

Telecommunications Act of 1996: A Paradigm of Deregulation?

Interdisciplinary Telecommunications Program
University of Colorado

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Agenda

- Public Policy Overview
- Pre-Telecommunications Act
- Telecommunications Act of 1996
- Conclusion

Public Policy Overview

- Goals
- Instruments
- Obstacles

Public Policy Overview

- Cost Minimization
- "Correct" Prices
- Rent Extraction (Monopoly)
- Equity?

Public Policy: Instruments

- Regulation/Social Control
 - ▶ ~~Rate of Return Regulation (ROR)~~
 - ▶ Benchmark (Yardstick)
 - ▶ Incentive Regulation
 - ▶ No Regulation
- Anti-trust/Monopoly Policy

Incentive/Price Caps Regulation

- Competitive Entry Encouraged
- Limit on the Incumbent's Prices
- Productivity Factor

Role of Competition

- Allocation of Resources
- Incentive for Efficiency
- Threat of Entry Discipline

Role of Competition

- Incentive for Efficiency
 - ▶ Prices => costs
 - ▶ Pressure to reduce costs
 - ▶ Selection of more efficient firms
 - ▶ Promote innovation
 - ▶ Diminish regulatory imperfections

Additional Motivation for Competition

- Product Differentiation
- Cost Differences
- Benchmark (Yardstick) Competition

Competitive Policy Overview

- Institutional Advantage (Incumbent)
- Technology Advantage (Incumbent)
- Regulatory/Competitive Synergy

Nuttall, Robin and John Vickers, *Competition Policy for Regulated Utility Industry in Britain*, Applied Economics Discussion Papers, Institute of Economics and Statistics, Oxford No. 178, February, 1996.

Competitive Policy Overview

- Institutional Advantage (Incumbent)
 - ▶ Institutionalized cross-subsidies
 - ▶ Name recognition
 - ▶ Established customer-base

Competitive Policy Overview

- Institutional Advantage
- Technology Advantage (Incumbent)
 - ▶ Numbering
 - ▶ Metering?
 - ▶ High customer switching costs

Competitive Policy Overview

- **Institutional Advantage**
- **Technology Advantage**
- **Regulatory/Competitive Synergy**
 - ▶ Competition substitutes for regulation
 - ▶ Competition complements regulation
 - ▶ Regulation can distort competition

Pre-Telecommunications Act of 1996

- **Telephone Companies**
- **Wireless**
- **Broadcasting**
- **Cable**
- **Computer Industry**

Pre-Telecommunications Act of 1996

- **Telephone Companies**
 - ▶ MFJ: Exchange/Long Distance Separated
 - ▶ MFJ: Horizontal Divestiture (Benchmark)
 - ▶ MFJ: Manufacturing Restrictions
 - ▶ No Telco/Cable Cross- Ownership

Pre-Telecommunications Act of 1996

- **Telephone Companies**
- **Wireless**
 - ▶ Preference given to Telco's
 - ▶ Two Wireless Providers

Pre-Telecommunications Act of 1996

- **Telephone Companies**
- **Wireless**
- **Broadcasting**
 - ▶ Protection from Cable (Limited)
 - ▶ Local Content
 - ▶ Ownership restrictions
 - ▶ No rate regulation

Pre-Telecommunications Act of 1996

- **Telephone Companies**
- **Wireless**
- **Broadcasting**
- **Cable**
 - ▶ Local franchises
 - ▶ Limited price control
 - ▶ Carriage requirements

Pre-Telecommunications Act of 1996

- Telephone Companies
- Wireless
- Broadcasting
- Cable
- Computer Industry
 - ▶ Unregulated

Telecommunications Act: Background

- Amendment to the 1934 Act
- Rural Dominance
- Budget Limitations on Congress

Telecommunications Act of 1996

- Universal Service Maintained
- Cross-Ownership Removed
- Manufacturing Restrictions Removed
- Local/Toll Restrictions Removed
- Broadcast Industry Open
- Computer Industry Status Quo

Competitive Policy Assessment

- Competitive Entry
- Price Discrimination
- Cross-Subsidies
- Universal Service Obligations

Competitive Entry: Positive?

- Cross-Ownership Removed
- Local/Toll Restrictions Removed

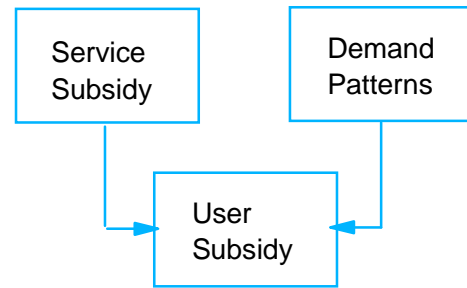
Cross-Subsidies

- No Market Test
- Inefficient
- Avoids Competition
- Anti-Competitive

Universal Service

- **Inefficient**
 - ▶ Not Marginal Subscribers
 - ▶ Not Targeted
 - ▶ Not Desired
- **Incidence Not Addressed**
- **Companies Subsidized**

Incidence



Public Policy Overview

- **"...unleashing monopolies before real competition could mean..."**
 - ▶ Higher prices for consumers
 - ▶ Hinder competition.
- **Transitional safeguards needed**

Agenda

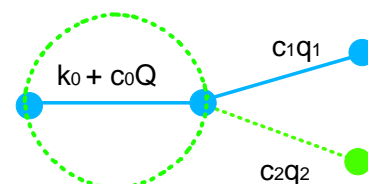
- **Public Policy Overview**
- **Pre-Telecommunications Act**
- **Interconnection Pricing**
 - ▶ Problem
 - ▶ Goals
 - ▶ Solution?

