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Testimony

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Center for Economic Freedom

Competition in the Texas Telecommunications Market

by Bill Peacock, Vice President of Research and Director of the Center for Economic Freedom

Mr. Chairman, members. Thank you for having me here today to testify before the Senate Business and Commerce Committee. My name is Bill Peacock. I am the vice president of research and the director of the Center for Economic Freedom at the Texas Public Policy Foundation, a free-market research institute here in Austin. I have been tasked with analyzing the costs and benefits of increasing competition in the Texas telecommunications market, including telecommunications service discounts.

Background

Across the nation, the telecommunications industry has experienced rapid development. As our society becomes more technologically advanced, measures once imposed to provide access to affordable and high quality telecommunications services for the elderly, the poor, and those in rural communities are no longer needed In Texas, current telecom regulations have begun their descent into irrelevance, and now serve as an unnecessary burden to competition and technological innovation.

The telecommunication industry has been shaped by years of judicial, regulatory, and legislative actions. Most recently in Texas, these actions have reversed 100 years of policy and moved us away from monopoly regulation towards competition. This began in Texas in 1995, again in 2005, and most recently with Senate Bill 980 in 2011. SB 980 took effect in September of 2011, ushering in a new era of competition for Texas' telecommunications industry. It removes many of the burdens telecom companies faced, and prevents the placement of further regulations on new technology. For example, the law prevented the levying of new regulation for Voice over Internet Protocol (VoIP) technologies, as well as enacting similar prohibitions that prevents the Public Utility Commission (PUC) from bringing already-deregulated companies under new regulation.

Other provisions of SB 980 include:

- prevents the PUC from regulating the rates of an already-unregulated provider;
- prevents use of Texas Universal Service Fund monies from being used to support providers in large deregulated markets, and limits the use of the monies in smaller markets;
- reduces requirements on incumbent local exchange carriers to act as Providers of Last Resort;
- limits the statutory restrictions on companies in the process of transitioning from regulation to deregulated status; and
- requires the PUC to review the state of the Texas Universal Service Fund (TUSF) and its objectives, and make recommendations as to whether it meets those objectives.[1]

These provisions reflect the need to allow competition to flourish in Texas in order to take advantage of rapidly changing technology in the telecommunications market, including the fact that landline service is no longer the dominant element in the new telecom paradigm; in Texas, landline usage has fallen in favor of VoIP and, more importantly, cellular technology.[2]

The following are a few of the indicators of the success of the move toward competition in the Texas telecommunications market:

- there are more wireline providers in Texas than any other state;[3]
- Texas has more VoIP providers than every state except Florida;[4]
- ninety-five percent of Texas zip codes have at least one wireline competitor;
- three-quarter of Texas zip codes have multiple competitors; and
- Texas has seen rapid growth in the provision of video service, both in communities with and without existing video service.[5]

The roles of cellular service, wire-based, mobile broadband and VoIP, have changed the very nature of the telecommunication regulation scheme, and made most, if not all, of past regulations obsolete. Given the advancing state of technology and the benefits we have seen from deregulation, Texas needs to continue to lead the way in deregulating this market.

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Competition in Other States

Other states, notably Indiana, Michigan, and Wisconsin, have also been leaders in telecommunication reform. In 2006, Indiana passed a comprehensive telecom reform bill,[6] 2006 HEA 1279, which eliminated most of the Indiana Utility Regulatory Authority's jurisdiction over rates and service quality for retail phone service, and created a statewide video franchising mechanism. After HEA 1279, "the only telephone service rates and charges that remained under IURA jurisdiction were standalone basic local services (BLS) for residential landline customers."[7]

The state of Indiana immediately realized several benefits from competition. In 2008, two years after the passage of HEA 1279, the Digital Policy Institute conducted a study analyzing the effect of deregulation in the state. The study noted several benefits including "accelerated deployments of digital subscriber line (DSL) services in more than 100 new rural Indiana communities, collective capital expenditures of more than $516 million in new infrastructure, new competition for video in multiple markets in Indiana, more than 2,200 new jobs created for Hoosiers, and finally, a positive impact on price in the marketplace."[8]

In 2009, largely due to the successes of deregulation, the IURC ordered that rates and charges for retail telecommunications services in Indiana be fully deregulated.[9] Yet, even in Indiana, traditionally at the forefront of telecom reform, there is still room for improvement. This State has yet to reform Provider of Last Resort provisions.[10]

However, Wisconsin and Michigan have both passed successful legislation that fixed the Provider of Last Resort requirement in light of today's rapidly expanding and accessible telecom technology. On May 26, 2011, Wisconsin passed SB 13, which provided a mechanism for a waiver of state POLR requirements. Wisconsin is expected to successfully eliminate those requirements by April 30, 2013.[11] In 2011, Michigan passed Public Act No. 58 (house Bill No. 4314), which provided that "a telecommunications provider shall not discontinue either service to an exchange unless one or more alternative providers for toll service, or two or more alternative providers for basic local exchange service, are furnishing a comparable voice service to the customers in the exchange."[12] Michigan has found a way to slowly eliminate the provider of last resort system. This ensures that those in underserved areas will have access to telecommunications under any scenario.

