

Statement of Reed E. Hundt
Before the
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Committee on Commerce, Science and Transportation
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Mr. Chairman and Members of the Committee:

Thank you for inviting me to testify today on the government's role in the future of telecommunications and broadband deployment. This is a vital subject and a timely hearing, as the telecommunications sector, which led the economy through extraordinary growth in the 1990s, is now leading the capital markets in the wrong direction in this decade. I am grateful for the opportunity to present my views.

My testimony today reflects only my personal views, and not the views of any company with which I am associated.

My two key points are that (1) competition is the right policy to build broadband networks, but (2) to ensure truly high speed and universal broadband networks, government needs to help pay at least for the early stages. By year-end, about 15 million homes will have broadband at speeds approximately 1 megabit per second (“mgbps”). This committee should vow to get 100 million homes on broadband at speeds never less than 10 mgbps by the end of the decade.

I am certain, Mr. Chairman, that you and the other Members of this Committee know well the current state of the telecommunications sector. It is in large part because of this Committee's leadership that the telecommunications sector became an engine of our dynamic economy of the late 1990's. The 1993 Budget Act opened the airwaves, or spectrum, to competition by making new licenses available through auction. The 1996 Telecommunications Act opened telephone markets to competition, and created the single most successful universal service program in history – the so-called E-Rate, which has put Internet access in ninety

percent of all classrooms in less than five years. Thanks to your visionary legislation, competition policies and tremendous technological innovation have together lowered prices for communications services. As a result, consumers and businesses have purchased more services than ever before, and aggregate revenues for telecommunications have grown steadily from the beginning of the 1990s to this date. Aggregate employment in the sector also grew steadily from 1992 until the middle of 2001.

However, capital markets and profits in telecommunications have been in decline since mid 2000. Inevitably, the decline for investors has translated to reductions in employment. Net job loss has plagued telecommunications for more than a year now. Ultimately, if firms do not make profits and investment does not begin to grow, instead of shrink, in telecommunications, we will not see the same rate of innovation, new services, competition, and revenue growth that characterized the 1990s.

The good news is that, as a whole, the telecom sector continues to grow rapidly, and consumers are spending a growing percentage of their income on an expanding array of telecommunications and information services, while benefiting from sharply lowered prices. The pace of growth in the U.S. telecommunications industry, including voice and data, wireline and wireless, is enviable. Total U.S. telecommunications revenues grew from \$164 billion in 1996 to \$242 billion in 2000, and current estimates indicate they will reach \$277 billion in 2002, and a staggering \$383 billion in 2006. Although revenues for long distance voice are shrinking and local voice revenues are under pressure, local data, long distance data, and wireless voice revenues are growing rapidly, with the result that revenues for the sector as a whole continue to

grow.

Telecommunications, moreover, is posting healthy gains as measured by its share of the gross domestic product (GDP). For example, U.S. telecommunications revenue represents an increasing percentage of GDP – just over 2 percent in 1996, projected to increase to over 3 percent in 2006, which represents a 4 percent compound annual growth rate. Residential telecom spending, as a percent of disposable income, is growing at an even faster rate– at a 5.7% compound annual growth rate.

Customers benefit tremendously from the price reductions that have occurred over the past few years as Congress' national competition policy has begun to take hold in all sectors of this industry. Long distance prices dropped an average of 6 percent per year from 1995 to 2000; wireless prices dropped 19 percent annually; frame relay prices fell 12.6% per year; and OC-3 prices fell a staggering 99 percent annually. Prices for local voice and for Internet access have been more or less stable over the past few years.

The effects of the competition policy introduced by this Committee, combined with technological innovation, have been profound. Specifically, that policy has lowered greatly the barriers to entry in all segments of the telecommunications sector; fostered extensive innovation and the deployment of a vast array of new services; and made possible the explosive growth of the most revolutionary communications medium in history - the Internet's network of networks. Moreover, the growth of competition has been largely responsible for both the ongoing reductions in the prices for most telecommunications services, as well as the continuing increases in aggregate revenues for the sector since the early 1990s. The number of jobs in the telecom

sector, while down from its peak in 2001, is still much higher in 2002 (1.6 million jobs) than it was in 1992 (1.3 million jobs). Finally, net income for the telecom sector is still positive, although it has shifted away from some firms and some technologies and toward others.

My conclusion from these facts is that competition provides exactly what the economists advertise -- tremendous advantages for consumers, opportunities for entrepreneurs and new capital to take risk and introduce new technologies, and continued growth in the nation's economy. It is also clear that a competitive sector means that companies can fail, as they do in every competitive economy, and that has happened to many firms in telecommunications. Some of the failures in this sector are due, it seems, to excessive investing in redundant business models; others to shoddy or even fraudulent practices. Good sense among investors, better corporate governance, and stricter regulation in financial markets are all right and proper remedies for these serious problems. But it is always true that there is some risk of misallocation of capital by the private sector, as we saw in the second half of the 1990's. And it is always true that this risk is the one policy makers should permit investors to take, in return for a competitive, innovative telecom sector. The potential reward significantly outweighs the risk.

Despite the recent downturn, I am confident that new capital spending will return to this industry. I am also quite sure that there is a right way and a wrong way for government to act during this prolonged period of disinvestments.

The wrong way is to react by repudiating the benefits of competition, and blessing monopoly instead. Down that path lies job loss, price increases, reduced innovation, reduced capital investment in the aggregate, fewer new services, a smaller GDP, and ultimately the loss

of the spirit of entrepreneurship and risk-taking that is part of the American spirit.

