Mandatory Unbundling and Irreversible Investment in Telecom Networks (2003)

by

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ABSTRACT

This paper addresses the impact on investment incentives of the network sharing arrangements mandated by the Telecommunications Act of 1996, with a focus on the implications of irreversible investment. Although the goal is to promote competition, the sharing rules now in place reduce incentives to build new networks or upgrade existing ones. Such investments are irreversible – they involve sunk costs. The basic framework adopted by regulators allows entrants to utilize such facilities at prices reflecting what it would cost a new, efficient, large-scale network to be built. Such sharing opportunities are extensive, covering virtually the entire suite of network services provided, and extremely flexible, as the entrant can rent facilities in small increments for short duration, with no long-term contracts required. Because the entrant does not bear the sunk costs, this leads to an asymmetric allocation of risk and return that is not properly accounted for in the pricing of network services, which creates a significant investment disincentive.