



December 6, 2005

Telecommunications Deregulation in Texas Promises Increased Competition, Innovation and Efficiency

by Alicia Hansen

In September 2005 the Texas legislature passed sweeping legislation aimed at deregulating the Texas telecommunications market. The legislation, titled an “Act Relating to Furthering Competition in the Communications Industry” (hereafter “2005 Competition Act”), will lead to increased competition and innovation in the Texas telecommunications market, which in turn should improve service, decrease prices, and increase the array of choices available to consumers.

The 2005 Competition Act will promote competition by eliminating entry barriers in two markets and deregulating pricing in a third. The Act contains three major reform measures, which are summarized in Table 1. These provisions work alone and synergistically to promote competition in the telecommunications marketplace. Each of the three reform measures is detailed below.

Table 1. Three Reform Measures of the 2005 Competition Act Promise to Promote Competition and Innovation in Texas’ Telecom Industry

Chapter	Title	Market Affected	Change in Law	Predicted Effect on Market
43	<i>Use of Electrical Delivery Systems for Access to Broadband and Other Enhanced Services, Including Communications</i>	Broadband Internet access	Allows incumbent electric utilities to offer broadband Internet access over their network facilities	Number of broadband Internet service providers will increase; competition with incumbent cable service provider and incumbent local-exchange telephone service provider will have spillover effect in other telecommunications markets.
65	<i>Deregulation of Certain Incumbent Local Exchange Company Markets</i>	Local-exchange telephony	Deregulates pricing in certain local-exchange telephone markets	Local-exchange service providers will set rates according to market conditions, not according to regulatory mandates

66	<i>State-Issued Cable and Video Franchise</i>	Video programming	<p>Creates state-issued cable and video franchise; replaces multiple-franchise system with single, state-issued franchise; levies 5 percent franchise fee; reduces time required to obtain franchise; eliminates build-out requirements.</p>	<p>Number of service providers will increase, leading to lower prices and an increase in quality and quantity of services; estimated gain in economic efficiency is \$15,396,424 per year for video programming consumers; estimated gain in consumer surplus for current video programming subscribers is \$98,066,313 annually.¹</p>
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¹ Donald L. Alexander, Ph.D., Tax Foundation *Background Paper* No. 50, "Telecommunications Deregulation in Texas: An Analysis of the 2005 Competition Act" (December 2005), p. 6.

Source: Tax Foundation

Chapter 43: Broadband Internet Access

Chapter 43 eliminates entry barriers in the broadband Internet access market by allowing, for the first time, incumbent electric utilities to offer broadband Internet access over their network facilities. This emerging technology, called "broadband over power lines" or "BPL," shows great potential for growth: the requisite network infrastructure is already built, and the investment that utilities would need to make to convert their network grids for Internet traffic is feasible.

Consumers would use only a simple modem device to connect to the service, and any household or business in Texas that has electricity is automatically connected to the network. This new technology promises to intensify competition in the broadband Internet access market.

Chapter 65: Local-Exchange Telephony

Chapter 65 deregulates pricing in certain local-exchange telephone markets on January 1, 2006, and in other markets on January 1, 2007. A market will be declared deregulated when it has three or more service providers—for example, the incumbent local-exchange telephone service provider, a facilities-based competitor and a wireless service provider. This condition is likely to be satisfied in many markets because wireless service is nearly ubiquitous and because the emergence of Voice over the Internet Protocol (VOIP) telephone is widely available to consumers with broadband Internet access. Local-exchange service providers will now be free to set rates for residential telephone service according to market conditions rather than regulatory mandates.

Chapter 66: Video Programming

Chapter 66 minimizes service providers' entry costs in the video programming market. It eliminates the requirement that service providers must negotiate and obtain a franchise in each local area they wish to serve—a time-consuming and costly process. Service providers are now required to obtain only a single state-issued cable and video franchise

that allows them to offer service in any local market in Texas. Chapter 66 also eliminates build-out requirements, thereby encouraging entry into the video programming market and giving entrants an opportunity to start on a small scale in a large market. While Chapter 66 encourages new service providers' entry and essentially eliminates the monopoly that exists in many video programming markets, it does not eliminate the state's control over entry into the video programming market.

