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Abstract (Document Summary)

Broadband internet is a voracious user of capacity. A broadband user who regularly downloads films and music, plays interactive games, shares files with peers and uses internet telephony will generate 230 times as much traffic as a typical narrowband internet user. Given that 85 per cent of international traffic is internet and data, and assuming that half of internet users switch to broadband within five years, by the end of the decade international traffic will be 100 times greater than it is today. Even if one radically scales down these assumptions, the results are still enough to swallow up the present huge excess capacity. And on top of that, offshore economic activities and wireless calls will generate major traffic increases.

Will new investments take care of the problem? Yes, but with a twist. No sensible bank, junk-bond investor or board of directors will commit funds to yet another boom-bust cycle of over-investment and crashing prices. The most likely scenario is a recreation, in some form, of the traditional consortium system. Jointly, the leading telecoms providers will keep supply matched to demand trends and maintain prices at a modestly profitable level, just low enough to deter new entrants. We may witness again the emergence of a kind of Opec of international telecommunications. Less competitive? Yes. But also less volatile and risky and slower-moving, as multi-partner ventures between complex companies with multiple goals and strategies always are.

Full Text (717 words)

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A crucial factor in the recent rise of offshore outsourcing has been the rapidly falling cost of international telecommunications transmission. Prices of international circuits are today less than 1 per cent of what they were just six years ago. Many white-collar jobs involving transactions in information have become potential candidates for migration to cheaper locations. Distance is said to be dead. I am not so sure.

In the good old days, international telecommunication was dominated by a global cartel of national monopolists that used it as a cash cow to subsidise domestic services. This changed about 12 years ago when rival operators began to emerge, first in satellite communications with PanAmSat, then in transatlantic communications with Atlantic Crossing and its progeny. These companies operated outside the traditional club and challenged its high prices. Meanwhile, the traditional state monopolists were privatised and energised, and began to take each other on as well.

As the collaborative system broke down, capacity soared and prices dropped like a rock. Soon, profits vanished, new entrants collapsed in droves, incumbents were awash with debt and unused circuits, and investment came to a standstill.

Where are we heading now? The conventional wisdom is that the capacity overhang is so large, especially given our ability to squeeze ever more transmission out of existing submarine cables, that we have all we need. Prices, it is assumed, will keep dropping as the bankrupt carriers re-emerge with their debt wiped clean.

Yet important changes are taking place that may well drag the system in the opposite direction, towards a shortage of capacity. If this seems inconceivable, consider the following. Worldwide, the connectivity to broadband internet has been growing by leaps and bounds. In South Korea, more than 40 per cent of households have it. In the

US, Canada, Japan and some European countries that figure is around 20 per cent. Growth rates in many countries are well above 50 per cent.

Broadband internet is a voracious user of capacity. A broadband user who regularly downloads films and music, plays interactive games, shares files with peers and uses internet telephony will generate 230 times as much traffic as a typical narrowband internet user. Given that 85 per cent of international traffic is internet and data, and assuming that half of internet users switch to broadband within five years, by the end of the decade international traffic will be 100 times greater than it is today. Even if one radically scales down these assumptions, the results are still enough to swallow up the present huge excess capacity. And on top of that, offshore economic activities and wireless calls will generate major traffic increases.

At the same time, no new capacity is being created outside the Indian Ocean region. Any telecoms company contemplating a Dollars 500m multi-year submarine cable investment would be punished by Wall Street and the City.

Thus, a capacity shortage may well be looming and, with it, increases in prices. Technological tweaks, restrictions on video use, or a redesign of network flows - making them more local and less international - will merely postpone the inevitable.

Will new investments take care of the problem? Yes, but with a twist. No sensible bank, junk-bond investor or board of directors will commit funds to yet another boom-bust cycle of over-investment and crashing prices. The most likely scenario is a recreation, in some form, of the traditional consortium system. Jointly, the leading telecoms providers will keep supply matched to

demand trends and maintain prices at a modestly profitable level, just low enough to deter new entrants. We may witness again the emergence of a kind of Opec of international telecommunications. Less competitive? Yes. But also less volatile and risky and slower-moving, as multi-partner ventures between complex companies with multiple goals and strategies always are.

This will mean a step backwards from the golden but brief period of free-wheeling international competition. It also means that companies whose offshore outsourcing activities are predicated on continuously declining costs of international communications may find themselves disappointed. Distance might be ill, but it is not quite dead yet.

The writer is professor of finance and economics at Columbia University and director of its Columbia Institute for Tele-Information. A longer version of this article appears online as part of the FT's New Economy Forum at www.ft.com/techforum

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