefore, for a substantial expansion of global service is control over facilities or infrastructure. And I suspect that this is not a sufficient condition. A sufficient condition might be competitive provision of infrastructure in

order to get competitive pricing on bandwidth. And even that might not be sufficient because genuine local presence may also be important.

So the reasons behind the slow growth of cross border services, particularly corporate services, in Europe are also at the root of the slow development of global services. The large VANs suppliers have a local presence but they don't have control over infrastructure. BT and MCI are developing infrastructure but they are not there yet. AT and T and on a smaller scale Unisource are going via operator partnerships but that does not necessarily solve the problem of aggressively pricing bandwidth and in any case the control over infrastructure is limited. Also in many cases, local presence is still very limited.

The alternative infrastructure providers such as the electricity and water utilities have not yet developed enough capacity in enough places and in any case international links are limited.

#### **EASY AT THE MOMENT FOR THE LOCALS TO FIGHT BACK**

In any case, it is easy for local operators to retaliate. Recently, SIP in Italy matched BT's offer of 30 per cent price discounts to Benetton and kept a key client. BT is offering Airbus a 19 per cent discount on their international account of 2 million dollars but France Telecom are likely to respond. The point is that very few companies have a sizeable proportion of international switched communications relative to their demand in one or two domestic jurisdictions. And there, often a single operator has control over infrastructure.

#### **INTERNATIONAL END TO END CONTROL IS USEFUL BUT FOR OTHER REASONS**

The other important development in the international arena is the desire to control end to end communications. This is happening in two ways. The first is by securing rights for future intercontinental cables. For example, Cable and Wireless has rights between Australia and New Zealand, which it has not yet exploited.

The second is by buying into operators at the "other end" of an international route. Examples of this are European or N. American operators buying into operators in Latin America or in C. and E. Europe. The most active operators here, on the fixed network side, seem to be Telefonica, France Telecom and Deutsche Telekom but STET and Marconi, Portugal are also active. The regional Bell companies have been more active in the mobile or cable TV area.

Now these are all regional or global strategies of different kinds. But I would argue that in some instances this has got less to do with global service provision and more to do with capturing some of the accounting rate revenues that are being given away to operators outside the OECD area or in extending monopoly pricing on international routes to the other side of the relation.

This can sometimes be quite a lucrative business when a substantial ex-patriate population is involved. AT and T efforts to capture a bigger share of traffic generated by service personnel in Germany is a case in point and the possibility of Cable and Wireless taking a share of the payments of American operators to the Philippines is another example.

### OTHER LESSONS FROM EUROPE

I should perhaps say something about Community policy on international communications.

Clearly there is a particular position in the context of GATT. But I think the most important thing is what will be negotiated after GATT, and there the most important aspect concerns the question of trade or access on basic services.

### THE PRESSURE OF RESALE ON ACCOUNTING RATES

Now in one sense, the Community or European situation after 1998, if not before, will be relatively liberal. On the one hand resale will be allowed up to the local premises, in other words there will be no restrictions on transporting within the equivalent of a LATA. On the other hand, and more importantly resale will be allowed across borders or between European nation states.

Two things are important here. First of all, resale will put pressure on accounting rates. In fact I would go so far as to say that they might disappear completely. Already in Europe we no longer have a system of accounting rates which are shared between operators but rather a system of termination charges which are effectively an average per minute charge for terminating calls to any domestic connection. In Sweden they have actually used the international termination charge paid by the other Nordic operators as the basis of interconnection for the second domestic operator.

The prospect then of international resale between 16 to 18 European countries plus resale arrangements with N. America, Australia and New Zealand brings a large proportion of global traffic into a new framework.



Now it could be a simple resale framework or it could be a more substantial interconnection framework and here I would suggest that Europe also has a model.

### THE ONP FRAMEWORK

The Community ONP Framework, the counterpart to ONA in the US, has been designed with a number of concerns in mind. One is with access to facilities, essentially bottleneck facilities or facilities in the hands of dominant providers. The second is with harmonising certain offerings or interfaces between national networks - both what you get and how you get it.

But the advent of full services liberalisation is expanding the role of ONP. First of all it will safeguard user interests such as supply conditions and universal service provision. Secondly, it will govern interconnection and access charges and related cost and accounting principles between network operators. In that sense within the Community, it becomes a trans-national guideline for interconnection and access once resale comes about and the traditional systems start to break down.

That would also incidentally imply that we should expect to see the equivalent CEPT organisation try to regain control in this area in the same way as it has made efforts to regain the policy initiative in the frequency and numbering area. The ITU, spurred on by the OECD, and TEUREM is making efforts to reform and update the accounting rate framework but I really believe that their efforts will be overtaken by events.

### CONCLUSIONS

I have essentially made two points.

The first is that the take-off of genuine global services requires greater control over cross border facilities plus competitive bandwidth pricing within such a framework. It probably also requires greater local presence. At the moment no-one really has any of these things and alliances between monopoly operators are not going to provide the right conditions, at least not for aggressive pricing of bandwidth. In that sense, the lessons from the lack of cross border or pan-European corporate services are paralleled in the global situation.

Moreover, as I have shown with the SIP example, it is always possible for the domestic operator to respond.

But the second point concerns the erosion of national power in the international context by moves towards international resale and then more nation states adopting facilities liberalisation.

Services liberalisation by 1998 in the Community and the consequent spread of international resale to a large part of the OECD area will move international traffic into the interconnection and resale domain and out of the traditional accounting rate framework. In the Community, the interconnection and access rules will be formulated within the context of ONP. This means that such a framework will cover 18 countries of the Community (probably by then enlarged) and current EFTA with a combined population of 380 million.

In this context, the ONP framework could provide a substantial influence on a global or GATT framework of trade in basic services.

If finally you ask the question when will there be some facilities competition in and between the countries that comprise the main traffic streams, (i.e. North America, the UK, Germany and France) then we are at most five years away. However, I suspect some bottlenecks in terms of ownership or cross-ownership restrictions will be with us for some time.

It is for this reason that I can go back to my analogy at the beginning and say that when the opportunity presents itself, some buying will take place. In that sense the real estate comparison is valid. If on the other hand, there is land released for new development, we don't have to worry - you can always build a new Park Lane and rent it out.