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The Regulation of Cable TV:

A Review of the 1985-95 U.S. Experience ♣

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The Telecommunications Act of 1996 lifted rate regulation for small cable operators and "sunset" cable rate regulation in March 1999. But cable rates are soaring once again. Some in Congress are now saying that the sunset date should be repealed, and that cable rates should continue to be regulated well into the new millennium.[1] Cable rates have increased about four times faster than consumer inflation. For example, a recent Federal Communications Commission (FCC) survey showed that regulated systems boosted rates by 8.5 percent between 1996 and 1997, and that rates among unregulated systems surged by 9.6 percent over the same period.[2] While the FCC appears reluctant to reregulate rates, though not ruling it out as a last resort, it is of policy importance to examine how effective rate regulations have been in the industry.

Background

For a cable television system to provide service, it must first lay down cable connecting its headend to homes that potentially subscribe to the cable service. This technological characteristic, which is similar to those of local telephone and electricity, has left most local cable systems as single service providers in each franchise. Without alternative service available to consumers, cable systems may raise price by restricting output, leading to a misallocation of resources, and an income transfer from consumers to producers. Typically, in such cases, governments have intervened in the markets and regulated the economic behavior of local monopolies.

The rationale for intervention is that consumers who would be willing to pay at least the cost of

providing the service should be able to receive it, thus improving consumer welfare.[3] In this regard, cable television industry has been no exception.

Regulation of cable television has been marked by two distinctive regimes. Before passage of the Cable Communications Policy Act of 1984, which became fully effective at the end of 1986, municipalities played the major role in cable television regulation.[4] Municipalities regulated cable pricing and quality decisions through competitive franchise bidding, price control, in-kind concessions, such as free TV channels for public use, and franchise fees.[5] Franchise fees were typically *ad valorum* taxes levied as a percentage of a cable company's gross, or basic service, revenue.

The 1984 Cable Act substantially restricted the role of municipalities, preempting their authority to control cable rates, and imposing a franchise fee ceiling at five percent of gross revenue.[6] However, the 1984 Cable Act failed to introduce competition, and left cable systems as "protected" local monopolies.[7] The 1984 Cable Act resulted in price increases, consumer complaints, and the enactment of the Cable Competition and Consumer Protection Act of 1992. The 1992 Cable Act directed the FCC to "reregulate" cable prices.[8] Rather than returning regulatory power to municipalities, the FCC opted for federally controlled price caps for most cable systems.[9] The FCC's original rate regulations took effect on September 1, 1993, but were revised and became effective on May 15, 1994. Under the revised regulation, cable systems could raise prices by meeting the conditions outlined by the FCC (e.g., number of TV channels offered).

Data Analysis and Some Implications

This note employs two data sets. The first set consists of cable systems that operated in Florida during the years of 1985-1990. Of the total number of cable systems, there were 72 with complete and consistent data. The second set includes Florida cable systems that operated during the years of 1990-95. Of the total number of cable systems, there were 78 with complete and consistent data. While the 1985-90 sample moves from regulation to deregulation under the 1984 Cable Act, the 1990-95 sample moves from deregulation to reregulation under the 1992 Cable Act.[10] Table 1 reports summary statistics for the two samples, revealing some noteworthy differences.

The 1985-90 sample shows that prices increased by about 64 percent. They increased 3.4 times faster than consumer inflation, and about two times faster than the household income. While this price increase is very large, the quality of service improved by a larger proportion. Channel capacity, on the average, increased by 66 percent, and the number of TV channels offered by a cable system increased by 85 percent. Consequently, the average price-per-channel (not shown in Table 1) fell from $0.67 to $0.63, and the average change of price-per-channel per system was a decrease of about 2 percent. In addition, cable systems were actively expanding their markets. The length of cable increased by about 54 percent, and the number of homes passed by cable increased by 50 percent. The 1985-90 sample shows that cable systems, freed from municipal rate controls, raised prices significantly but also improved the quality of service by expanding channel capacity and by increasing the number of channels offered. As a result, more people subscribed to cable service, with the penetration rate (not shown in Table 1) rising from just above 64 percent to 67.4 percent. The average penetration rate increase per system was approximately 9 percent.

