

Regulation and Market Dynamics Panel Keynote

Remarks of FCC Commissioner Kathleen Q. Abernathy

ITU Asia Telecom 2002

Hong Kong -- December 3, 2002

As prepared for delivery.

Thank you very much for inviting me to participate in this panel.

Across the Asia-Pacific region, from Djakarta to Seattle, we share common goals of ensuring that our citizens enjoy the benefits of communications networks and services essential to prosperity. And we recognize that competition is uniquely suited to achieve these goals. At the same time, all of us are facing pressing challenges brought about by a challenging economic climate. I rely on ongoing discussions with my colleagues from around the world, most recently at the 2002 Plenipotentiary conference in Morocco, to help me navigate these uncharted waters. And I look forward to today's exchange of ideas and ongoing future discussions.

Our panel today is "regulation and market dynamics." I've thought a great deal about the current turmoil in the telecommunications marketplace and its implications for regulatory policy. Before getting into specifics, however, let me begin by offering some perspective. While I believe that we have suffered declines in economic growth, accounting scandals, and bankruptcies, there are a number of reasons to be confident about the telecom sector's long-term prospects. The robust and innovative Japanese experience with wireless applications offers evidence that consumers can and will embrace new technologies that speak to their daily realities. More generally, the Internet revolution may have slowed a bit, but it clearly continues. In the United States, overall Internet usage continues to increase at a rapid pace, and consumers are adopting broadband services, which will pave the way to a whole new world of applications. Korea, with its world-leading rates of DSL penetration, is already beginning to experience the impact of widespread broadband access. And more of the same is on the horizon, as the development of exciting new platforms to complement DSL and cable modem services; most notably, WiFi systems based on unlicensed radio spectrum are experiencing explosive growth.

Communications capabilities are such a fundamental part of the information age, and are so critical to economic health and development, that we are bound to see a rebound in the financial health of leading providers over time.

In the meantime, it is useful to try to understand the root causes of harsh dynamics currently shaping the market and to discuss what, if anything, regulators should do in response.

I believe that several factors are collectively responsible for the economic malaise the telecom sector has been experiencing. One factor is an apparent glut in the supply of high-capacity fiber transmission facilities. During the late 1990s, many providers rushed to build fiber networks to carry data traffic that was widely reported to be experiencing limitless growth. Well, we now know that the supposed doubling of U.S. Internet traffic every six months was a myth, leading providers to increase capacity based on unrealistic projections. Moreover, technological advancements in the area of data compression have allowed providers to transmit data using a fraction of the capacity previously required. The new compression techniques then exacerbated the impact of the excess capacity.

Another factor in the downturn is the mixed signals sent by the investment community. After the U.S. Congress opened local markets to competition, a gold rush mentality ensued as competitors raced to build out national networks. Some providers sensibly wanted to invest in infrastructure gradually as they built a customer base, but financial backers often pushed them to increase their deployment to quickly achieve a broader scale. The theory was: If there were going to be a small number of large competitors, no company wanted to be left behind as a result of being too timid.

Unfortunately, as investors became concerned about mounting debt loads and disappointing revenue growth, companies were expected to quickly change strategies and become profitable over a much shorter time horizon. This change forced carriers to cut back spending dramatically. The sudden drying up of capital also meant that many service providers found it difficult to meet their debt payments. In addition, this slowdown in spending in the U.S. has had a dramatic impact on equipment vendors. Suppliers of networking equipment have been hit very hard by slow demand and have been forced to lay off large portions of their work forces and write off massive amounts of inventory.

While most of the causes of the telecom meltdown have had little to do with regulatory policy, I believe that regulators must be willing to evaluate their past policies honestly against their stated goals and make course corrections as necessary. The FCC is doing just that and it now appears that some FCC policies during the late 1990s did not help matters, and may even have contributed to the problems. The FCC at the time seemed intent on stimulating competition as quickly as possible, without regard to whether the *kind* of competition that it was promoting was sustainable over the long haul. Such policies may well have over-stimulated competitive entry, as hundreds of competitive carriers began providing service. Once investors began insisting on profitability, many of these new competitors that did not have sound business plans found they could not survive.

As FCC Commissioner it's my duty to consider what the FCC can do to help turn around the sagging telecom economy. I believe that our top priority must be to restore certainty to the regulatory landscape. For example, court reversals of previous FCC policies have left U.S. providers with little guidance about the network elements that will be available at regulated cost-based rates. As a result, incumbents may be reluctant to invest in new facilities, because they do not know whether they will have to share the

fruits of that investment with competitors. And new entrants are unsure which facilities will be available from incumbents at cost and which must be self-provisioned or obtained at market-based rates. Therefore, as FCC Commissioner I am working to restore certainty. To achieve this goal the FCC must develop unbundling rules that balance the need to open up true bottlenecks and the need to preserve the incentive to invest in facilities that are *not* bottlenecks. And, just as importantly, we must develop rules that will be sustained by the courts as being consistent with the statute enacted by Congress.

The initial efforts to develop unbundling and interconnection policies were largely theoretical, by necessity. We now have the benefit of six years of real-world experience under the Telecommunications Act of 1996. We therefore have a better understanding of which facilities competitors truly need at regulated prices, and which they can self-provide or obtain at market-based rates. We also have a better understanding of the importance of intermodal competition – that is, competition among providers that use wireline telephony, cable, wireless, and satellite platforms. We know that this type of facilities-based competition is most effective in spurring innovation, and we are more mindful of the need to balance the objectives of promoting competition within the telephone platform and across different platforms.

For a regulatory agency to evaluate and refine its policies in the light of experience on the one hand, while promoting regulatory certainty on the other hand, its regulatory process must be transparent and predictable and it must be widely viewed as neutral by all stakeholders. In the United States, we believe that only a regulatory agency that is independent, both from operators, but also from day-to-day political pressures of executive branch policy-making, can have the necessary credibility. It may be possible in other governmental structures to devise other administrative solutions. Any country that wants to attract significant infrastructure investment, especially in the current harsh investment climate, must create a regulatory structure that is both impartial, and perceived to be impartial, and thus an honest broker among the various competing interests in contemporary communications industry. This challenge now faces Chinese policy makers as they move to implement their welcome accession to the World Trade Organization. As the post-WTO regulatory regime is developed in Beijing, China has the great advantage of an outstanding test case in the world class regulatory process administered in Hong Kong by Oftel.

Finally, I believe that it would be a mistake to respond to economic struggles or accounting scandals by questioning the market liberalization policies that regulators have been pursuing in Europe and the U.S. Despite some setbacks along the path to more robust competition, I have no doubt that competitive markets remain the desired outcome. Competition delivers to consumers the benefits of lower prices, better service quality, more innovation, and more choice. No matter how good our intentions may be, regulators simply cannot be as efficient or as effective as markets. Markets will always have ups and downs, and will occasionally go through extremely turbulent periods like the last few years; some providers will go bankrupt and some consolidation is inevitable. But consumers will be better off if we ride out such turbulence than if we retreat from market-based policies and impose more heavy-handed regulations. In my view,

responding to current conditions with increased regulation, far from promoting new investment, would only create a further obstacle to economic recovery.

But there is no doubt that we are in a far different telecom world than what we faced over the past several years. So as regulators we must continue to share ideas and learn from each other so that the benefits of advanced telecom capabilities are delivered globally.