

Commentary

Franchise reform: A no-brainer

By Lawrence J. Spiwak
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Twelve years ago, the Federal Communications Commission found the "local franchise process is, perhaps, the most important policy-relevant barrier to competitive entry in local cable markets." Unfortunately, not much has changed, except cable rates which, according to the FCC, have increased 93 percent over the last 10 years.

While one would think franchise reform would be a no-brainer and a "win-win" for everybody, political infighting prevented Congress from passing legislation to bring consumers meaningful wireline video competition. To their credit, the FCC has stepped into the breach by issuing an order that defines what constitutes an "unreasonable refusal" of a competitive franchise under Section 621 of the Communications Act. Though not a clean fix, the commission's efforts are at least a constructive step in the right direction and should be commended.

Stated simply, streamlined entry into the video market is essential to broadband deployment because basic economics teaches us nobody will make significant network investment just to offer a \$30 voice service to price-conscious residential customers. The old AT&T and MCI never did it, and neither will anybody else.

Instead, additional revenue streams from data and, more specifically video, are required. The big rub is that although the Cable Competition and Consumer Protection Act of 1992 prohibits exclusive franchises, the inherent barriers embedded within the local franchise process -- i.e., the interminable (and lawfully infinite) delay of the process coupled with the imposition of onerous build-out requirements and other political shakedowns -- so hampers new entry that very little wireline video competition has emerged to date.

As a result, entry delayed is entry denied: Recent empirical research demonstrates U.S. consumers stand to lose \$8.2 billion if policymakers delay by just one year the removal of entry barriers to new wireline video providers, and losses increase for each year of delay and would rise to almost \$30 billion if market entry is delayed four years.

Undoubtedly, certain constituencies will cry foul to the FCC's efforts. For example, advocates for municipalities have argued that cable franchise reform will cost local governments at least \$300 million in revenue per year. This claim simply is not true.

To the contrary, introduction of head-to-head wireline competition for video promises to significantly increase gross industry revenues and therefore could substantially increase local franchise fee collections (particularly as satellite does not have to pay any franchise fees). Indeed, recent research reveals that if wireline video competition is successful, then as price declines and consumers buy more, gross taxable revenues from the wireline video industry will increase by an estimated 30 percent.

Others will no doubt argue that franchising reform will somehow lead to economic redlining and the disenfranchisement of the poor and minorities and, therefore, aggressive build-out requirements as a precondition for granting competitive franchises. Empirical research also does not support this claim.

First and foremost, buildout requirements -- despite their altruistic motivations -- are patently anticompetitive because they raise costs and deter entry. Indeed, while it might seem "equitable" for new entrants and incumbents to face symmetrical build-out requirements, incumbents and new entrants view their sunk costs in a very asymmetrical way. Thus, as mandatory build-out requirements unambiguously make entry more costly, entry for much-needed new wireline video competition becomes less likely.

Understanding this important economic fact is not some new revelation: Nearly nine years ago, a Democrat-controlled FCC explicitly preempted state laws that required new facilities-based telephone entrants from any "build-out" requirements, and there is no reason the same logic should not apply to the video side. As such, build-out provisions are a self-defeating exercise and do much to deter competitive entry to rich and poor communities alike.

More significantly, recent research reveals that policies such as local franchise requirements that hinder a new

entrant's ability to sell video programming will strongly diminish that entrant's incentive to deploy broadband networks to low-income households. While there are data that support the conclusion broadband deployment is related to income, the data also reveal low-income households subscribe to video service at roughly the same rate as higher-income households and, as such, the ability of entrants to offer video services substantially improves the financial case for new network investment in low-income neighborhoods. Stated another way, video service takes on the role of a "silver bullet" -- i.e., when the network firm can bundle video with telephony and broadband, the percentage of poverty and minority homes with access to the network rises significantly. It follows, therefore, that policies that make video competition more difficult will lead to significantly lower deployment of advanced broadband networks in low-income areas than would occur with pro-entry video policies.

In sum, the dismantling of the franchise system should have occurred years ago. Although bipartisan efforts in such diverse states such as California, Texas, Indiana, Michigan and New Jersey have taken aggressive steps to promote video entry, the current entry-deterring franchise process continues to deprive millions of American consumers with lower prices and better customer service for their video needs. While FCC action within its authority cannot, by definition, solve the problem completely, until Congress and other states take the necessary steps to eliminate an anachronistic and patently anticompetitive franchise process, the FCC at least has made a significant contribution toward increasing additional broadband deployment and video entry.

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