
Economics as a Guide to Telecom Reform

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What is the goal?

- ☎ Consumer welfare: Every unit of every resource employed in the use that produces the most value for consumers
 - ☎ Affordability: Every consumer has the opportunity to purchase some minimum level of service regardless of income or location
 - ☎ Public safety: Network must support certain services even if many consumers might not opt to purchase them
 - ☎ Tax revenue: “Get the most feathers with the least squawking”
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Why consumer welfare?

- ☎ Treats telecom the same way antitrust treats other industries
 - ☎ Good for consumers
 - ☎ Prices reflect costs; services offered when they pass cost/benefit test
 - ☎ *Sustainable* innovation and job creation
 - ☎ Forces companies to focus on satisfying consumers instead of wasting resources lobbying
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When consumer welfare isn't enough

Accomplish other goals with least possible sacrifice of consumer welfare

- ☎ Identify specific, concrete outcome sought
 - ☎ Measure it
 - ☎ Identify alternative policies
 - ☎ Assess how each alternative will affect amount of desired outcome
 - ☎ Assess how each alternative will affect consumer welfare
 - ☎ Decide how much consumer welfare is “worth” sacrificing to accomplish how much of the other goal
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What promotes consumer welfare?

- ☎ Competition
 - ☎ Markets open to entry/exit
 - ☎ Freedom to set prices for individual services and bundles
 - ☎ Freedom to innovate and reap rewards for it
 - ☎ Prevention of fraud/deception
 - ☎ Regulation for other purposes is crafted to minimize loss of consumer welfare
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What has telecom regulation done historically?

- ☎ Enforced monopoly
 - ☎ Prevented exit
 - ☎ Mandated rigid prices
 - “Taxed” price-sensitive consumers to subsidize others
 - Below-cost prices discourage competitive entry
 - ☎ Discouraged new services and bundling
 - ☎ Prevented fraud/deception (but sometimes paternalistic)
 - ☎ Often achieved other goals with policies that *maximized* sacrifice of consumer welfare
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Understanding unseen consumer costs

Higher prices = fewer consumers subscribe

These consumers lose difference between what the service is worth to them and what they would have paid for it

Firms lose operating profit on these consumers

Loss is big when demand is sensitive to price (eg, wireless, video, broadband, long-distance)

Annual effects on overall welfare

Federal USF charges	-\$1.2 billion <i>in addition to</i> revenue raised
Pre-reform Texas USF charges	-\$176 million <i>in addition to</i> revenue raised
Texas USF reforms (2007)	\$144 million reduction in USF fees plus \$41 million gain in welfare
Interstate long-distance access charges	-\$1.5 billion <i>in addition to</i> revenue raised
ALL wireless add-on charges	-\$9.6 billion <i>in addition to</i> revenue raised
10-year voice mail delay	-\$1.27 billion annually
Delay intro of cell phones	-\$50 billion annually
Barriers to wireline video competition	-\$6.8 billion nationally

Sources: See final slide.

What is a competitive market in telecom?

- ☎ Wrong answer #1: Numerous small firms
(Sufficient, but not necessary)
 - ☎ Wrong answer #2: Competition prevents incumbent from raising prices above current, regulated levels
(Some regulated prices may be below long-run incremental cost)
 - ☎ Possible right answer #1: Competition prevents incumbent from raising price substantially above long-run incremental cost
 - ☎ Possible right answer #2: Competitors offer similar services or bundles at similar prices, no collusion, and consumer switching is easy
 - ☎ Possible right answer #3: Competitors offer diverse services or bundles at prices that reflect value to consumers of differential quality, no collusion, switching is easy
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Texas “big bang” telecom reform 2005

- ☎ Opened entry via video statewide franchising and authorizing broadband over powerlines
 - ☎ Encouraged entry by permitting increases in some prices that were below cost
 - ☎ Deregulated 74% of access lines by 2007
 - ☎ Exchange-specific quality of service standards eliminated in deregulated markets
 - ☎ “Basic network services” – prices capped until PUC reforms universal service
 - ☎ 2008 settlement reduces USF payments to 4 large incumbents and allows some rate increases on basic network services
 - ☎ Largest incumbent required to reduce intrastate access charges to interstate levels
 - ☎ Provider of last resort allowed to use any technology that meets standards at similar price to landline phone
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References

Figures mentioned in this presentation can be found in these articles or sources cited therein.

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