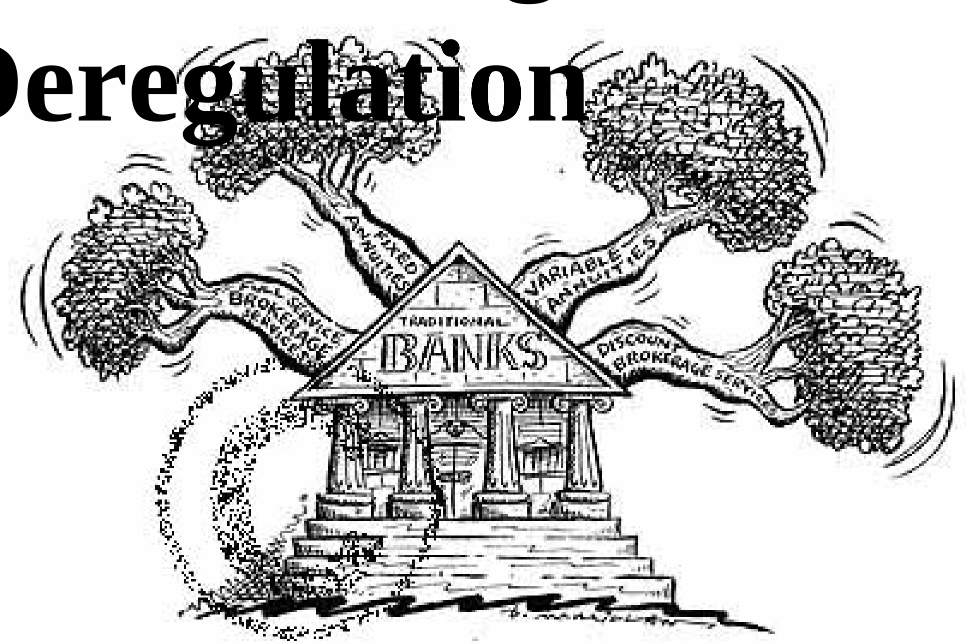
Telecommunications Act of 1996: A Paradigm of Deregulation



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- Public policy overview
  - Monopoly, Regulation, Competition
- Pre-Telecommunication Act
- Telecommunication Act of 1996

Introduction

- Effective on February 8, 1996
- First major change in US communication Laws since 1934 (62 years)
- It affected all parts of industry
- Part of **"Competition – Regulation – Competition"** cycle