The right way is to encourage new investment and to foster competition and innovation. And a key part of the right way is to recognize that certain essential elements of a modern telecommunications network are not likely soon to be constructed purely by the operation of competitive private markets. Therefore, to some degree public monies should be spent to provide a base or floor for private sector capital investment. And a final part of the right way is to identify as well the extent to which public money must be spent to make essential communications services available and affordable to all Americans.

All private markets leave some services too expensive to be affordable to all. For most services and goods, there is no good public policy reason to address this issue. But part of maintaining democracy and our uniquely inclusive society is to include everyone in our country – those in distant rural areas and those in high cost demographics and those in nonaffluent income classes and those in classrooms and government buildings and health care facilities – as part of a single fabric of communication. Just as roads link every small town and farm to every big city and business location, so we have long set as a national goal the linking of everyone in America to the most modern conceivable communications networks.

And where private markets do not through the operation of innovation and competition make such networks available and affordable to everyone, the government should step in. At this perilous time for capital markets it is doubly important to reaffirm this traditional universal service goal because the right amount of public money, spent in the right way, can help build essential facilities that are necessary for the further evolution of America's communications

networks and industries.

Everyone in the information sector acknowledges that the next technological leap in telecommunications is broadband. Policy and competition has to date built a broadband market of about 15 million households and small businesses now subscribing to high speed connections that deliver data, also known as Internet content and communication, over cable modem or DSL.

But 15 million is not enough, especially when we see that more than 40% of households in Korea, for example, have broadband. We need a broader dissemination of broadband than private markets, under today's economic constraints, are likely to provide, if we want to make broadband universally available and affordable. Moreover, if we want a communications network that would serve as a base for advanced data services then we should not be content with the speeds of today's broadband networks.

Our goal should be speeds to all business users that range from 100 megabits per second to 1 gigabit per second, or even 10 gigabits, and to all residential users at speeds from at least 10 megabits per second to 100 megabits. These speeds will require a combination of upgrades of existing facilities, deployment of new wireless technologies, and ultimately installation of fiber. Whether it is in connection with education, business, health care, entertainment, or any other part of our modern life, a robustly networked America will be a productive America.

I would like to describe the best approach to broadband as "Having our cake and eating it too." We should take advantage of competitive market structures to build this

broadband network. That's the cake. And every American should have broadband available to them; it should be universal and it should be affordable. That's the eating.

The only way we will get a broadband market that meets these twin goals is if the government provides the leadership and economic stimulus to accomplish it. It took government leadership and some public funding to build a truly national electric system and a truly national highway system, and it will take it here. Unfortunately, as of today private capital simply will not invest to build a universal broadband system. There is capital available to build the current lower speed version of broadband in parts of the country, where the population density and the economics of the families or businesses passed justify the investment, but it is not universal and it is not high speed enough.

I am sure the Members of this Committee know that there are many countries around the world that are ensuring that broadband is universally available, with networks touching every citizen. If they succeed and we falter, the applications and the hardware for these networks will be developed in those countries, not here. For decades, we have been the world leader in technology and telecom, but there is no guarantee that we will remain the leader.

It would be great if we could sit back and watch private capital build a universal high-speed network. But it won't happen soon enough, nor will it be universal, nor will it provide efficient communications services to all business and residential users and service providers, unless government establishes a plan to make it happen.

Only if the federal government provides leadership, and financial incentives, will we have the high-speed networks that ensure our continued world leadership in telecommunications. We

can afford it, because these networks will pay for themselves over time, but they will not pay for themselves soon enough to attract private capital today and they will not pay for themselves in important but remote or underserved parts of the country.

There are many ways that the federal government could provide the leadership. I don't favor government ownership of a broadband network, but I do favor government assistance to communities that need the help to provide broadband to all their citizens. Wireless technologies are advancing rapidly, and we should be doing everything we can to make sure that the spectrum is available and the technology is encouraged so wireless can be part of our broadband solution.

A next generation, universal broadband network will cost tens of billions of dollars. But we know consumers will pay for the network over time if the monthly user price is affordable and the applications are attractive, and everyone is on the network. Therefore, to some extent this network, like all transportation and communications services since the telegraph and the first macadam roads, simply has to be built in order to attract the traffic, as opposed to waiting for unmet demand to build before the network is built. After all, did America wait to build roads until after every garage had a car? Not at all; even while Ford's cars were pouring out of factories in the 1920's, Secretary of Commerce Herbert Hoover used government leadership to build a network of roads linking every town and city in the country. Similarly, even while computer processing speeds continue to double every couple of years and Internet applications consist of more and more bits all the time, we need to extend and expand the underlying communications networks so that they have the reach and the capacity to take advantage both

of processing speeds and the complexity and volume of Internet applications.

If the government will help finance the network, in time it will recover the cost, directly from the fees paid by consumers, and indirectly from the gains in technology and productivity that will be part of our economy.

Mr. Chairman, as you and the Members of this Committee know from your deliberations and actions over the last many years, it takes vision and leadership to ensure that a sector of the economy like telecommunications remains vigorous, competitive and dynamic. Unfortunately, it is a job that requires constant attention. As markets and technology change, new visions are necessary. We will fail if we sit back, take a break, and hope that we can continue to lead the world by doing nothing here in Washington. Technology advances and we can either use the combined forces of the government and the marketplace to make technological innovation available to all Americans, or others will take the lead.