Institute For Policy Innovation
IPI Ideas
Innovative Insights on Today's Policy Debates
NO. 40 FROM THE IPI CENTER FOR TECHNOLOGY FREEDOM OCTOBER 2006

VIDEO FRANCHISE REFORM: GOALS, PRINCIPLES, AND LESSONS OF DEREGULATION

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Government franchising and licensing began with federal government grants of rights of way to the railroads in the 19th century, creating incentives for the completion of the Transcontinental Railroad. State, county and municipal governments got into the act by requiring power, gas and telephone companies to sign franchise agreements in exchange for access to rights of way. The assumption behind these franchises was that such infrastructure services were "natural monopolies," and that competition in such was unlikely. The function of these grants was to bring a flow of lucrative licensing and franchise fees into municipal coffers in exchange for giving service providers monopoly status.

Today, new communications options have come on-line that do not use local rights of way. Yet some local governments insist on requiring licenses and franchise fees simply because they can, regardless of whether they are appropriate.

The only residual justification for the franchise system has been the power to award monopolies and retain revenues. The concept of a "natural monopoly" in communications services, including video services, is now obsolete. With new competition, the time has come to re-evaluate the need for franchise agreements and licensing requirements.

GOALS OF TELECOM DEREGULATION

Lower barriers to entry and exit. New competitors should find it as easy as possible to enter a market, and as important, to exit a market. When economics dictate, a company must be able to freely engage or disengage from commerce.

Allow markets to set prices. Normally, when a market is regulated, prices are artificially set, capped, or otherwise controlled by governments, rather than set by free contracts between customers and vendors. Just as a sign of a healthy organism is movement, the sign of a healthy market is prices that move as information changes. Prices are information about a market. When the market changes, the information changes, and the change in price communicates that change in information to the consumer.

End anticipatory regulation. Much regulation is anticipatory, assuming that companies will behave badly unless they are regulated. Anticipatory regulation, where government anticipates problems that may never exist, places burdens on companies and the economy without benefit. But in a deregulated environment there are still mechanisms to deal with bad actors. When industry is deregulated, government doesn't go away. Antitrust law doesn't go away. A deregulated industry is not immune from prosecution. Rather, the industry is freed to be more nimble and flexible in order to reach their customers—government steps out of the way, and stops functioning as a gatekeeper and rent-extractor.

The goals of telecom deregulation should be reducing barriers to entry and exit, allowing prices to move, and ending anticipatory regulation. Notice it is not a goal of deregulation to lower prices. Prices could be lowered by regulatory mandate and price controls. Some consumer groups would endorse that approach, but that is antithetical to the free market and would not stimulate the new innovation, investment, and job creation that naturally result from deregulation.

GUIDING PRINCIPLES

No discrimination between different ways of doing the same thing. As there are many modes of delivering video to consumers, if they are to be taxed and regulated, then they ought to be taxed and regulated exactly the same way. Public policy should be neutral and non-discriminatory, and should not pick winners and losers.

Government should not be a gatekeeper. That a company must obtain the permission of a government before entering a perfectly legal business is offensive. Government at its worst inserts itself between consumers and producers in

order to extract revenue. Franchise fees are pass-through taxes on consumers, having little to do with accessing the municipal rights-of-way. Companies that provide video content are already taxed—companies pay corporate income taxes, shareholders pay dividend and capital gains taxes, and employees pay income and sales taxes. Additional taxes in the form of franchise fees are not justified.

In some recent agreements, franchise fees have been increased so that the taxing authorities and the companies could reach an agreement. Its facilitation of hidden taxes on consumers is yet another reason why the entire franchise system should be eliminated.

Prices should move. Prices in the telecom industries have long been largely determined by appointed or elected regulators. In almost every other industry, prices are free to move, including trucking, airlines and railroads—industries deregulated years ago. The same pricing freedom must be brought to telecom.

Respect property rights. The networks are owned by private entities, not by the government, or by the "people." These are private networks, built with private capital, and the owners of them should be free to direct their deployment and use with a minimum of interference.

Times have changed. Today, telecom and cable companies are aggressive, competitive risk-takers. They are making enormous investments and offering new products and services. They must be free to try new things, to test a new service in a particular test market without being required to deploy it everywhere. They must be allowed to experiment, to expand where opportunity presents itself, and contract where opportunity no longer exists.

Lessons from Texas

In 2005 we helped encourage Texas to streamline, simplify, and deregulate its market for telecom services. While the Texas law is to a significant degree an appropriate model, Texas did not get everything right—for example, deregulation should not result in an uneven playing field for certain competitors, and the franchise system should be eliminated altogether.

Texas adopted a statewide franchising system for telecom providers which allowed any video provider, not just telecom companies, to obtain a statewide franchise, rather than having to negotiate franchises jurisdiction-by-jurisdiction. Almost immediately telecom companies began investing in provision of video services in Texas, as in other states where deregulation has occurred, new broadband networks are rolling out as never before.

This rollout means critical new investment. New capital has flowed into Texas creating new jobs. This investment will also bring new tax revenue into state coffers. This is the right kind of revenue increase: not raising the tax burden on existing entities, or subjecting them to unfair competition, but generating new revenue through economic growth.

Implications Beyond Texas

According to Bank of America Equity Research, in Texas, Florida, and Virginia, where new franchise authority has been given, incumbent service providers have begun to offer more competitive rates to the local customers for both bundled and unbundled services. In addition, a study prepared by Citigroup Equity Services indicates that in the short run, the trend is toward increased competition and lower pricing structures.

Market competition is the key to benefiting consumers. Companies do not invest in rolling out broadband without a reason to do so, and there is no doubt that the existing panoply of municipal franchise regulations has raised costs, delayed rollouts, and impeded competition.

Conclusion

A growing and innovative communications industry is vital to the continued economic dynamism of the US economy. Congress and the states should move in a timely manner to deregulate the communications industry to provide consumers with enhanced choices and options in the video business and foster the creation of new products and services.

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