Moving Forward with Competition in Texas

Texas joins these other states as a leader in the reform of telecommunications regulation. However, there are still plenty of subsidies, regulations, or taxes which need to be significantly reduced or eliminated. I'd like to highlight just a few of these areas and make some recommendations:

Local Franchise or ROW Fees

In 2011, the cost of the right of way (ROW) fee to consumers and businesses in the 10 largest Texas cities was more than $530 million. Since 2008, the cost to consumers has totaled more than $2 billion. Rather than serving as benefit to taxpayers, these excessive fees represent a major cost to consumers, as well as a bar to new competitive entrants into these markets. Today's excessive franchise fees stymie competition and strain consumer budgets. Charging a fee to cover the cost of providing ROW access is appropriate; charging Texas consumers over $2 billion since 2008 to essentially use their own property is not.

Recommendation: The Legislature should give the Public Utility Commission of Texas the ability to lower ROW/franchise fees, similar to the process that was used for universal service. The PUC should be directed to reduce the ROW fees based on these principles: 1) the ROW fee should be based on the marginal cost of using the public right of way in order to benefit Texas consumers, not Texas governments, and 2) the application of the ROW fee should be based on the physical occupation of the right of way, not the various services being transmitted through the wires.

Telecom Taxes

Consumers who subscribe to cable television and wireline and wireless voice services pay an annual tax bill of $318. Landline telephone customers paid an average of $11.12 per month, or 22.30 percent on an average monthly telephone bill. Wireless telephone customers pay an average effective tax rate of 19.25 percent. Cable video customers paid an average of $5.90 per subscriber per month, or 14.33 percent of an average monthly bill.

In addition to the high level of taxation faced by consumers, telecommunications taxes have harmful and disparate impacts on the industry. One example of this is that certain telecommunications providers are appraised differently for the purposes of property taxes. In particular, wireline telephone companies are treated as "utility" companies, while other voice service companies are not. Another example is the application of the Texas sales tax on certain non-retail, or higher-order, telecommunications equipment. This equipment includes machinery, equipment, and software purchased by telecommunications companies that are used in delivering consumer-based products and services.

Recommendation: 1) The tax-on-a-tax aspect of telecommunications taxes, i.e., applying the state sales tax on various mandated taxes/fees, should be eliminated, and 2) the ap-

plication of the sales tax on various non-retail goods should be ended.

Regulatory Restraints on Competition

Price Floors – Despite recent reforms, Texas telecommunications law still contains price floors prohibiting an incumbent provider from charging less than its long-run incremental cost for a service. Though there are provisions in statute that relax this requirement somewhat, the law makes it clear that providers charging less than this are subject to complaints that the rate is "anticompetitive or unreasonably preferential, prejudicial, or discriminatory."

Recommendation: Price floors and related threats of prosecution under antitrust and related laws should be removed from statute.

Rural Competition – Rural competition is hindered in several ways: 1) USF support, 2) artificially low regulated rates, and 3) inability of the PUC to deregulate markets.

Recommendation: 1) Rural rates should be allowed to increase, and 2) the PUC should be given the authority to under its own initiative deregulate a market of a company that it previously determined should remain regulated.

Telecommunications Service Discounts

The current telecommunication discount scheme for certain government and non-profit entities such as libraries, universities, and other non-profit institutions cost consumers tens of millions of dollars per year. The discount was expanded and extended by SB 773 in 2011.[13] The discount must be offered by certain providers until 2016. The discount itself is poor public policy; there is no reason to provide these institutions government-mandated subsidies. But even worse is the manner in which this subsidy is provided, which rather than place the burden for this subsidy on all taxpayers, puts it on the employees, shareholders, and customers of only a few companies.

Recommendation: The service discounts hinder competition, distort business and investment decisions, and harm consumers. And unlike most other subsidies which are being phased out or eliminated, these were actually extended last session. They should be eliminated in 2013.

Conclusion

Competition in the telecommunications market is an important component to the continued growth of the Texas economy. These proposed reforms will bring greater competition to this market. ✯

[1] "Bill Analysis: SB 980," Texas State Legislature, 2011.

[2] "Scope of Competition in Telecommunications Markets in Texas," Public Utility Commission of Texas (Jan. 2011).

[3] *Local Telephone Competition: Status as of June 30, 2011*, Federal Communications Commission (June 2012) 28.

[4] Ibid.

[5] Kaye Husbands Fealing, et al, *Statewide Video Franchising Legislation*, University of Minnesota (Mar. 2009).

[6] "House Enrolled Act No. 1279," Indiana, Second Regular Session 117th General Assembly (2012).

[7] "Telecom Regulatory Reform: Indiana Update 2012," *The Digital Policy Institute*, Ball State University (Jan. 2012).

[8] Ibid.

[9] Ibid.

[10] Ibid.

[11] Ibid.

[12] Ibid.

[13] "Bill Analysis: SB 773," House Research Organization (23 May 2011).

About the Author

Bill Peacock is the vice president of research and director of the Texas Public Policy Foundation's Center for Economic Freedom. He has been with the Foundation since February 2005.

Bill has extensive experience in Texas government and policy on a variety of issues including, economic and regulatory policy, natural resources, public finance, and public education. His work has focused on identifying and reducing the harmful effects of regulations on the economy, businesses, and consumers.

Prior to joining the Foundation, Bill served as the Deputy Commissioner for Coastal Resources for Commissioner Jerry Patterson at the Texas General Land Office. Before he worked at the GLO, Bill was a legislative and media consultant. He has also served as the Deputy Assistant Commissioner for Intergovernmental Affairs for then-Commissioner Rick Perry at the Texas Department of Agriculture and as a legislative aide to then-State Rep. John Culberson.

Bill has a B.A. in History from the University of Northern Colorado and a M.B.A. with an emphasis in public finance from the University of Houston.

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