Effect of the 2005 Competition Act on the Digital Divide

Although a "digital divide" still exists in Texas with regard to income, population density and education, it has narrowed considerably in recent years, and high-speed Internet services are now available in almost every zip code.

However, as Table 2 and Table 3 show, although almost all Texans had access to high-speed service in 2004, only 83 percent of the poorest zip-codes had at least one high-speed subscriber. Therefore, to the extent that the digital divide still exists, it appears to be a demand-side rather than a supply-side problem. As a result, regulatory policies aimed at eliminating it are not likely to be effective.

Increased competition and the resulting price decreases will likely narrow the digital divide more than any regulatory policies will. The 2005 Competition Act should lead to lower Internet service prices and facilitate access for low-income households.

Table 2. Percentage of Zip Codes with at Least One High-Speed Subscriber, Ranked by Median Household Income, 2000 and 2004*

Median Household Income of Zip Code	Percent of Zip Codes with at Least One Subscriber	
	December 2000	December 2004
\$53,494 - \$291,938	96.1	98.8
\$43,617 - \$53,478	88.9	97.6
\$38,396 - \$43,614	79.5	96.7
\$34,744 - \$38,395	74.5	95.0
\$32,122 - \$34,743	71.2	94.3
\$29,893 - \$32,121	67.4	93.8
\$27,542 - \$29,892	66.9	93.6
\$24,855 - \$27,541	65.1	92.6
\$21,645 - \$24,855	61.2	92.9
\$0 - \$21,644	54.9	83.3

* These data relate to the percentage of zip codes sharing a particular median household income. In the second column, 96.1 percent means that 96.1 percent of all zip codes with a median household income between \$53,494 - \$291,938 have at least one high-speed subscriber.

Source: FCC, *High-Speed Services for Internet Access: Status as of December 31, 2004*, July 2005, Table 15.

Table 3. Percentage of Population Residing in Zip Codes with High-Speed Service, Ranked by Median Household Income, 2000 and 2004*

Median Household Income of Zip Code	Percent of Population Residing in Zip Codes with High-Speed Service	
	<i>December 2000</i>	<i>December 2004</i>
\$53,494 - \$291,938	99.8	99.8
\$43,617 - \$53,478	99.0	99.9
\$38,396 - \$43,614	97.8	99.8
\$34,744 - \$38,395	96.6	99.7
\$32,122 - \$34,743	95.9	99.6
\$29,893 - \$32,121	94.5	99.4
\$27,542 - \$29,892	93.8	99.4
\$24,855 - \$27,541	93.1	99.2
\$21,645 - \$24,855	91.1	99.3
\$0 - \$21,644	91.5	99.0

* These data relate to the percentage of zip codes sharing a particular median household income. In the second column, 99.8 percent means that high-speed Internet service is available to 99.8 percent of the population living in zip codes with a median household income between \$53,494 - \$291,938.

Source: FCC, *High-Speed Services for Internet Access: Status as of December 31, 2004*, July 2005, Table 15.

A Model for Other States

With the 2005 Competition Act, the Texas legislature made great strides in telecommunications deregulation. The resulting increase in competition will benefit consumers, telecommunications companies and taxpayers alike. Ultimately, taxpayers bear the burden of excessive and costly state regulations, and all Texans suffer from economic distortions caused by overly restrictive regulatory policies.

While the 2005 Competition Act has been in effect for only two months, economic theory, combined with similar deregulation experiences in other markets, suggests that it will increase competition in local video programming markets throughout Texas. It also provides a model for policymakers in other states who want to transform their regulated telecommunications markets into competitive, innovative, thriving marketplaces that will better meet the economic challenges of the 21st century.

(This “Fiscal Fact” is based on the forthcoming Tax Foundation Background Paper “Telecommunications Deregulation in Texas: An Analysis of the 2005 Competition Act,” by Donald L. Alexander, Ph.D. For more information please contact [William Ahern](#) at (202) 464-5101.)