Prices and Outputs Under Cable TV Reregulation

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Abstract
Cable television reregulation in October 1992 did succeed in constraining subscriber bills about 9% below trend by October 1994. Yet, the growth rate of basic cable television subscribership fell sharply during the period of rate reductions. Only when real rates began rising in the period following October 1994—after an explicit relaxation of controls—did reliable industry output measures return to the pre-regulation growth trend. These data suggest that rate regulation becomes substantially less viable as the complexity of the regulated good increases.

1. Introduction
Price regulation is well-known to cause economic distortions in competitive markets: shortages emanating from binding price ceilings, surpluses from binding price floors. The more interesting case occurs where market power exists in the sector, allowing firms to administer prices in excess of their opportunity cost. This pricing behavior restricts output from the competitive level, imposing social losses. In this instance, price controls may prevent an under-provision of the good or service in question. By squeezing price-marginal cost margins, regulators can increase supply toward the optimal level of output.

This forms the theoretical argument for rate controls in local cable television (distribution) markets. There is overwhelming evidence that cable operators set prices in excess of marginal (and average) costs (FCC 1994h), and there is little doubt that a lack of competitive pressure has allowed monopoly operators to restrict output to achieve this result. Indeed, when competition has emerged in a limited number of markets, the evidence is clear that prices decline substantially—about 17%, according to one estimate by the Federal Communications Commission (FCC 1994a, 1995). While the recent entry of various wireless

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competitors points to emerging competition in the sector, traditional (wired) cable monopolies still account for about 90% of multichannel video subscribers in the United States.  

Cable television rates became a hotly debated public issue in the late 1980s, when prices were increasing rapidly in the wake of the 1984 Cable Communications Policy Act, which pre-empted local rate controls concerning about 99% of U.S. subscribers as of 29 December, 1986 (GAO 1989). Virtually the entire public debate turned on the issue of how much cable rates had risen following deregulation. Congress ordered the General Accounting Office to survey cable TV rates in 1989, 1990 and 1991, and the evidence of rising subscription rates formed the core of the argument for reregulation. To wit, the words of Senator Daniel Inouye (D-HA), then-Chair of the Senate Communications Subcommittee:

> The GAO report demonstrates that the 1992 Cable Act is needed now more than ever. Cable rates for the most popular basic tier of programming have increased 61 percent since deregulation went into effect in 1986.... During the same 4 1/2 year period, the cost of consumer goods rose by only 17.9%... (Congressional Record · Senate [29 January, 1992], S362).

This argument won the day, and the Cable Consumer Protection and Competition Act was enacted (in the only over-ride of a veto by President Bush) on 5 October, 1992. Yet, the single instrument of product price cannot be casually employed as a proxy for consumer welfare. Because regulated operators, as well as suppliers of financial capital, may elect to respond to the imposition of rate controls by changing their behavior, the price-regulated package may systematically differ from the non-regulated alternative.

2. Economic Analysis of Cable Rate Regulation

This [rate regulation] should lead to more sales, which should lead to more growth, which should lead to more jobs.

The economic literature on the subject of rate regulation in cable television markets (thus far focusing on the deregulation episode) has attempted various ways to analyze this issue. One approach has been to compare the rates of regulated firms with those of unregulated firms in cross-sectional estimations which attempt to adjust for product quality differences (Zupan 1989; Hazlett 1991). A problem encountered here lies in the nature of the dichotomous regulated/unregulated categorization. Some local governments choose to

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2 The Federal Communications Commission (FCC 1995) puts the cable share of the multichannel video distribution market at 91%.
3 The cable industry even marks a day on the calendar to commemorate this "event." Employing a derisive tone, a recent trade report noted: "Next month we'll celebrate the 6th anniversary of the birth of the Age of Cable Competition. It was Nov. 15, 1989, when then-Sen John Danforth of Missouri opened hearings that eventually led to the punitive law of 1992." (Cable TV Investor [17 October, 1995]: 1.)
4 "Deregulation" in the 1984 Act applies to rates but not to other important dimensions of cable TV markets. For instance, barriers to competition were strengthened in the Act both by imposing a franchise requirement and in statutorily outlawing local telephone company entry.
5 There is also the obvious point that high prices, rather than rates, rates, rates the inappropriate indices of monopoly power.
7 Other than the mixed results: Zupan finds price increasing effects from rate regulation, whereas Hazlett does not.