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HOW CONSUMERS WILL BENEFIT FROM LESS TELECOM REGULATION

By Barry M. Aarons

The evidence is overwhelming: Less telecommunications regulation benefits consumers. State regulatory oversight and its pervasive system of tests, filings, rules and requirements have had a negative impact on the investment decisions of incumbent local exchange carriers (ILECs) such as SBC and Verizon—the successors to the Bell System companies. In the end, consumers lost out. Consumers have benefited, by contrast, in areas where there has been a lack of regulation, from wireless to satellite.

Regulatory barriers affecting ILECS are fewer today than two decades ago. But there is still much work to be done. Continuing the process of deregulation will engender better prices, higher quality, more jobs, and a broader array of product offerings.

THE SKY DIDN'T FALL

A Bell System executive once said that the former Bell operating companies were not in the phone business, they were in the rate-case business—the business of setting utility rates. That was in the days of rate-of-return regulation, when Bells were forced to keep their profits down, and when competition for basic telephone service did not exist.

Prior to the 1984 AT&T divestiture, each year the company established what it expected its system-wide earnings needed to be. In turn, the Bell operating companies each had to commit a certain net revenue number to AT&T. Each state within those operating companies' territories would have their net revenue requirement to the operating company set. Then each company's state operation would look at its authorized rate of return under its most recent rate case and try to determine whether it needed to go into the state public utilities commission to ask for an increase in rates.

That is an oversimplified explanation, to be sure. But over decades, it is how the local telephone system worked. Because the local phone company was a monopoly, regulators dictated rates that shielded protected classes, kept residential rates low and put the burden on the heaviest users. It was not unusual for 20 percent of customers to pay 80 percent of the rates.

At the time of the Bell System breakup, consumerists suggested that the price of local service would skyrocket and that certain classes of customers—the elderly and indigent—would be denied basic telephone service. Of course, that didn't happen. In fact, prices remained roughly the same or actually dropped during the ensuing years. Back then and still today, the percentage of Americans with telephone service is in the mid- to high 90s.

DEREGULATION'S BOUNTY OF BENEFITS

History is repeating itself. Recently, the U.S. Solicitor General decided not to appeal the D.C. Circuit Court's decision on the Federal Communications Commission's regulatory authority to the Supreme Court. It is a move toward deregulation; the decision relaxes the requirement that incumbent telephone carriers share their networks with competitors at a discount.

Sure enough, today we again hear dire predictions of rising prices and displaced consumers. Rest assured: it won't happen this time either.

First, it is important to remember that in 1984, competition for wireline service for residential customers did not really exist. Cable television had not entered the field, divestiture clearly separated local and long distance, and cellular was too expensive and unreliable to offer a reasonable alternative.

In reality, what existed in 1984 was the continuation of the local wireline monopoly, pervasively regulated by local and state commissions with little or no real local exchange residential competition.

Fast-forward 20 years and it's a different world.

A recent newspaper ad compared the residential telecommunications services of four different carriers: the local ILEC; two long-distance facilities-based carriers that supply local service; as well as a cable television company that also provides local service. The four companies' offerings included local, long distance, cable television, and high-speed Internet service. That is real competition with competitive pricing.

But in addition to inter-company competition for wireline services, there are intermodal competitive offerings. Wireless services—from cellular to WiFi (wireless fidelity) to VoIP (voice over Internet protocol)—all contribute to consumer choice. The percentage of the market that ILECs control for two-way voice services is currently well below 50 percent.

Why would any of these companies want to raise their prices above competitive levels? It wouldn't make any sense.

When regulation is eliminated, there is an almost instant response as companies realize they can now plan their investment decisions with more freedom. It also allows them to ramp up investment into more risky types of research and development. That investment results in:

- Capital formation and jobs creation.
- New product development and deployment.
- Increases in consumer choice.
- Price stability or even reduced prices, as the increase in supply of new products and services creates new demand (once research and development costs funnel through).

Instinctively, ILECs want to preserve market share while developing new opportunities in the changed marketplace. Raising prices clearly is not the way to do that. There is little or no evidence that this has occurred and no reason to believe it would occur.

The availability of consumer products—like wireless and VoIP—has exploded faster than wireline expansion, due in large part to the absence of regulation. Since the 1984 Bell System divestiture, there has been a reduction in the level and depth of regulation. Rate-of-return regulation is out, and flexible rates are in. There is a deeper separation in the overall communications business, and greater residential spread of rates. Most importantly, there are different levels of regulation for different yet competing technologies.

But the back of regulatory restriction still has not been broken; some competitors continue to push for regulation in order to maintain their market share.

It should come as no surprise that there is a negative correlation between the amount of regulation and growth in the number of products and services. The wireless industry has increased market share because of its ability to develop, expand and enhance its products, distribution and transmission. Without a doubt, the lack of pervasive regulation has contributed to this phenomenon. The same is true for cable, although cable's oligopolistic position seems to have encouraged less pricing restraint.

(Additionally, competition from a less-regulated technology, satellite, has prompted cable companies to seek egregious governmental solutions to help them maintain market share. Few industries have sought taxation of their competition as aggressively as cable has of satellite. The latter is yet another example of a low-regulated industry leading to high expansion.)

Consumer Contentment

Although the Bush administration is sending mixed signals, the direction appears to be toward less regulation in telecom. The Solicitor General's decision not to appeal to the Supreme Court will result in expansion of the industry. By the same token, however, the administration's suggestion for a freeze in interconnect agreement costs is regulatory and constrictive. But if we take that as a suggestion and not as a policy recommendation, it can and likely will be taken into consideration by the ILECs and the CLECs (competitive local exchange carriers) who negotiate new interconnection agreements.

Less regulation will result in more investment flexibility, which in turn will lead to more capital formation, jobs creation, products, and services, as well as better prices. What more could consumers want?

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