



Telephony prices, competition and the 1996 Act

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What was our goal?

“to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies”

Why promote competitively priced services?

Because, so long as there are no externalities, competition is most likely to efficiently produce lower prices, higher quality services and innovation.

We might also wish to do things the market may not do, notably ensure access to those who cannot afford it. However, this goal is very different to the goal of the Act. It is likely best achieved by, not by competition, but by carefully targeted subsidies such as Lifeline & Link Up, but unlike much of our aid to rural consumers.

So in a way the question is whether prices for voice telephony services for at least, say, urban subscribers with a willingness to pay for voice telephony that exceeds the 20th percentile are competitive.

What does the NASUCA survey tell us?

I identified 10 states that essentially responded to all the questions (AK, CA, DE, IL, ME, NV, NY, OH, PA, TX)

Looking at nonbasic services (call waiting, forwarding etc.), 8 states reported price rises (AK, IL, ME, NV, NY, OH, PA, TX), & all these appeared large.

These were also the 8 states in which the PUCs had found the supply for these services to be competitive.

Looking at basic services, only 5 states (AK, IL, NY, OH, PA) were deregulated or allowed price adjustments under a cap. In all of these, there were material price rises in the monthly basic access charge.

Of these 5 states, only 4 had passed some judgement suggesting that the market for basic services was competitive (AK, IL, NY, OH)

Summary: non-basic price rises in 8 out of 8 states that are said to be competitive; basic price rises in 4 out of 4 states that are said to be competitive.



In at least 4 of the basic service cases, the rises were constrained by a cap (AK, NY, OH, PA), so they were in line with regulatory policy, but suggests higher prices might otherwise have been observed.

Does this suggest a lack of competition?

Are the price rises too high (or without the caps, would they have been too high)? Were the state PUCs wrong in finding the relevant markets to be competitive?

It's not easy to say by just looking at prices. Were regulated prices set too low so this is just rebalancing (exactly one of the reasons why, if possible, it is better to rely on competition as a regulator for the broad market, than regulation)?

Steady losses in fixed line call volumes and subscriptions (or perhaps not as will be seen) are consistent both with regulatory prices having been set too low, with rebalancing occurring in a competitive environment and with prices reflecting market power.

But amounts of this loss is due to switching toward mobiles. For example, calling substitution from fixed to mobile service has likely amounted to substantially in excess of than 25% of pre mobile fixed calling volumes.

More interestingly, a 2008 Neilson survey found that 17 percent of all homes with a phone rely solely on cell phones (up fourfold in five years). (15.8% in latter half of 2007 (Early Release of Estimates from National Health Interview Survey—<http://www.ctia.org/advocacy/research/index.cfm/AID/10323>); in 2004, the Bureau of Labor and Statistics found that 50.5% of rural households have wireless service, versus 53.5% of urban households. CTIA's analysis of FCC data shows that 51.13% of consumers living in rural areas had wireless phones in 2004, versus 53.9% of all Americans nationwide. http://www.ctia.org/advocacy/position_papers/index.cfm/AID/10308).

Majority are from lower income brackets. Cost cutting is a common reason for dropping the fixed line.

Price increases are likely to only increase loss of fixed line subscribers. Further, shedding of customers that only wish to purchase basic *fixed* telephony service may increase in recession without further price increases.

What is driving carriers' decisions to accept loss of 1st fixed lines?

Is fixed access relatively less profitable than bundles with broadband and/or subscription television, and given the rapid expansion of these bundles, are 1st line losses just due to an inability of the carriers to focus on all lines of business simultaneously? Surely, this is not true of carriers like AT&T and Verizon.