The 1990-95 sample shows some significant differences from the 1985-90 sample. While prices increased in both periods, the 42 percent average rise in the 1990-95 period was smaller than the 64 percent increase in 1985-90. The price increases relative to inflation and household incomes were also smaller.[11] Specifically, they were 2.7 times and 1.8 times greater than inflation and the household income, respectively, versus 3.4 times and two times greater in the 1985-90 sample. While they all increased in absolute terms, the percentage increases in channel capacity, the number of TV channels offered, and the length of cable, were smaller in 1990-95 than in 1985-90 (33, 40, and 22 percent respectively, versus 66, 85, and 54 percent).[12] Consequently, the price-per-channel rose only slightly (from $0.65 to $0.66), and the price-per-channel per system rose by about 9 percent. The 1990-95 sample shows smaller price increases than for 1985-90, but the quality of service in terms of channel capacity and the number of channels offered did not increase as much as they did in the earlier period. The penetration rate showed no significant change over the years of 1990-95.[13]

At least two points are inferred from the data. First, while they are different in form, both local franchise regulation (before the full implementation of the Cable Act of 1984) and federal price cap regulation (under the Cable Act of 1992) appear to have had negative impacts on the quality of service. Lower prices imposed by governments may have discouraged cable operators from increasing the quality of service. Second, in terms of consumer welfare, these results place the efficacy of federal price regulation in question. The data indicate that federal price capping, which was applied uniformly to most systems, was binding. The standard deviation of price-per-channel (not shown in Table 1), as of 1995, shows a large reduction from the 1990 value, decreasing from $0.31 to $0.22. However, price-per-channel increased by around 9 percent and the penetration rate remained the same over the years of 1990-95.

The influence of factors other than regulation (such as the industry moving into a more mature and slow growing phase) have not been specifically accounted for. At the same time, the data do not appear to provide evidence that federal price capping has improved consumer welfare. This, presumably, being amongst its main objectives.

Table 1: Percentage changes on the basis of the 1985-90 & 1990-95 samples

	1985-90 % Change	1990-95 % Change
Price	64.33	42.00
Consumer Price Index	19.11	15.45
Number of Channels	85.47	40.11
Channel Capacity	65.76	32.98
Length of Cable	54.14	21.87
Homes Passed	50.23	24.39
Number of Subscribers	55.25	24.52
Household Income	32.63	23.12

Table 1 (*continued from previous page):*

	1985-90 % Change	1990-95 % Change
Price per Channel	-2.03	9.19
Penetration Rate	9.57	0.38
Age of System	13.49	16.01
Number of Observations	72	78

For the full table please contact the corresponding author.

ENDNOTES

1. Pursuant to a “sunset” provision adopted by Congress in the Telecommunications Act of 1996, cable programming services will not be subject to rate regulation after March 31, 1999. However, on July 29, 1998, Representatives Billy Tauzin (Republican, Louisiana) and Ed Markey (Democrat, Massachusetts) introduced legislation that would allow the FCC to regulate cable TV systems at anytime after the so called sunset date if the local franchise authority declares that the system failed to offer “fair prices and fair choices”.
2. FCC Report (FCC 97-409).
3. Note that this is the normative argument for regulation. For a detailed account of the evolution of the cable television regulation, see, for example, Owen and Gottlieb (1986).
4. Some cable systems were state-regulated/deregulated.
5. For a discussion of local franchise regulation, see Prager (1990) and Zupan (1989a & 1989b).
6. Only a small number of mainly rural cable systems were still subject to rate controls.
7. Owen and Gottlieb (1986) argue that the 1984 Cable Act made it more difficult for entrants to challenge incumbents.
8. Premium services, such as HBO, have never been rate controlled, but are indirectly affected by basic service rate control. See Mayo and Otsuka (1991).
9. Once again, some cable systems, mostly rural ones, were exempted from price caps.
10. Hazlett (1997) reports that the effects of reregulation appear around 1994.
11. This relatively smaller price increase may have been due to competitors such as home satellite systems. However, the prices of home satellite systems were still much higher relative to those of cable service as of 1995. Further, the industry had some difficulty entering urban and suburban areas due to federal regulation that restricts the delivery of traditional broadcast (over-the-air) programs via home satellite systems where such signals are available over-the-air.
12. Note, however, that the slow down in growth in terms of channel capacity, the number of TV channels and the length of cable, may be partially attributed to the industry moving into a mature phase.
13. The finding of no significant increase in the penetration rate over the years of 1990-95 may not be attributed entirely to the increase in price-per-channel, however. It may be partly owing to the natural progression of the industry as cable systems expanded to areas where the expected penetration may have been much lower. The average increase in the number of homes passed during the 1990-95 was 6664 per system and the increase in the number of subscribers was 2472 per system. The penetration rate in the newly cabled areas is then only about 37 percent. This is significantly lower than the average penetration rate of the already cabled areas, which is 65 percent as of 1990, in the 1990-95 sample.

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♣ *The views expressed here are personal to the author(s) and do not necessarily reflect those of the other staff, faculty or students of this or any other institution.*

Book Review:

Peter Gowan. (1999) The Global Gamble: Washington's Faustian Bid for World Dominance. Published by Verso, 1999. PP 280. ISBN 1 85984 271 2.

