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# POLICY

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# UNLEASHING VIDEO COMPETITION:

## THE BENEFITS OF CABLE FRANCHISE REFORM FOR MISSOURI CONSUMERS

*By Joseph H. Haslag*

Statewide video franchise reform was first enacted in Texas in 2005. Since then, at least ten other states have enacted similar legislation. The Missouri legislature is currently considering SB 284, a bill that would create a state-wide video franchise system on the Texas model.

Cable television was first developed in 1952 as a way to improve network broadcast signals to rural households. Technology progressed, permitting cable television operators to deliver additional channels. Today, the cable television industry is the dominant provider of video services to American households. A majority of the 109.6 million TV households subscribes to some multichannel video programming distributor.

A review of the economics literature dealing with the video services market demonstrates that it has been hampered by a lack of competition. The market for multichannel video programming services has been dominated by cable system operators. Direct-to-home satellite has

made significant gains in recent years, but it still only accounts for slightly more than one quarter of the subscriptions in U.S. households. Because of technical limitations, direct-to-home satellite is an imperfect substitute for cable systems. Hence, for many consumers, the local cable company is the only realistic option for premium television services.

### History of Federal Cable Regulations

In the 1970s, cable television was frequently depicted as a natural monopoly within municipal markets. But because deregulation was being widely applied to other industries, there was significant political pressure to deregulate the cable television industry. In 1984, Congress freed cable system operators from local, state or federal rate controls in any community where "effective competition" was found to exist by the Federal Communications Commission.

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**More competition  
in the cable  
market means  
lower prices for  
consumers.**

Cable television rates were effectively deregulated on December 29, 1986. In practice, deregulation did not create a competitive market. Contracts between the cable television operators and the local governments typically gave one cable operator a de facto monopoly by granting exclusivity to the city's right-of-way. Not surprisingly, cable prices rose much faster than the rate of inflation.

After attempting to deregulate and observing unexpected price increases, the federal government's knee-jerk reaction was to re-regulate prices with the Cable Television Consumer Protection and Competition Act in 1992. The act also tried to promote competition by providing that "a franchising authority may not unreasonably refuse to award an additional competitive franchise." However, competition continued to be very limited. There are over 33,000 municipal or county jurisdictions that issue cable television franchises. Dealing with each

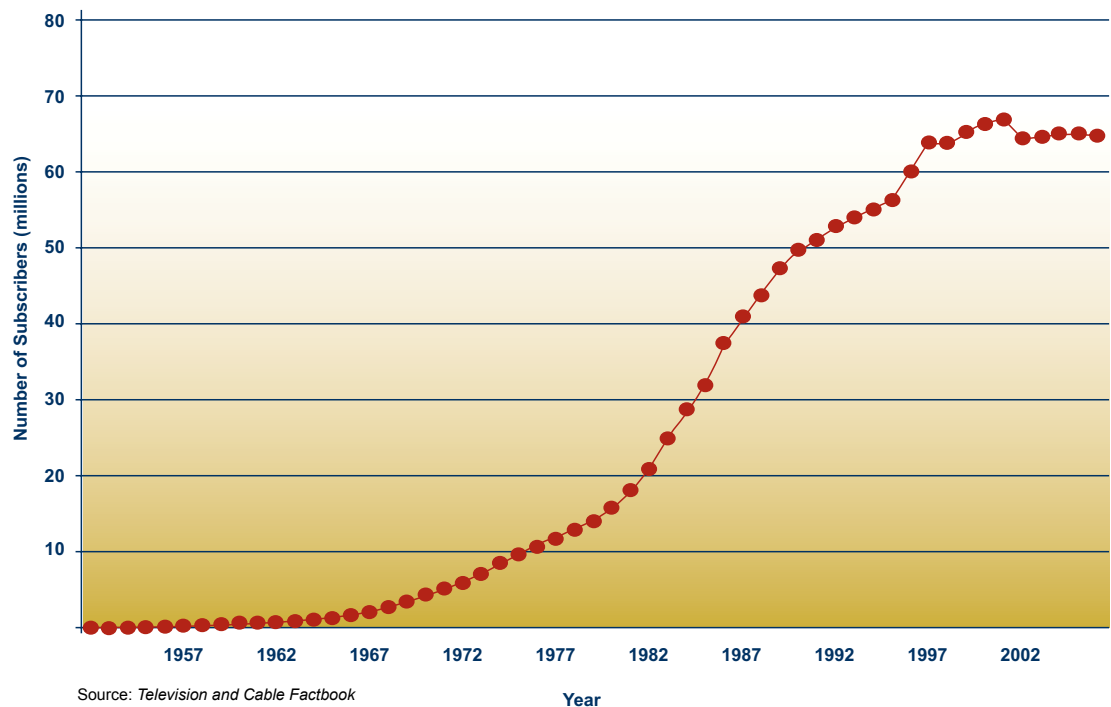
one can be a time-consuming process for a new entrant. This is especially true when local government authorities impose administrative hurdles, including claims that the second franchise would disrupt community activities or that the entrants would be too unregulated.