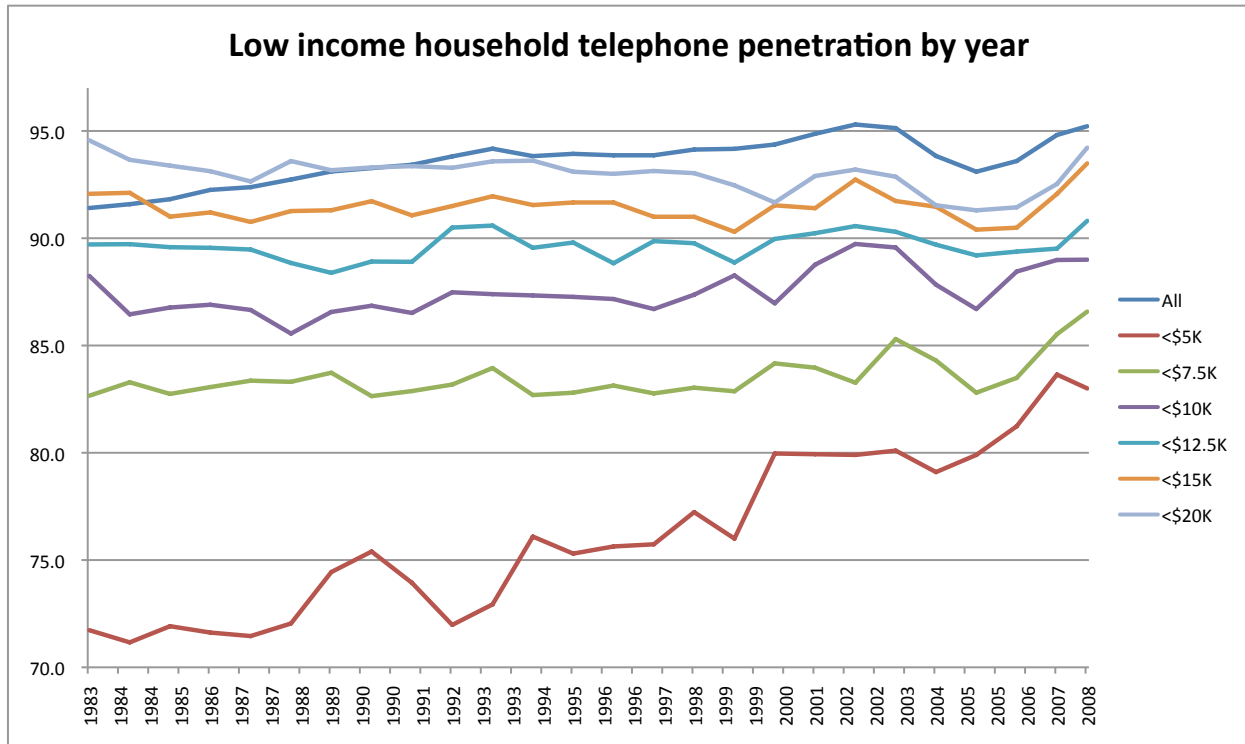
Is *fixed* access not profitable so the losses are consistent with competitive behavior? This seems inconsistent with growth of low value mobile services. Mobile carriers appear to have found a way to profitably service low income households—prepaid telephone service.

Is this because they are subject to much more effective competitive pressures & less distorting regulation?

Why don't the fixed line carriers follow suit? Could tariffing/disconnection etc. rules simply similar approaches on fixed line service impossible?

What do we know about competition for voice services?

Low income customers are not being ignored: penetration among low income customers does not appear to moving significantly differently to other customers, and indeed may be rising (see chart).



As noted, it seems it is mobile carriers that are meeting this demand.

It also appears that some 25% of phone customers are prepared to try mobile only service, & a similar percent are plausibly contestable (will switch for lower prices):

on top of the 17 percent who only have a mobile, a further 10% of those with a landline had returned after attempting to solely rely on mobile phone (cost of cell only options was a cited reason for return);

If 25% of market would switch for lower prices, & this seems especially so for low demand customers, then this suggests the problem is not lack of competition for voice only, or low demand voice only customers (depending on what the appropriate customer market is), but an unwillingness to supply *fixed* voice services under present conditions or tariffs. Is this because the ILECs face regulated terms and conditions (not a matter of price level) that make it hard for them to provide differentiated service (such as prepaid packages that are attractive to lower income groups)?