Act divided into 7 titles

Title 1: Telecommunication services

Title 2: Broadcast services

Title 3: Cable services

Title 4: Regulatory Reform

Title 5: Obscenity and violence

Title 6: Effects on other laws

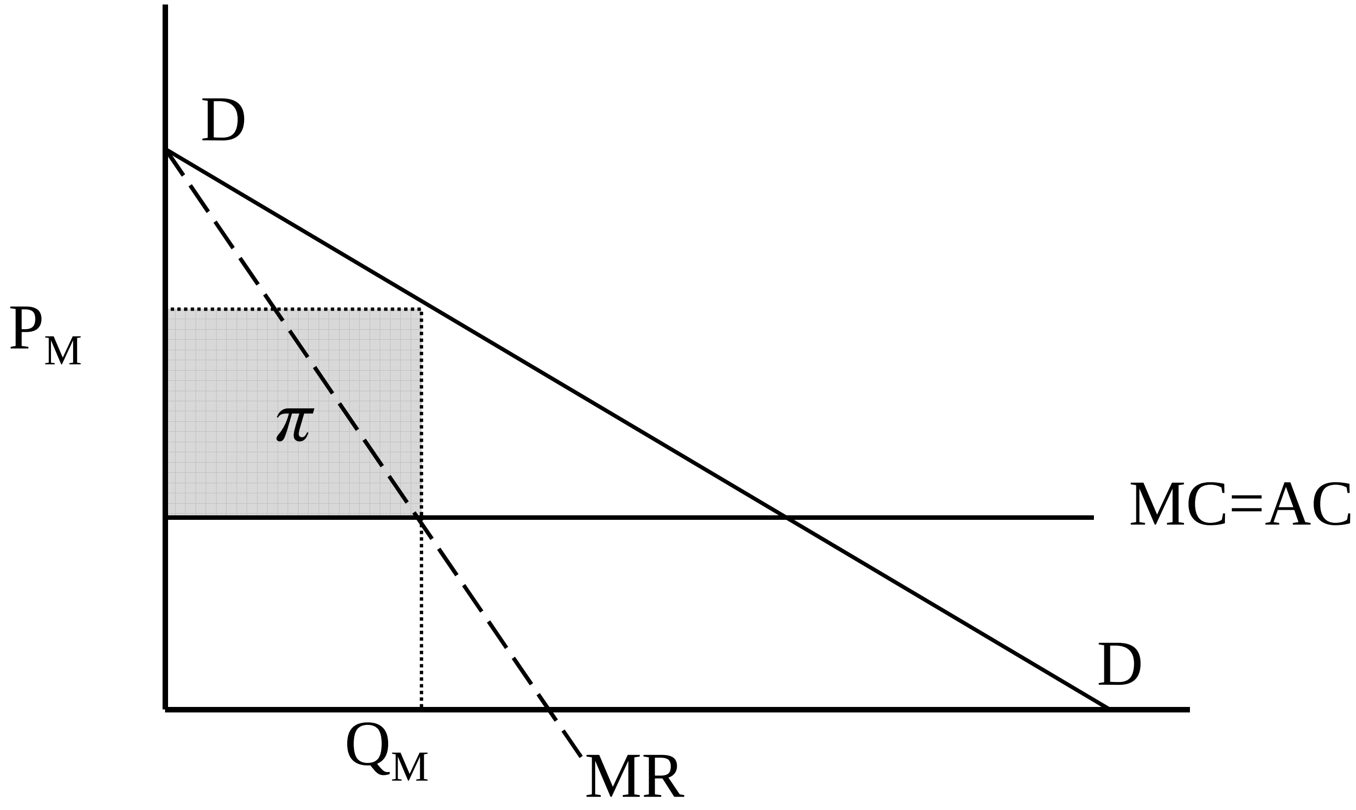
Title 7: Miscellaneous Provisions

Public Policy Overview

Goals:

- Cost minimization
- Correct prices
- Rent extraction (get rid of monopoly profit)
- Equity (equality and fairness)

Monopoly profit



Public Policy Overview: Regulation

Ways to Control:

Regulation/Social control

Rate of return regulation

Revenue Required (RR) for the firm

RR= Operating Expense + Depreciation (t)

$+ r (I - \Sigma \text{ Depreciation})$

Price = RR/Q

No incentive for the firm to save cost

Benchmark (yardstick) regulation

Public Policy Overview: Regulation

Incentive regulation (Price caps regulation)

- Incentive to lower the cost
- Most countries and many states in USA
- Competitive entry encouraged
- Initial price ceiling based on the **standalone cost**
  - $SAC_{yz\ldots} = TC(0, y, z, \ldots)$
  - $IC_x = TC(x, y, z\ldots) - TC(0, y, z, \ldots)$
- Automatic increase limit each year ≤ ΔCPI - X
- Limit on the incumbent's prices (ΔCPI)
- Productivity Factor (incentive to lower cost)
  - X = Industries rate of productivity growth

Public Policy Overview: Competition

- **Anti-trust/Monopoly** policy
- **Competition**
  - Role of competition
    - Allocation of resources
    - Incentive for efficiency
      - Prices based on costs
      - Pressure to reduce costs
      - Selection of more efficient firms
      - Promote innovation
      - Diminish regulatory imperfection
    - Threat of entry discipline

Public Policy Overview: Competition

- Additional motivation for competition
  - Product differentiation
  - Cost differences
  - Benchmark competition
- Advantage of competition
  - Institutional Advantage (Incumbent)
    - Institutionalized cross subsidies
    - Name recognition
    - Established customer-base

Public Policy Overview: Competition

- Technology Advantage (Incumbent)
  - Numbering
  - Metering (pattern of customer's usage, customer-based information)
  - High customer switching cost
- Regulatory/Competitive Synergy
  - Competition substitutes for regulation
  - Competition complements regulation
  - Regulation can distort competition

Pre-Telecommunication Act of 1996

- Telephone companies
  - MFJ: Exchange/Long Distance separated
  - MFJ: Horizontal Divestiture
  - MFJ: Manufacturing restrictions to the LEC
  - No Telco/Cable cross-ownership
- Recent mergers after 1996: SBC+Ameritech, AT&T+Media1, WorldCom+MCI

Pre-Telecommunication Act of 1996

- Wireless
  - Preference given to Telco's
  - Two wireless providers in each city
- Broadcasting
  - Protection from cable
  - Local content
  - Ownership restrictions
  - No rate regulation

Pre-Telecommunication Act of 1996

- Cable
  - Local franchises
  - Rate regulation (price cap)
  - Carriage requirements (local content)
- Computer Industry
  - Unregulated
  - Microsoft’s bundling Internet Explorer into OS

Telecommunications Act

- Background
  - Amendment to the 1934 Act
  - Rural dominance in Congress
  - Budget limitation in Congress
- Major changes
  - **Universal service** maintained
    - Reasonable quality and rate
    - Access to advanced service
    - Access in rural and low-income subscribers
    - Special access for public schools, hospitals and libraries

Telecommunications Act

- **Cross-ownership** restriction removed
  - Telco are permitted to offer cable TV service, or "comparable video service over telephone facilities
- **Manufacturing** restrictions removed
- **Local/Toll** restriction removed
  - RBOCs are freed to provide LL service outside their regions, and inside their regions once completing a series of steps to remove entry barriers

Telecommunications Act

- LECs are required to interconnect with new entrants
  - permit **Resale of service** (non-facility based competition)
  - provide **Unbundled network elements** (switch, local loop, trunk,..)
  - allow **Facilities-based interconnection** (building own facilities)
- Rate deregulation in **Cable TV** except the basic tier
- **Broadcast** industry open
- **Internet and online computer service** includes provisions on “indecent” communications