The Telecommunications Act of 1996 was the last swing in the pendulum as the federal government effectively deregulated cable rates again. So, in March 1999, prices charged on most cable television packages were no longer regulated by federal statute. With the entry of telephone companies and new cable start-ups, legislators argued that prices would be held down by new competitors.

### The Benefits of Competition

Competition is beneficial to consumers and to society. In the absence of competition, a monopolist will set prices too high, hurting consumers who

*Number of U.S. Households Subscribing to Cable, 1952-2006*



*Planned Investment and Number of Expanded Basic Subscribers, by State*

STATE	INVESTMENT (MILLION)	NUMBER OF SUBSCRIBERS	INVESTMENT PER SUBSCRIBER
Michigan	\$620	785,133	\$790
California	\$1000	3,265,808	\$306
Texas	\$800	1,954,378	\$409
Kansas	\$247	307,855	\$802
Indiana	\$250	546,856	\$457

Source: *Television and Cable Factbook*; Investment numbers provided by AT&T

have to pay higher prices. It also hurts those consumers who are priced out of the market entirely, but who would have purchased the product at the competitive price. Economic theory shows that these losses to consumers are larger than the gains to the monopolist—the monopoly is a net loss for society as a whole.

Various scholars have demonstrated that more competition in the cable market means lower prices for consumers. For example, a 2004 paper concludes that cable prices are \$4 per month lower than they would be without the competition provided by satellite television. The lower price benefits the nation’s 67 million cable customers by \$3.22 billion annually. In addition, the study estimates that the additional competition spurred quality improvements to the cable package that are worth about \$1 per month per customer—\$800 million annually. Thus, DBS entry has benefited consumers to the tune of \$4 billion each year.

To calculate the benefit to Missouri consumers from increased competition, I need two statistics. First, I need an estimate of how much the entry of a new competitor will reduce the price of cable television services. The General Accounting Office recently estimated that “overbuild” competition reduces average cable rates by \$7.39 per month. The

FCC, on the other hand, estimates that a second wire line competitor would reduce prices by \$6.50 per month. I use both of these figures in my calculations.

The second statistic I need is a measure of how sensitive consumers are to changes in price—what economists call elasticity of demand. Estimates for the elasticity of demand for cable range from -1.5 to -3—that is, a 1 percent increase in price causes a 1.5 to 3 percent reduction in the number of subscribers. I use 1.5 percent—a conservative value—in my calculations.

I find that Missouri consumers would benefit by between \$66 million and \$76 million from statewide video competition. A review of the literature shows that other scholars have found even higher values. Two recent papers, one by Thomas Hazlett and the other by Jerry Brito and Jerry Ellig, each find that consumers nationwide would benefit by more than \$8 billion from nationwide wire line competition. Adjusting for population, this figure is about twice my estimate.

To compute the net benefit to society from franchise reform, we must also take into account the harms to the video firms themselves. My calculations suggest that incumbent cable providers would be harmed by between \$45 million and \$53 million per year from increased

**Missouri consumers would benefit by between \$66 million and \$76 million from statewide video competition.**



**Increased capital investment will increase state tax revenues.**



Hundreds of millions of dollars of new investment could flow into Missouri as a result of increased video competition. *Photo courtesy Paul Keleher.*

competition. Therefore, the net benefit to the state as a whole is at least \$20 million.

### **The Benefits of Capital Investment**

In addition to the welfare gains accruing to Missouri citizens from price competition, there are also positive effects from new capital investment. A survey of planned investments in five states that have enacted franchise reform shows that on average, incumbent phone companies plan to spend \$553 per subscriber in those states to roll out new video services. If they invest \$553 per subscriber in Missouri, they will spend \$420 million to roll out video services across the state.

But that's not the end of the story, because capital assets generate productive activity that further increases state GDP. I estimate that an investment of \$420 million will increase state GDP

by \$449 million in the first year, and by \$698 million (in present value terms) over 25 years.

Increased capital investment will also increase state tax revenues. If the entire \$420 million were invested in the first year, the state would see a one-time revenue windfall of \$17 million in that first year, and an additional \$1 million in revenues each year thereafter.

In short, increased competition in the market for multichannel video programming would benefit consumers, the state government, and the Missouri economy as a whole. Policymakers should look for ways to dismantle barriers to competition, such as overly restrictive franchising rules, to unleash this competitive potential.

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***For more details, please see Show-Me Policy Study no. 8, which is available at [www.showmeinstitute.org](http://www.showmeinstitute.org).***



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