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ADDENDUM: PHOENIX CENTER POLICY BULLETIN NO. 13

February 2006

STATE-BY-STATE BREAKDOWN OF THE CONSUMER WELFARE COST OF FRANCHISE REFORM DELAY

In PHOENIX CENTER POLICY BULLETIN NO. 13, *"In Delay There Is No Plenty:" The Consumer Welfare Cost of Franchise Reform Delay,*[1] we estimated that delaying video entry by one year would cost Americans $8.2 billion in consumer welfare and, moreover, that these losses increase with each year of delay (nearly $30 billion for a four year delay). In this ADDENDUM, we provide a state-by-state breakdown of these consumer welfare losses, by means of the same methodology used in POLICY BULLETIN NO. 13.

Seeking to emulate the success of Texas's recent overhaul of their local franchise process, other state legislatures are also exploring whether their local video franchising rules should be modified in order to accelerate entry.[2] The delays and increased entry costs caused by the local franchising process are well-documented, and it is no surprise to us that the only competitors that have made any significant inroads into the multichannel video programming distribution market are Direct Broadcast Satellite firms, which are specifically exempt from the local franchising process and do not pay franchise fees. Nevertheless, the Federal Communications Commission and the Government Accountability Office have repeatedly found that DBS

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1 G.S. Ford and T.M. Koutsky, *"In Delay There is No Plenty:" The Consumer Welfare Cost of Franchise Reform Delay,* PHOENIX CENTER POLICY BULLETIN NO. 13 (January 2006) (available at: http://www.phoenix-center.org/PolicyBulletin/PCPB13Final.pdf).

2 At the time of this writing, the media has reported that franchise reform legislation is either under consideration or is about to be introduced in such diverse states as Indiana, Florida, Virginia and New Jersey, and more states are expected to join the fray shortly.

competition does not provide consumers with lower prices to the same degree that direct, wireline video competition presents.[3]

The premise of POLICY BULLETIN NO. 13 was that delays in reforming the franchise process force consumers to pay higher prices for video services. Cable rates are the ultimate "kitchen table" issue—every month a family pays a cable bill that is higher than it otherwise could be, and once spent that money cannot be made given back to the consumer by future competition. Moreover, in places where states act, consumers see almost immediate benefits. Last year, the Texas legislature implemented a statewide franchising law without build-out requirements, and consumers in Texas are seeing significant new entry[4] and cable price cuts *immediately:* a recent survey by Bank of America shows that in areas where Verizon's new FiOS television service is now available, incumbent cable companies have implemented price cuts of 28-42%.[5]

Policymakers should engage in a cost/benefit analysis when making decisions that affect consumers. The dramatic price cuts that await American consumers if wireline video competition emerges are real and not mythical. Delaying the onset of these lower prices for video services imposes a real cost on consumers, and POLICY BULLETIN NO. 13 tried to quantify the costs to consumers. We showed that policies that delay entry for one year would cost American consumers $8.2 billion nationwide; policies that delay entry for four years would cost consumers $29.9 billion. In this ADDENDUM, we use the same methodology to estimate the costs of delay on a state-by-state basis. A short description of that methodology follows, and the results are found in the attached tables.

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[3] *Direct Broadcast Satellite Subscribership Has Grown Rapidly, but Varies across Different Types of Markets, Report to the Subcommittee on Antitrust, Competition Policy and Consumer Rights,* Committee on the Judiciary, U.S. Senate, US Government Accountability Office, GAO-05-257 (2005) ("GAO 2005 Study"). *See also* George S. Ford and Thomas M. Koutsky, *Franchise Fee Revenues After Video Competition: The "Competition Dividend" for Local Governments*, PHOENIX CENTER POLICY BULLETIN NO. 12 (November 2005) at nn. 16 and 27 (available at: http://www.phoenix-center.org/PolicyBulletin/PCPB12Final.pdf), for a detailed analysis of the price effects from competition estimated by the GAO 2005 Study.