Intermediate Pricing Problem

- **Essential/Bottleneck Facility**
- **Natural Monopoly**
- **Input to Competitive Service**
- **=> Interconnection Price Critical**

Intermediate Pricing Applicability

- **Wireless Competition**
- **Exchange/Toll Competition**



Intermediate Prices Goals

- **Encourage Entry**
 - ▶ Avoid Inefficient Bypass
 - ▶ Avoid Network Duplication
 - ▶ Incentive to Develop & Maintain Network
- **Promote Competitive Market Transition**

J.-J. Laffont & J. Tirole, "Creating Competition through Interconnection: Theory & Practice," ITS Workshop, Wellington, New Zealand, April 10 - 12, 1995

Interconnection Policy

- **Pricing Standard (Sec. 252)**
 - ▶ Based on Costs
 - ▶ Nondiscriminatory
 - ▶ Reasonable Profit
- **FCC's NPRM 96-98**
 - ▶ Determines Policy
 - ▶ Usurps Cable/IXC/States/LECs

Merger Policy Impact

- **Horizontal Mergers Allowed**

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 - ▶ Eliminates Competition --

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SWB/Pacific Telesis (7 becomes 6)

Merger Policy Impact

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 - ▶ Eliminates Competition --
SBC/Pacific Telesis (7 becomes 6)
NYNEX/Bell Atlantic (6 becomes 5)

Merger Policy Impact

- **Horizontal Mergers Allowed**
 - ▶ **Eliminates Competition --**
 - SBC/Pacific Telesis (7 becomes 6)
 - NYNEX/Bell Atlantic (6 becomes 5)
 - ATT/SBC (eliminates potential competition)

Merger Policy Impact

- **Horizontal Mergers Allowed**
 - ▶ **Eliminates Competition --**
 - SWB/Pacific Telesis (7 becomes 6)
 - NYNEX/Bell Atlantic (6 becomes 5)
 - ▶ **Removed Benchmark Competition**

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 - ▶ **Economies of Scale?**

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 - NYNEX/ Bell Atlantic (6 becomes 5)
 - ▶ **Removed Benchmark Competition**
 - ▶ **Economies of Scale?**
 - ▶ **Access Bottleneck Enhanced?**

Long Distance Competition

- **Premature Entry of LEC?**

Rural Issues

- **Carriers' Waiver (2 % rule)**

Rural Issues

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 - ▶ Interconnection exemption

Rural Issues

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- **Rural Competitive Entry Restricted**

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 - ▶ **Competitive Response Limited**

Rural Issues

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 - ▶ Interconnection exemption
- **Competitive Entry Restricted**
- **Rural <= Urban Rates**
 - ▶ Discourage Expansion
 - ▶ **Competitive Response Limited**

Video Policy

- No FCC Rate Review of Cable

Video Policy

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- Redefinition of Video Competition

Video Policy

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- Redefinition of Video Competition
- Common Carriage VDT

Video Policy

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- Redefinition of Video Competition
- Common Carriage VDT
- LEC's Video Rates?

Video Policy

- No FCC Rate Review of Cable
- Redefinition of Video Competition
- Common Carrier VDT
- LEC's Video Rates?
- No Separate Subsidiary, Programming

Policy Assessment: Positive

- Interconnection Required

Policy Assessment: Positive

- **Interconnection Required**
 - ▶ **Agreements mandated**

Policy Assessment: Positive

- **Interconnection Required**
 - ▶ **Agreements mandated**
 - ▶ **Non-pricing rules established**

Policy Assessment: Positive

- **Interconnection Required**
- **Entry Policy Encouraged (in part)**
 - ▶ **Cross-ownership**

Policy Assessment: Positive

- **Interconnection Required**
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 - ▶ **Exchange/toll entry**

Policy Assessment: Positive

- **Interconnection Required**
- **Entry Policy Encouraged (in part)**
 - ▶ **Cross-ownership**
 - ▶ **Exchange/toll entry**
 - ▶ **Horizontal/vertical mergers**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
 - ▶ **Price rules indeterminate**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
 - ▶ Price rules indeterminate
 - ▶ **(Economic) principle undefined**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
 - ▶ Price rules indeterminate
 - ▶ **(Economic) principle undefined**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
- **Entry Policy Distorted**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
- **Entry Policy Distorted**
- **Price Policy Distorted**
 - ▶ **Universal service obligations**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
- **Entry Policy Distorted**
- **Price Policy Distorted**
 - ▶ **Universal service obligations**

Policy Assessment: Negative

- **Interconnection Policy Incomplete**
- **Entry Policy Distorted**
- **Price Policy Distorted**
 - ▶ **Universal service obligations**
 - ▶ **Cross-subsidies (schools/institutions)**