

THE HEARTLAND INSTITUTE

19 South LaSalle Street #903
Chicago, IL 60603
phone 312/377-4000 · fax 312/377-5000
<http://www.heartland.org>

Good News, Bad News on Texas Telecom Reform

Author: Bill Peacock
Published: The Heartland Institute 02/01/2006

With very little fanfare, the Texas Public Utility Commission recently issued its decision that local telephone service would be deregulated in markets covering more than 15 million Texans, effective January 1, 2006. No news organizations covered the story. No companies issued press releases.

Perhaps one reason for the lack of interest is that those 15 million Texans, who mostly live in and around major metropolitan areas, are likely to see little change in their phone service; deregulation is a long-term process. Another reason is that for most of those areas deregulation was mandated by legislation passed last summer by the Texas legislature.

Still, it is good news that telecommunications reform is moving forward in Texas. But there is a lot of work yet to be done if Texans are going to fully enjoy the fruits of a truly deregulated telecommunications marketplace.

The issue of the digital divide still needs to be addressed. This is not the mythical separation between the rich and the poor so often highlighted by the media, but rather a geographical separation between urban and rural customers intensified by telecommunications law.

Even though more than 15 million Texans live in areas where telephone service has been deregulated, only three incumbent phone companies serve those people. The vast majority of phone companies will continue to operate in regulated markets serving more than 7 million Texans located mostly in rural parts of the state.

These fully regulated companies will continue to receive significant subsidies from the state in return for offering local phone service at low cost, often below the companies' cost of providing it. While a low monthly phone bill may be appealing to rural consumers, it comes at a price.

Other telephone companies will be hesitant to enter into these rural markets where the incumbent offers prices at below-market cost. Without competition to spur investment in new technologies, these rural markets may fall further behind their urban neighbors in services such as broadband Internet access and next-generation video. Rural Texans might continue to pay only \$8 a month for a phone line, but they may have a long wait for the latest technology to come their way.

Another area of concern is taxes. Texans are highly taxed on their telecommunications services, paying an average 25.29 percent in state and local telecom taxes. This gives Texas the third highest rate in the nation, almost twice the national average of 14.17 percent. Adding in federal taxes makes the average total Texas tax bill almost 30 percent. Two of these telecom taxes are the focus of state policymakers right now.

The first is the Texas Universal Service Fund (USF) fee. It amounts to about a 3.6 percent tax on monthly phone service and is used to subsidize low-cost phone service, especially in rural Texas. In 2004, this tax cost consumers approximately \$586 million in direct payments, plus another \$177 million in reduced welfare.

Last summer, legislators mandated an interim review of the USF in an effort to make it more efficient. Whether this review lowers the USF fee or simply streamlines its distribution remains to be seen.

The second tax under review is the municipal right-of-way fee. This is a monthly charge on phone bills designed to compensate cities for the use of the public right-of-way by phone companies. The charge varies by city: Houston charges \$1.58, Dallas \$1.42, and Austin \$1.19. In Austin, that represents about 6.5 percent of the cost of local service.

Until now, only traditional telephone companies were required to charge this tax to their customers, since they are the only companies that actually occupy and use right-of-way. But now an effort is underway, led by cities seeking greater revenues, to apply this tax to any provider of voice services regardless of whether they use physical right-of-way.

If this effort is successful, wireless resellers and voice over Internet Protocol (VoIP) providers would have to begin charging their customers this fee. This could even include customers who use instant messaging through AOL, Yahoo, or MSN to place computer-to-landline calls--or ultimately, even for free online chats!

When it comes to expansion of telecom services, state and local governments want it both ways. They say they want to encourage new competition and new investment, yet they treat every new entrant and every new service as a cash cow to be milked for special taxes, surcharges, and fees. Instead the emphasis must shift to lessening regulations, reducing subsidies, and lowering or eliminating taxes. This is the work that needs to be done today to keep Texas at the forefront of telecommunications reform.

Bill Peacock (bpeacock@texaspolicy.com) is the economic freedom policy analyst at the Texas Public Policy Foundation, an Austin-based research institute.