[4] According Texas Public Utilities Commission's official "State-Issued Certificate Of Franchise Authority Directory" (available at: http://www.puc.state.tx.us/cable/directories/SICFA/SICFA_Directory.htm) as of the date of this writing, over fifteen new franchises were granted since the passage of the Texas legislation, and seven other new franchises (all of them ironically from existing cable MSOS) are pending.

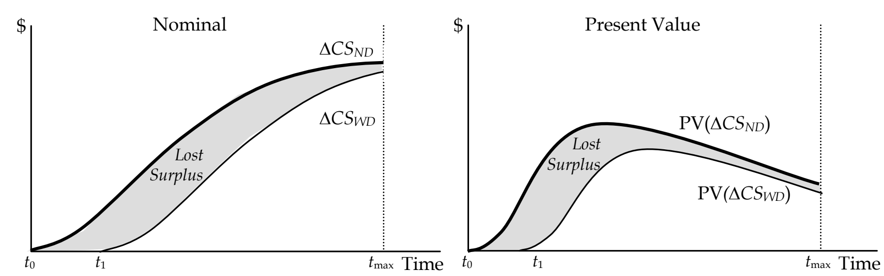
[5] Bank of America Equity Research, *Battle for the Bundle: Consumer Wireline Services Pricing,* (January 23, 2006), 10. Verizon Chairman and CEO Ivan G. Seidenberg testified that "even customers who don't have FiOS TV like it. That's because, where FiOS TV competes with cable, consumers see their cable bills go down."). Testimony of Ivan G. Seidenberg, Chairman and CEO, Verizon Communications, before the Senate Committee on Commerce, Science and Transportation (January 31, 2006) (available at: http://commerce.senate.gov/pdf/seidenberg-021506.pdf) at 2.

Estimation Methodology. Generally, the welfare loss we compute is the difference between the consumer welfare in a scenario where franchising is eliminated and consumers begin to realize the benefits of increased competition in the video services markets now versus elimination at some point in the future. The gains to consumers are measured in the form of price reductions for video services and the (monetized) welfare gains from prices moving closer to marginal cost. Since construction and penetration of the rival network occurs over time, all the benefits are measured as the present value of the flow of surplus over the planning horizon.

Figure 1 illustrates the calculation. In the left-hand panel, the S-curves for consumer welfare gains without (ΔCS_{ND}) and with delay (ΔCS_{WD}) in franchise reform are illustrated. The "difference" in these two curves is the lost consumer surplus from delay (the shaded area labeled "Lost Surplus").[6] A full description of the left-hand side figure and calculations are provided in POLICY BULLETIN NO. 13.

In the right-hand panel, the changes in consumer welfare are presented in their present value or discounted form [*i.e.,* PV(ΔCS_{ND}) and PV(ΔCS_{ND})]. Discounting implies future dollars have less value than current dollars. For example, at the discount rate assumed in the simulation (5.25%), a dollar twenty years from now is worth only $0.36 today. The downward sloping portions of the Present Value curves are manifestations of discounting. As illustrated in the right-hand panel, most of the gains from franchise reform are in the early years of the planning horizon, showing why changes to the planning horizon do not materially alter the results.[7]

Figure 1. Loss Calculation, Nominal and Present Value



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6 It is the difference in the integrals of the two curves (or, the area beneath the curves).

7 *See* POLICY BULLETIN NO. 13, *supra* n. 1 at Sec. IV.E. ("If the horizon is reduced to 20 years, then the surplus loss falls by about 5%. Alternately, if we increase the horizon to 30 years, then the surplus loss increases by about 4%.")

