THE WALL STREET JOURNAL.

# Bringing the Broadband Miracle to Europe

October 11, 2004

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In the mid-1990s, Korean policy makers set out to inject competition into local telephone service. They enacted rules allowing rivals to challenge the erstwhile state monopoly, Korea Telecom. Yet, by mid-2004, KT still accounted for 95% of local phone lines.

A failure? On the contrary, Korea's policy has proved a smashing success. Because, as an additional lure to attract phone entrants, the government ended regulation of advanced telecom applications. The result: While competitors largely avoided (regulated) voice services, they invested billions to create new (unregulated) high-speed Internet networks. The broadband technologies unleashed by telecom rivals forced KT to modernize its network, which now serves just half of the high-speed market.

And that's a big market: 78% of Korean households subscribe to broadband, the highest penetration rate in the world and nearly four times the average European country. While broadband via standard cable modems and digital subscriber line (DSL) services are available for about $27 a month, households paying about $52 a month receive lightning fast 20 mbps VDSL service -- connections sufficient to receive live high-definition TV. In short, the apartment dweller in Korea enjoys the same level of Internet service as the largest corporate customers in Europe. All this in a country of 48 million that, in 1979, had just 240,000 phone subscribers.

In 2001, OECD policy analysts undertook to explain broadband deployment. The key question was how much to rely on network sharing-mandates, or forced "unbundling." Under these rules, existing telecom networks must allow new competitors to use their facilities at prices set by the government, on the theory that giving entrants a low-cost path to the retail market will jump-start rival networks.

Researchers evaluated how countries with high cable-modem and digital-subscriber-line (DSL) adoption had achieved this result. Attention turned immediately to Korea. The OECD concluded that "[t]he success being experienced by Korea in the roll out of high speed Internet access is due to competition between companies, different technologies, and infrastructure." But the study, which evinced a distinct preference for network-sharing regulation, spun its observation thusly: "To stimulate further growth Korea has decided to introduce unbundling..." This was reminiscent of the University of Chicago legend regarding the student who fell asleep in Milton Friedman's class. Upon being awoken by his professor's jarring question, he blurted: "Dr. Friedman, I apologize for dozing off -- but the answer is, reduce the money supply."

The difference is that reducing monetary growth actually lowers inflation. Network-sharing mandates, on the other hand, are observed to deter investment in both incumbent and competitive telecommunications networks.

In short, it is no coincidence that Korea's sprint to broadband supremacy occurred without network-sharing mandates. Sang-Seung Yi, an economist at Seoul National University, explains that the "Korean broadband market succeeded because of fierce facilities-based competition among Hanaro, Thrunet and KT. This took place not because of 'smart' government regulation such as unbundling, but because of the absence of regulation." Other factors fuel the broadband miracle, of course. Koreans live in close proximity to one another, so the cost of building networks tends to be low. The Korean government has subsidized certain applications and invested public monies in broadband and wireless. And the fabled Korean demand for online gaming, suggests a hunger for broadband applications.

But these alibis for why others do not do as well are overrated. Most Koreans do not live in apartments, and many parts of Europe are much more densely populated than many parts of Korea. Subsidies have been

handed out in Korea, but the major network competitors depend on private capital markets. Thrunet reorganized under bankruptcy laws in 2003, and Hanaro reported its first profits only in mid-2004. Other countries pour subsidies into communications markets, while even larger cross-subsidies are embedded in rates, all without seeming to gain any advantage in network growth. As for appetite, Korean demands were revealed only after Internet cafés-or "PC baangs"-dotted the country, luring customers to online games, music, and videos. Networks then built out; subscribers followed.

It is also crucial that Korea's deregulatory climate has protected investments in new infrastructure, inducing capital to flow freely into broadband. As Prof. Yi explains, "Because Hanaro could not 'free-ride' on KT's investments, it made massive investments in laying out fiber-optic cables. That, in turn, prompted KT to make its own massive investments. And it could realize 100% of its returns, because it had no unbundling requirements." A report issued by Korea's Ministry of Information and Communications likewise claims that the key to the broadband market is "facilities-based competition."

In Europe, countries that attempt to promote network sharing through regulation tend to underperform in the broadband race. A 2003 study submitted to the European Commission by the Brussels Round Table found broadband deployment most advanced in countries where rival networks vie for customers, as in Belgium or the Netherlands. Nations most aggressive in imposing network-sharing rules conversely exhibit relatively little broadband adoption. Germany is a good example. Singled out by the OECD in 2001 as "one of the countries leading unbundling," it is today identified by Strategy Analytics as a "less competitive country." It notably lags the average penetration level (20% of households) achieved throughout Europe.

Not only does an emphasis on "facilities-based competition" protect investment incentives, it embraces current realities. New technologies are displacing legacy monopolies even in the voice market where a century-old franchise exists. In Finland, about 93% of households subscribed to a fixed-line phone service in 1990; now just 61% do. Rivalry from wireless networks has undone "natural monopoly."

Promoting regulated competition through extensive unbundling mandates was an approach tried by many, but results have been disappointing. Countries like Korea are demonstrating that investment incentives -- including deregulation -- are as vital to the emergence of next-generation networks as the advanced communications technologies they exploit.

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