

TELECOM DEREGULATION

THE ISSUE

For most of the last century, cheap and universally available local residential phone service was the primary telecommunications goal of policymakers across the country. The resulting regulatory regime kept competition at bay in order to maintain an elaborate web of subsidies that supported artificially low local service prices.

In the 1970s, when it became clear to everyone that consumers were demanding services that the regulated system couldn't deliver, the country began to move into the new era of telecommunications deregulation.

Texas has recently been one step ahead of the rest of the country, passing major telecom reform legislation in both 1995 and 2005. Thanks to the most recent legislation—SB 5—local telephone service for more than 15 million Texans was significantly deregulated as of January 1, 2006. This was a major step forward in reducing costs and bringing new technologies and services to millions of Texans.

But there is still room for improvement. Even though more than 15 million Texans live in areas where telephone service has been significantly deregulated, only three incumbent phone companies serve those people and there are still price controls in effect in those areas. For instance, companies must apply rates evenly across a deregulated market, consistent with pricing flexibility that was available on August 31, 2005. Companies are also subject to price floors for all services set at the service's long-run incremental cost. Finally, they are also subject to applicable PUC rules relating to "discriminatory" and "predatory" pricing under Chapter 60 of the Public Utilities Code.

The vast majority of phone companies continue to operate in regulated markets serving over 7 million Texans located mostly in rural Texas. In these areas, companies are subject to price caps, price floors, and/or tariffs.

THE FACTS

- ★ Competition ALWAYS brings consumers the best products at the best prices. The history of telecommunications deregulation proves this time and again.
- ★ When the telecommunications equipment market was deregulated in the 1970s, the prices for phone handsets, key telephones, and private branch exchanges declined at a real rate of between 6 and 7 percent per year between 1972 and 1987.
- ★ From 1984 to 1995, when there were just two cellular providers per market, inflation adjusted rates fell by an average of only 3 to 4 percent annually. However, in

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1993, the government allowed up to six competitors in each market, resulting in declines in wireless rates averaging 17 percent annually from 1995 to 1999. A cellular phone call that averaged 50 cents per minute in 1984 has declined to 8 cents per minute today.

- ★ Upon deregulation, interstate long distance rates fell 68 percent from 1984 to 2003, while intrastate rates fell 56 percent. The slower decline of intrastate rates is due largely to state regulators who have kept intrastate access charges artificially high in order to maintain subsidies of local phone rates.
- ★ The dual system in Texas of deregulated urban markets and regulated rural markets could create a “digital divide” between urban and rural customers.
- ★ The urban/rural digital divide could have a significant impact on taxpayers as it builds political pressure to increase, rather than decrease, telecommunications subsidies through the Texas Universal Service Fund.

RECOMMENDATIONS

- ★ The relics of monopoly regulation—such as price caps and floors—should be removed from the current system. Texas telecommunications policy should reflect the ongoing vibrant competition in many markets by immediately removing all price controls in deregulated markets to provide a positive incentive for companies to choose deregulation.
- ★ Firm timelines should be set for the deregulation of the currently regulated suburban and rural telecommunications markets. It is clear that technology brings real competition in telecommunications to every part of the state. A phased-in approach to deregulation in mid- and small-sized markets would encourage competition by ensuring that market participants (current and potential) understand that competition is inevitable.
- ★ Pricing flexibility that comes with deregulation should be paired with reductions in subsidies.

RESOURCES

- *Texas Telecom Deregulation* by Bill Peacock, Texas Public Policy Foundation (Apr. 2006) <http://www.texaspolicy.com/pdf/2006-04-27-testimony.pdf>.
- *Texas Telecommunications: The Road Ahead* by Bill Peacock, Texas Public Policy Foundation (Oct. 2005) <http://www.texaspolicy.com/pdf/2005-11-telecom-pp.pdf>.
- *A Telecommunications Policy Primer* by Dianne Katz, Texas Public Policy Foundation (Jan. 2005) <http://www.texaspolicy.com/pdf/2005-01-tele.pdf>.
- *Texas Telecommunications: Everything Is Dynamic Except the Pricing* by Robert W. Crandall and Jerry Ellig, Texas Public Policy Foundation (Jan. 2005) <http://www.texaspolicy.com/pdf/2005-01-telecom.pdf>.
- *Communications Without Commissions: A National Plan for Reforming Telecom Regulation* by Braden Cox and Clyde Wayne Crews, Jr., Competitive Enterprise Institute (Oct. 2005) <http://www.cei.org/pdf/4911.pdf>.