For state level estimates of the welfare loss, we employ the exact same methodology as in POLICY BULLETIN NO. 13, but replace national with state-level inputs where necessary. This procedure requires the replacement of three inputs: (a) the number of television households; (b) household growth; and (c) aggregate video penetration.[8] Inserting these three inputs into the simulation algorithm, the share of the total welfare loss for each state can be computed.[9] The other benchmark assumptions are unchanged, including the own-price demand elasticity for video service (-1.5), the price reduction from competition (15%), an average monthly price of $50, and a terminal overlap of the rival network of 90%. The deployment rate of the rival network is homogeneous and identical to that in POLICY BULLETIN NO. 13 (S-Curve parameters are $b = 4.3$, $k = -0.27$). Welfare effects are computed over a 25-year planning horizon and are discounted at a nominal social discount rate of 5.25%. We provide a sensitivity analysis of the results to key assumption in POLICY BULLETIN NO. 13, so we do not repeat that analysis here.

By using state level to run the simulation rather than simply allocating welfare losses by television households, we get a more accurate indication of what consumers lose from a delay in franchise reform. A state with a lower penetration of video services or slower household growth will have less to gain from lower video prices, and our method accounts for this fact. A simple household allocation scheme would not.

Table 1 summarizes the state-level welfare losses. By design, the sum of the state estimates equals the national aggregate values from POLICY BULLETIN NO. 13. We do note that the $8.2 billion (for one-year delay) is only $7.6 billion once we account for the fact that the state of Texas has passed a law radically reforming the franchising process and consequently substantially reducing barriers to entry for terrestrial video competition (reducing the loss to consumers by $597 million). As the Texas experience indicates that consumers will immediately enjoy the fruits of franchise reform in the form of lower prices, increased choice and, perhaps most significantly, advanced broadband network deployment,[10] the benefits to consumers estimated here, which are by no means exhaustive of the benefits of increased competition in video and related markets, should be accounted for in a cost-benefit analysis of franchise reform.

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8 For the first two inputs, census data is used. For aggregate video penetration, we use estimates provided on the website for RFDTV dated January 1, 2005 (http://www.rfdtv.com/demographics.asp).

9 The simulation computes total consumer welfare loss, but we use these numbers to allocate the $8.2 billion for consistency. The simulation actually estimates a national welfare loss of $7.9 billion, which is very close to the $8.2 billion using national figures (less than a 4% difference). The differences are attributable to the different data sources and methods by which national data is constructed from state data.

10 *See* Bank of America, *supra* n. 5.

Table 1. Consumer Welfare Losses from Delayed Franchise Reform

(M = Million)

Region	State	One-Year Delay	Two-Year Delay	Three-Year Delay	Four-Year Delay	Five-Year Delay
West						
	AK	$12M	$24M	$35M	$45M	$55M
	CA	852M	1,653M	2,404M	3,114M	3,783M
	CO	150M	291M	421M	544M	658M
	HI	31M	59M	86M	112M	136M
	ID	33M	64M	93M	121M	146M
	MT	22M	42M	61M	79M	97M
	NV	103M	197M	285M	366M	441M
	OR	94M	182M	265M	342M	416M
	UT	62M	120M	173M	224M	271M
	WA	173M	336M	488M	632M	767M
	WY	15M	30M	44M	57M	69M
Southwest						
	AZ	178M	344M	498M	642M	777M
	NM	49M	94M	137M	178M	216M
	OK	90M	175M	255M	331M	402M
	TX	597M	1,156M	1,678M	2,169M	2,630M
Southeast						
	AL	134M	260M	378M	490M	595M
	AR	74M	143M	208M	269M	327M
	FL	626M	1,211M	1,756M	2,268M	2,748M
	GA	348M	673M	975M	1,257M	1,522M
	KY	124M	240M	349M	453M	550M
	LA	117M	227M	330M	428M	520M
	MS	76M	147M	213M	276M	336M
	NC	288M	556M	807M	1,043M	1,264M
	SC	129M	250M	363M	469M	569M
	TN	177M	343M	498M	645M	783M
	VA	236M	457M	664M	858M	1,042M
	WV	54M	105M	153M	198M	241M