Throughout the last decade the world has experienced unprecedented instability – a New World Disorder. The background to this has been the Long Stagnation and productivity slowdown; and the resulting deepening conflict between the major industrialized powers. Instead of capital being invested in capacity expanding plant and equipment in the financially powerful states, we have seen an asset price bubble of outlandish proportions and mushrooming national and cross-border take-overs. Peter Gowan in his new book sees this as the eventual result of the US project to enforce worldwide what he dubs the Dollar-Wall St Regime (DWSR), in the wake of the collapse of Bretton Woods and the growing economic threat from its major rivals. The US - in alliance with the City of London – was then free to use the power of the dollar, together with the overweening dominance of its financial markets, to tear down barriers to unrestricted capital flows. This saw a shift from Central Bank to commercial bank control of the world financial system.

Gowan documents how the US used its dominance over the mid-East oil producers to engineer the quadrupling of oil prices in 1974 so as to economically wound its German and Japanese competitors. This simultaneously strengthened its banks by recycling the excess petrodollars – through the eurodollar market centred in the City – to much of the Third World. Additionally, argues Gowan, during the last quarter century the US has manipulated the dollar exchange rate as a policy instrument. This had

first required the re-establishment of the dollar as a store of value, reversing the inflationary vehicle for transactions that it had become in the dying years of Bretton Woods. Of course, the other financially powerful states didn't stand idly by. Accordingly, the Bonn-Paris axis sought ways to counter the DWSR. A common currency was the only feasible option. The sting in the tail, however, was that this sort of reply by the EU meant adapting to the Anglo-Saxon model of corporate governance, thereby advancing the DWSR. Gowan is at pains to point out that this underlying hostility didn't rule out collaboration amongst the core powers in the various world institutions – but he documents how such collegiality was almost always on US terms. Meanwhile, as US power grows and the DWSR engulfs ever-greater sectors of the world, the development of new exotic financial instruments marches on unabated. The ballooning stock markets and essentially unregulated derivatives markets has been the result, exposing the world's financial markets to unprecedented systemic risk.

As the US has taken the steps necessary to advance the DWSR, notably through the manipulation of interest rates, it has learned that the ensuing crises in the Third World actually have beneficial effects in furthering its strategy. Any country in crisis sees a "flight to quality" (engineered by the top hedge funds), a consequent currency collapse, and financial and economic mayhem. In return for IMF bail-outs the victims are forced to re-organise their relations of production to the advantage of US finance capital, exposing the most viable private corporations and financial institutions to take-over at now bargain-basement prices, and through enforcing privatisation, opening up the patrimony of Third World countries to MNC predators. Indeed, Gowan plausibly suggests that it was US determination to impose the DSWR over the East Asian economies that precipitated the 1997 crisis.

This radical and original thesis is not some simple flight of fancy, but draws on authoritative sources, including from central spokespeople of various US administrations. However, Gowan does tend to somewhat over-state his case. He quite rightly rejects the notion that the increasing power of MNCs means the weakening of the nation state, as is often claimed – quite the opposite. Yet, he gives far too much weight to US statecraft in establishing the DWSR. Equally, his contention that the breakdown of Bretton Woods was a conscious political decision designed to strengthen the US is surely open to question. The demise of Bretton Woods was the other side of the growing economic threat of its major rivals, and signaled the end of US hegemony, not a platform allowing it to scale greater heights. Thus, despite its subsequent success with the DWSR project, the US is weaker today than it was at that time. The dollar does not dominate the world as it once did. A *vehicle* currency should not be confused with a *top* currency, albeit continuing to derive huge seigniorage benefits in the former role. Despite the early stumbling of the *euro*, it is the first serious challenge to the dollar. But whereas the dollar could take over from sterling as the world's top currency, this the *euro* can never do. Thus, insofar as the dollar cannot assume its former glory, the advent of the *euro* promises greater world financial instability.

There is also room for argument over Gowan's insistence that the main strategic threat to US interests lies in the cluster of Asian economies, headed by Japan. A serious economic threat does come from this quarter. However, the major *strategic* obstacle in this region is China. And the Russian challenge has by no means been removed. In both these cases, the task is not that of re-organising a specific form of capitalism in line with the DWSR, but rather to restore capitalist social relations as such. The US is perhaps further away from achieving this than it was a decade ago.

Nonetheless, Gowan's is an important contribution to understanding today's world. The documented sources he digs out are fascinating and cast new light on well-known events. It is a scholarly work breaking down the artificial academic compartmentalization between politics, international relations and

economics. Yet his analysis and narrative read like an exciting novel.

Brian Grogan

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April 9-11, 2001: Annual Conference of the Royal Economic Society, to be held at the University of Durham, UK. Theme: Papers in all areas welcome and should be sent to Professor Carol Propper, Chair of the RES 2001 Conference, Department of Economics, University of Bristol, 8 Woodland Road, Bristol BS8 1TN, UK.

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