Surprise, Surprise: Cable Rates Fall After Deregulation

By Thomas W. Hazlett

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Last year television addicts were told to brace for the worst. A wicked feature o f the 1996 Telecommunications Act was kicking in: Rate controls on the popular tiers of cable TV programming in over 60 million U.S. households were set to expire. "A funny thing happens when you deregulate a monopoly," warned Rep. Peter DeFazio, a Democrat from Oregon. "Consumers get shafted."

Predictions of doom were ubiquitous. The Palm Beach Post reported, "Cable Rate Restraints Off; Prices May Soar." Newsday headlined the rate hikes as a done deal: "It's Pay Pay Pay TV; Cable Rates Range Higher and Higher." The Greensboro News & Record editorialized, "Deregulated Cable TV Equals Pricey Mischief," and predicted price increases of $24-$36 a month in the first year of deregulation.

Consumers' Union issued its own stark estimates of the damage. One official predicted rates would annually increase at 5%-6% above the overall rate of inflation. Another condemned lawmakers for allowing the anticipated slaughter, charging "policymakers bear some responsibility to protect consumers from price-gouging monopolies." The solution? "Congress must take immediate, forceful action to correct its mistake and give consumers relief from spiraling cable rates."

An unresponsive Washington yawned. Cable rates were, in fact, deregulated April 1, 1999.

The results of that legislative inaction are now in. According to data for the consumer price index collected by the Bureau of Labor Statistics, inflation-adjusted cable rates declined over the following nine months.

This is astounding news, not only for those who saw deregulation as a death knell for consumers, but for those who saw regulation as a quick fix. Under much-heralded re-regulation in the Cable TV Consumer Protection and Competition Act of 1992, rates rose 2.39% annually, adjusted for inflation. Yet, since deregulation tossed consumers to the wolves in March 1999, real rates have declined about 0.75% annualized. Power Failure The theme of the public debate over cable rate controls was the substitutability of regulation for competition. The underlying assumption was that if monopoly reigns, regulation must be at least a short term palliative. While everyone agreed that the ultimate goal should be the advent of additional choices for subscribers, rate controls were seen as an effective, even necessary, stopgap to protect consumers.

Experience proves this a false dichotomy. Monopoly with counterproductive regulation can be worse than monopoly all by itself.

Despite the continuing, though dissipating, market power of U.S. cable systems, the cable rate controls enacted in 1992 utterly failed. The Federal Communications Commission enacted a series of tough rate rollbacks, pushing down monthly fees by as much as 10% by October 1994. Yet cable-subscriber and ratings growth actually declined from trend in 1993-94-powerful evidence subscribers did not appreciate the "consumer protection."

Cable operators reacted to the controls with countermeasures. They exploited some of the more obvious regulatory loopholes, which is why new service charges mysteriously popped up on subscriber bills in 1993. More creatively, cable-system operators filled their menus with additional shopping networks, where channels pay the operator for carriage.

The ultimate escape hatch was capital flight. Like a South American businessman fleeing the economic policies of a despot, the owners of cable systems stopped investing in their less-profitable properties.

Programmers and equipment manufacturers got hit the hardest. Take Scott C. Anixter. Oh, he's fine, today. His new company, Anicom, is quite successful. But in 1993 he got rid of his old one, Anixter, a cable-television supply firm that yet bears his name.

"Anixter International was deeply entrenched with TCI . . . when the company halted most of its capital spending in the early 1990s following a lending squeeze followed by reregulation of the industry by Congress," reports a recent trade-journal article.

The FCC heard shrill sounds from those who didn't flee. Under intense pressure from cable network programmers to lift controls, it quietly instituted so-called going-forward rules in November 1994. Never again-until deregulation-would rates go up by less than the rate of inflation. More and Higher The regulatory retreat was a success. With rate increases, cable operators improved service and program menus such that consumer growth rebounded strongly in 1995, and stayed positive even as direct broadcast satellite services began cutting into sales following the launch of DirecTV (1994) and EchoStar (1996). From the time of the going-forward rules until the end of controls in March 1999, cable rates rose at 4% annually in real terms-about three times the rate of inflation.

Keeping prices low and quality high turns out to be an impossible task for cable regulators. The turnaround in cable rates after price caps were ended suggests a level of complexity difficult to administer via the FCC's econometric model of cable-TV pricing.

For instance, while high rates are a nuisance, the 11 million households now subscribing to DirecTV or the Dish Network (up 31% in 1999) suggest that cable-TV packages are too skimpy. People are clamoring for greater channel selection and enhanced service quality, and are willing to pay more to get it. Congress' long-delayed enactment, on November 29, 1999, of legislation permitting DBS to carry local TV signals was an important pro-competition measure.

While the FCC's recent report on cable competition applauded DBS as "cable's largest competitor" and pointed to the trend in declining cable monopoly market share, this progress could be reversed. Ominously, the mandate for putting local broadcasts on satellites included the seed of its destruction. Starting in 2002, satellite companies broadcasting any local channel would have to broadcast all of them, without regard to market demand. This could prevent satellites from offering any broadcast network programming. Power of Competition While the 1996 Telecommunications Act did not promote DBS, it did pave the way for a different form of competition. By repealing a 1984 ban enacted by Congress, it permitted telephone companies to own cable television systems. That provision has actually proven more successful than is commonly understood.

Ameritech, for example, aggressively moved into cable markets, receiving franchises in about 108 Midwest communities. By August 1999, it served some 250,000 subscribers. While Ameritech's expansion is in doubt due to its acquisition by SBC, the upstart company RCN has even been bolder, acquiring competitive cable licenses in Boston, New York, Philadelphia, Washington, Los Angeles and San Francisco. In a recent SEC filing, it reported holding some $3.5 billion in cash, including $1.6 billion from Microsoft co-founder Paul Allen. These funds will fuel its construction of integrated voice-cable-Internet facilities, competing with telephone, cable TV and dial-up Internet access companies, through 2003. RCN currently has about 300,000 cable TV subscribers, and a market cap of $5 billion.

Other innovative firms are being spawned by these successes. WideOpenWest is getting competitive cable franchises in Denver and Portland, and is eyeing Dallas. Knology operates "overbuilds" in several markets, including Huntsville and Montgomery, Alabama, and is planning a $75 million system in Knoxville, Tennessee. And Western Integrated Networks has raised half a billion dollars to build in Sacramento and Austin.

The millions of subscribers now living in areas served by multiple cable systems can testify to the effectiveness of market solutions. In Fairfield, Connecticut, Cablevision faced direct rivalry from Southern New England Telephone in early 1999. It charged $30.66 for 73 channels of basic cable service. In noncompetitive Westchester County, New York, Cablevision priced 50 channels at $38, some 24% higher-81% per channel.

Remarkably, these markups were governed by FCC pricing rules designed to impose rates that would prevail in a competitive market. Clearly, regulation failed to emulate competition. But what we also see, with unregulated prices now falling across the country, is that controls failed even to constrain monopoly rates.

When regulation ended last March, FCC Chairman William Kennard said: "The government will be watching closely." Let's hope so.