# The Broadband Economy Needs A Hero

THE WALL STREET JOURNAL.

**By GEORGE GILDER and BRET SWANSON**
*February 23, 2001*

Dear Mr. Powell:

Whether you know it or not, your leadership and decisions over the next four years will have more impact on the economy than those of Federal Reserve Chairman Alan Greenspan.

Surely, our stock-market swoon of 2000 and stagnating economic growth in 2001 are partly due to the Fed's inexplicable liquidity leash combined with the highest tax burden since World War II. But the chief threats to the 21st-century economy are the politicians, bureaucrats and Silicon Valley know-nothings responsible for America's broadband connectivity crisis.

We owe Les Vadasz of Intel an apology for making fun of his prediction that narrowband links would prevail into the 21st century. The Internet as we know it is about seven years old, yet fewer than 7 million of 100 million American homes enjoy broadband and its wealth of social, commercial and educational opportunities.

Contrary to popular belief, the chief obstacle to progress is not entrenched Bell operating companies, but a regulatory regime that presumes to "level the playing field," "equalize access," and "promote competition." The only result of these policies has been the effective nationalization and paralysis of broadband.

The 1996 Telecommunications Act ruled that in exchange for the right to enter the long-distance telephone business, the Bells must open their residential copper lines to competitors, as well as allow these competitors to locate equipment in Bell central offices and offer digital subscriber line (DSL) services over Bell-owned copper. In November 1999, the FCC issued a further decree forcing the Bells to stop dragging their feet and cooperate.

The FCC actions spawned a new category of start-ups known as broadband competitive local exchange carriers (CLECs), which planned to compete with the Bells. Funded by billions of dollars in Silicon Valley venture capital and public offerings, companies like Rhythms, Northpoint, Covad and Jato earned praise from "libertarians" in both Washington and Palo Alto, Calif. Northpoint even had freedom-loving former FCC Chairman Reed Hundt on its board.

But despite all good intentions, these were not high-tech start-ups. They became venture capital-funded lobbying and litigation shops intent on forcing the Bells to share their copper. With more press releases on new lawsuits than on new subscribers, one of the companies epitomized the strategy: "Rhythms continues successful regulatory litigation."

The result of all this lawyering? The CLECs won everything. Access to copper wherever they sued. Multimillion-dollar awards from the Bells. And bankruptcy. Bankruptcy?

Late last year, Northpoint filed for Chapter 11 after Verizon withdrew an $800 million investment. Jato closed its doors. Rhythms cut its staff by 23%. Covad is slashing 800 jobs and closing 260 central offices. Of Covad's 274,000 lines in service, 92,000 are not "recognizing revenue." And all of this is happening in the face of massive consumer demand for broadband services.

The problem is that DSL is risky and hard. Some studies have reported that 50% of DSL hook-ups fail on the first try. Even amicable relationships between CLECs and Bells are a software nightmare, with a different billing and provisioning system for each service provider. Such difficulties render DSL not a matter of will and politics but of technical and entrepreneurial risks. Companies are forced to invest heavily in research and engineering personnel, but have few opportunities for outsized rewards.

That's because Congress and the FCC set up an awkward scheme in which everyone got a piece of the action but no one could make any money. Often barred from carrying signals across long-distance boundaries, the Bells hand off traffic to other long-distance carriers. CLECs rent lines from the Bells. And Internet service providers end up doing costly customer service and marketing to get people signed up in the first place. In short, as many as four parties routinely battle for low- or negative-margin chunks of $40-monthly bills.

By summoning new competition and then mandating the rivals cooperate in open access, the government effectively privatized the risks and socialized the profits. By December, the Bells had signed up 1.8 million users and the CLECs 600,000, combining for just 2.4 million DSL subscribers among the 120 million or so copper-connected U.S. homes and businesses.

Cable modems, with 4.9 million subscribers at year-end, have done better, but AOL Time Warner and AT&T, America's two cable behemoths, are bogged down by the same open-access nonsense that plagues DSL. Over the past two years, AT&T CEO Michael Armstrong acquired $140 billion in cable assets while watching his company's $184 billion market capitalization plummet to $81 billion.

Just last month the Federal Trade Commission ruled that AOL Time Warner must offer "at least one non-affiliated cable broadband ISP [Internet Service Provider] service on Time Warner's cable system before AOL itself begins offering service, followed by two other non-affiliated ISPs within 90 days and a requirement to negotiate in good faith with others after that." The nation's second-largest ISP, EarthLink, will now get access to AOL's expensive cables pretty much for free.

This regulatory morass treats the most dynamic, technically creative, and transformative industry in the world economy as if it were some static commodity market for corn or pork bellies.

Mr. Chairman, in a recent speech you made the key point that innovation is more important than price competition. When it comes to leading-edge services and technologies, narrow price competition is almost meaningless. Internet innovation means qualitative change, order-of-magnitude price reductions and constantly changing services that always constitute monopolies when first launched.

No Internet advantage can last more than a couple of years. In 1999 and 2000, over 150 million kilometers of optical fiber were laid world-wide, enough to stretch to the sun. Hundreds of billions of dollars have already been invested by metropolitan fiber-optic network builders (Metromedia Fiber, Level 3 Communications), optical hardware companies (Avanex, ONI, Sorrento) and optical service providers (Yipes, Cogent, Sphera). These companies are already rendering the metropolitan DSL debate moot with thousand-fold increases in price performance over existing technology. Similar breakthroughs are on the way in residential wireless. But none of these deployments, including fiber to the home, can flourish under a regime of forced sharing of entrepreneurial assets and profits.

In this environment, let the Bells compete in long-distance and extort any temporary profits they can from their local copper cages. Let the cable companies capitalize on their advantage for the few years it will last. Allow the infinite spectrum of air and fiber to be exploited in any way its owners wish. Then, sit back, and nostalgically recall those early days of the Internet, when we naively thought a 5% economic growth rate was really something. The broadband economy needs a hero. President Bush and Mr. Greenspan need a technology savior. You are the man best equipped to play that role.

*Mr. Gilder, editor of the Gilder Technology Report and Senior Fellow of Discovery Insitute, is author of "Telecosm: How Infinite Bandwidth Will Change Our World." Mr. Swanson is a technology analyst at the Gilder Technology Report.*