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Unleash Growth--Deregulate Telecom Now

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I have great news. I have found the free lunch that economists are always looking for. A policy that will spur capital spending, increase growth, create jobs, reduce inflation, and help us remain the dominant economy in the world. It will even shrink the budget deficit. All we have to do is deregulate the telephone sitting right by your elbow.

High speed communications technology has produced huge productivity gains for the American economy in recent years by making *large* American companies much more efficient producers. Making high speed communications available to *small and medium sized businesses and households*, by replacing copper wire with fiber optic cable, will produce even larger gains in the future. But invasive regulations, price controls, and a dysfunctional policy process have created a state of confusion in which no responsible business manager can see far enough into the future to approve the almost $90 billion in capital projects needed to make it happen. Unless someone replaces policy confusion with clarity those investments will never take place.

The telecom industry today is frozen in a state of nuclear winter. Investment in telecommunications infrastructure has collapsed from $118 billion in 2000 to just $45 billion in 2003. The eye of the hurricane is wireline investment—the lines that bring phone service to your home or business—where capital spending fell by almost two-thirds over the same period, from $85 billion to just $30 billion. One half the nation's fiber optic plants are closed, 75% of fiber optic workers have been laid off. R&D budgets at Lucent and Nortel have been slashed by a third. Equipment manufacturers like HP and Dell and software companies like Microsoft are shifting operations to China, India, and Malaysia. Market capitalization in the telecom industry fell $2 trillion. 500,000 people lost their jobs.

It's no surprise, in light of this telecom capital spending depression, that growth is weak for the overall economy. The Commerce Department reported last Friday that GDP grew by 3.3% growth in the second quarter, about half the normal growth we see in the first year of a recovery. Worse still, defense spending was responsible for 1.7% of that growth—ex-defense the economy grew at a meager 1.6% annual rate. There are bright spots—the dividend tax cut has pushed stock prices up 20% since spring. But the incredible American job machine just isn't working.

This is a big problem for President Bush and the congressional class of 2004. Three million workers have lost their jobs in the 30 months President Bush has been in office. Weak growth has undermined tax collections which, along with the politically contentious costs of policing the gulf, have pushed the budget deficit to nearly $500 billion. The President has responded with a growth program and has appointed a manufacturing czar. Treasury Secretary Snow has been traveling the world talking the dollar down in an attempt to spur exports. Congress has passed laws cutting the number of skilled foreign work visas in half. None of these will do the job.

We need a policy that will increase capital spending, spur R&D efforts, boost growth, and generate enough tax revenues to decrease the deficit. That policy is telecom deregulation. Not the phony deregulation we have experienced during the seven years since the 1996 Telecom Act; real deregulation.

The productivity and growth boom of the 1990's was driven by the increasing speed and reliability of the telecom and technology networks. That productivity boom is still going on—the most recent figure is 6.8% per year. As American workers found out, productivity growth has a dark side too, at least in the short run. If the Federal Reserve fails to create sufficient demand to take the extra product off the shelves the result is job losses and deflating prices. But productivity is the engine of growth and rising living standards and the source of our dominance in the global economy. We need all we can get.

The future of telecom is high-speed communications—broadband in industry jargon. Last week the New Millennium Research Council released a study by Robert Crandall, Charles Jackson, and Hal Singer that showed broadband deployment to households alone would generate $140 billion in new investment, increase GDP by $414 billion, add $500 billion to consumer welfare, and create 2.7M new jobs over the next decade. All these things—growth, jobs, the profits from increased capital spending, and the dividends and capital gains earned by investors—mean increased tax collections and smaller budget deficits. These numbers would be still higher if they included the benefits of broadband deployment to businesses.

These estimates show what a wonderful world it would be if we had the policies in place to allow the broadband rollout to proceed. Alas, that is not the case. Instead, we have an almost Orwellian policy which forces some companies (the regional bell operating companies, or RBOCs) to build and maintain the network, then forces them to provide access to essentially all the elements of their business to other companies (AT&T, MCI and others) at discount prices set by local political authorities. The result, according to a Merrill Lynch report, is that RBOC earnings this year will be $2.3 billion lower than they would be in the absence of the FCC's forced sharing policy. This corresponds to more than $20 billion of lost market value.

These policies undermine capital spending—the capital spending we need to restore economic growth--by reducing the after-tax return on capital invested in future projects. The gridlocked FCC makes the problem worse. In February, the FCC released a four page preliminary summary of the rules it would impose on telecom companies regarding the forced sharing of network elements described above. Details were to follow shortly. The final order was not released until August 28, six months and one day later. Policy uncertainty of that sort erodes market value and stifles capital spending by causing investors to increase the risk premium they demand to offset the risk of having their capital appropriated by the regulators.

Policies which lower the return on capital invested in US telecom assets have an even worse impact in a global economy. There is an intense global competition for capital underway. The US and China are the two main contestants. Where US growth has slowed, China's has accelerated. Industrial production in china grew 17% in the most recent year. China is cooperating with Japan and Korea to develop new high-tech standards. They are taking steps every day to make China a destination resort for capital. They are succeeding. In recent weeks Nortel announced a new $200 million R&D facility at the Beijing campus, Lucent announced a $230 million contract with china United Telecommunications, and Intel announced their new high speed Itanium 2 chip will be used to network 100 Chinese universities.

It doesn't have to be this way. In a matter of weeks, the President and the Congress could direct the FCC to take the steps to clarify policy and turn telecom investment in broadband around. The resulting increases in capital spending and growth would fuel a second major wave of productivity gains over the next decade which, in turn, would help to keep inflation and interest rates in check, support higher stock prices, and generate the tax revenues we need to close the budget deficit. With the election just over a year away, this is one free lunch the Administration and Congress should eat quickly before it gets cold.