What about higher income customers?

Customers who demand bundles, not merely of voice services, but including subscription television & broadband, generally have two choices of suppliers. It may also be that for higher income customers the fixed line is not a substitute for mobile service. Thus, even for voice only service, higher income customers may essentially face only two suppliers.

As a result, at least the supply of bundles may not be competitive (and the present recession may be revealing in this respect), but perhaps also supply of voice only service for higher income. Thus, one can see some sense in high voice prices, as a means of maintaining high bundled prices. However, this still does not explain why the ILECs do not price discriminate so as to be able to compete for low demand customers (for example, through prepaid service, as mobile carriers do). That is, it is implausible that the ILECs do not compete for low demand customers because they are per se afraid of cannibalizing their high value demand. Rather, as suggested it may be the case that the ILECs face barriers that make it difficult to implement such prices.

It also seems implausible that the ILECs do not compete for these customers because fixed line cost make it impossible for them to offer fixed line service at a competitive quality-adjusted price. The ILECs effectively market a vast range of services to a vast range of customer groups. It makes little sense that they would be unable to market to profitably meet low income fixed voice demand. For the same reason, it is unlikely that the ILECs are too focussed on bundles to care about voice only fixed line services. Lastly, the ILECs failure to effectively compete for voice only service to low income groups is unlikely to be because they are, after all these years, still Bellheads, incapable of getting beyond past marketing categories, and in particular, cannot learn from their mobile rivals, or for that matter, their own mobile operations.

What does this leave us with?

The regulated price may not have been too low, since mobile prices appear competitive and taking market share.



But the fixed carriers appear to be acting as if 15-25 percent of their possible customer base does not matter to them. One possible explanation for this is that they lack pricing flexibility (not a question of price levels) due to regulatory constraints (since mobile carriers seem able to price discriminate between low and high demand customers).

Prima facie competition for higher end services, notably bundles that include one or both of subscription television and broadband, may be limited.

Going forward within the context of the Act: Increasing competition and deregulating

Deregulate fixed price requirements (not just levels).

Make it as easy as possible for new entrants, and market expansion by existing entrants. New Clearwire (wimax) may help (commercial rollout is occurring, but recession will no doubt hold it back). Access to white spaces may also help over medium term. (Door has been opened to broadband over power lines.) Statewide franchising.

A key question, however, remains as to the extent to which wimax, 3G wireless, and what emerges from access to white spaces ultimately can place substantial constraints on subscription television or fixed broadband in the range of 10 or more Mb/s. Broadband over power lines, while commercially available, will take time to claim substantial market share (if it ever does). That said, competition at the anchor level of broadband may still constrain broadband with superior bandwidth.

Ensure price level regulation does not discourage overbuild (which implies acceptance of higher prices to some extent). If USF is doing its job, then perhaps we should allow market forces, even if not fully competitive, to determine prices and rollout. This is not the only market we make purchases in, in which the key players may have some degree of market power. Overbuild—now Verizon is doing it as well as smaller players like RCN, but unlikely to affect large numbers of customers in the short run, and especially in the current economic environment.

Other ways forward

Is it time to call for a new regulatory compact? For example, a return to rate-of-return regulation rather than long run imaginary costs, where a guaranteed return on audited investments will induce broadband rollout? Problems: likely to result in high cost, rather than efficient, networks; unlikely to generate competition, so permanently embeds regulation. Requires the picking of winners in terms of who (& what) to regulate under what rate-of-return.

Government infrastructure funding?? Many problems. Likely to require ongoing regulation with all its problems), unless willing to provide government funds to sufficient entrants that market is ex post competitive which would be expensive. Would likely



result in lack of efficiency in production, entry and innovation, as such a program requires the picking of winners in terms of who (& what) to fund or subsidize. Difficult questions would be raised about duplicative infrastructure both from existing competitors and if a firm desired to enter on the same terms and conditions as subsidized firms.

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