Interconnection

Interconnection is a general term for the way in which different networks connect to allow traffic to pass between them

Problems

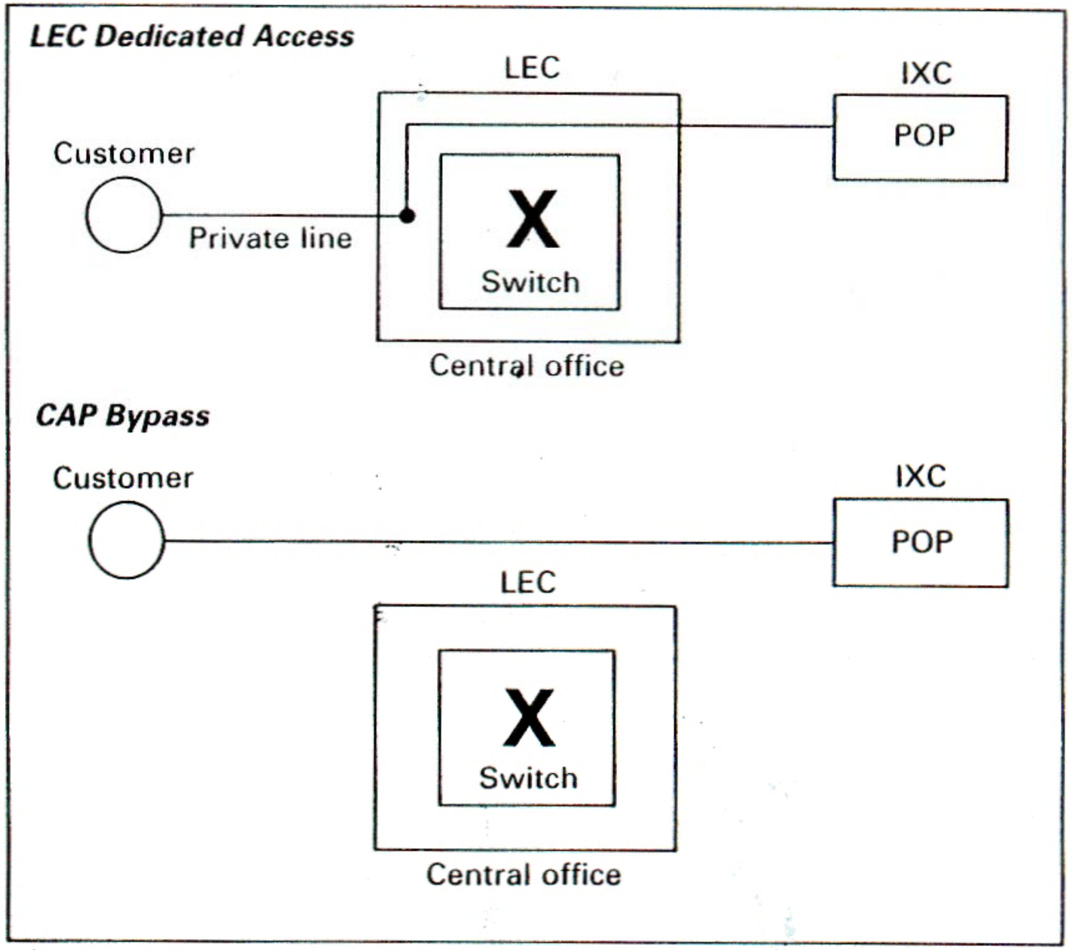
- Essential/Bottleneck facility at local exchange area
- Natural monopoly
- Input to competitive service
- Interconnection price critical
- Wireless competition
- Exchange/Toll competition

Interconnection Pricing

Intermediate Prices Goals

- Encourage entry
  - Competition drives prices toward costs, promote innovations to save cost, and efficiency
- Avoid inefficient bypass and network duplication
  - *Bypass:* A direct private line connection between the customer premises and the IXC POP
  - Incentive to develop and maintain network
- Promote a transition to competitive market

FIGURE 6–1
SPECIAL ACCESS



NOTE: POP, point of presence.

Interconnection Pricing

Interconnection Pricing Standard (Section 252)

- Based on costs
- Nondiscriminatory
- Reasonable profit

Horizontal mergers allowed

- Eliminates competition
  - SBC/Pacific Telesis/Ameritech → SBC
  - Bell Atlantic / NYNEX → Verizon
  - WorldCom/MCI
  - Qwest/USWest → Qwest
- Removed benchmark competition
- Economies of scale?
- Access bottleneck enhanced?

Summary (Telecommunication Act of 1996)

- A Paradigm of Deregulation
- Public policy:
  - Goal
  - Regulation: incentive regulation
  - Competition
- Major changes
  - Universal service maintained
  - Cross-ownership restriction removed
  - Manufacturing restrictions removed
  - Local/Toll restriction removed
  - Broadcast industry open