Table 1. Continued

Consumer Welfare Losses from Delayed Franchise Reform

(M = Million)

Region	State	One-Year Delay	Two-Year Delay	Three-Year Delay	Four-Year Delay	Five-Year Delay
Northeast						
	CT	$93M	$181M	$263M	$341M	$415M
	DC	12M	24M	34M	44M	54M
	DE	27M	52M	76M	98M	119M
	MA	165M	321M	468M	607M	739M
	MD	151M	292M	425M	551M	669M
	ME	37M	72M	105M	136M	166M
	NH	39M	76M	110M	143M	173M
	NJ	229M	445M	647M	839M	1,020M
	NY	458M	889M	1,295M	1,680M	2,045M
	PA	329M	639M	930M	1,206M	1,467M
	RI	26M	51M	75M	97M	118M
	VT	18M	34M	50M	64M	78M
Midwest						
	IA	85M	165M	240M	311M	378M
	IL	339M	657M	956M	1,239M	1,505M
	IN	174M	337M	490M	634M	770M
	KS	73M	141M	206M	266M	324M
	MI	271M	525M	764M	989M	1,202M
	MN	140M	271M	393M	509M	617M
	MO	151M	294M	427M	553M	672M
	ND	18M	35M	51M	66M	80M
	NE	49M	95M	138M	179M	218M
	OH	306M	593M	863M	1,119M	1,360M
	SD	21M	40M	58M	75M	91M
	WI	149M	289M	420M	543M	660M

Table 2. Consumer Welfare Losses from Delayed Franchise Reform
(Per Video Household)

Region	State	One-Year Delay	Two-Year Delay	Three-Year Delay	Four-Year Delay	Five-Year Delay
West						
	AK	$73	$145	$212	$272	$333
	CA	78	150	219	283	344
	CO	100	194	281	363	439
	HI	79	150	219	285	346
	ID	94	183	265	345	417
	MT	72	137	199	257	316
	NV	136	260	376	483	582
	OR	80	156	227	293	356
	UT	98	190	275	355	430
	WA	82	160	232	301	365
	WY	72	145	212	275	333
Southwest						
	AZ	106	204	296	382	462
	NM	81	155	226	294	357
	OK	74	144	210	272	331
	TX	90	174	253	327	396
Southeast						
	AL	77	150	218	283	344
	AR	79	152	221	286	348
	FL	95	184	267	344	417
	GA	104	201	291	375	454
	KY	79	152	221	287	349
	LA	75	145	211	273	332
	MS	78	151	219	284	346
	NC	94	182	264	341	413
	SC	88	170	246	318	386
	TN	82	160	232	301	365
	VA	86	166	242	313	380
	WV	71	137	200	259	315

Table 2. Continued

Consumer Welfare Losses from Delayed Franchise Reform

(Per Video Household)

Region	State	One-Year Delay	Two-Year Delay	Three-Year Delay	Four-Year Delay	Five-Year Delay
Northeast						
	CT	$69	$134	$195	$253	$308
	DC	65	130	184	238	292
	DE	85	165	241	310	377
	MA	68	133	194	252	307
	MD	78	150	219	284	345
	ME	74	143	209	271	330
	NH	79	153	222	289	349
	NJ	72	140	204	264	321
	NY	68	133	194	251	306
	PA	71	137	200	259	315
	RI	66	130	191	247	300
	VT	75	141	208	266	324
Midwest						
	IA	78	151	220	284	346
	IL	76	147	214	277	336
	IN	82	159	231	299	363
	KS	77	149	218	282	343
	MI	77	149	217	281	342
	MN	85	165	240	310	376
	MO	78	152	220	285	346
	ND	75	145	212	274	332
	NE	77	150	218	283	344
	OH	74	144	210	272	330
	SD	83	158	229	296	359
	WI	82	159	231	298	362