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When Government Competes with Private Enterprise:
How Lebanon, Ohio Got into the Telecommunications Business

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In 1999, the City of Lebanon, Ohio, became one of the few municipalities in the nation to sell Internet and cable television service directly to its citizens. In 2002, they added phone service. While government officials in Lebanon describe the telecommunications system as a success, both the creation and operation of the system raise questions for both taxpayers in Lebanon and other communities where similar proposals are under consideration.

This report looks at the history of the system, how the city interacts with its rival cable company, the financial costs of the system, how the low prices produced by the system are offset by the high cost of the system to taxpayers, and what policy makers can learn from Lebanon's venture.

Examining Lebanon's system, three issues are especially alarming:

1. The city has used its police and regulatory power to undermine its business rival, Time Warner Cable.

2. The city-run telecommunications system incurred a large amount of debt to the taxpayers of Lebanon during its start-up phase. Since the cable system either runs at a deficit or barely breaks even most years, there is little chance the cable system will be able to repay taxpayers.

3. The city-run telecommunications system covers its yearly deficits by receiving transfers or advances from other city departments. It appears these departments are helping the telecommunications system to disguise its operating losses.

Among a host of promised benefits, the only one that has materialized is that cable prices are lower in Lebanon than in other Ohio towns. However, these lower prices are more than offset by the high costs to taxpayers and political turmoil associated with the project.

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Lebanon's experience building and operating a telecommunications system illustrates the perils to cities of undertaking such an experiment

Introduction

With Congress and many state legislatures considering reforms to laws that govern cable television services in America, there has been considerable discussion about how best to promote competition for video services. Numerous studies have shown that competition in this market lowers prices and improves services, but most Americans have little or no choice about the company from which they buy their cable television.

While most of the current legislative proposals focus on how to reform laws that prevent such competition, there are also some who contend that government-run cable systems are a good investment for cities. There are a handful of municipalities around the nation that run their own cable systems, and one of the oldest is located in Lebanon, Ohio. In 1997, the city of Lebanon decided to enter the cable business, competing against Time Warner cable. They now offer high-speed Internet and telephone service as well.

It is a large financial undertaking for cities to become involved in such a business. They will face significant financial costs and fierce competition from the established cable provider. The city of Lebanon's experience building and operating a telecommunications system illustrates the perils to cities of undertaking such an experiment.

This study will examine the following areas:

- *Establishment of the Lebanon System.* The rationale for the system and debate within Lebanon about its implementation.

- *The Use of Government Power to Support the System.* Lebanon's status as a government entity running a business has led to situations where it has used its governmental power to support the telecommunications system.

- *The Financial Conditions of the System.* Examining the revenue and expenses of the system.

- *Cost Savings from City-Owned Cable.* The city-run cable company has lowered prices for cable customers, but there are also hidden costs to consider.

- *Conclusions for Policymakers.* Policymakers can learn a great deal through analyzing the Lebanon system. One of the main lessons is that cities should be wary of going into business against private companies. As Lebanon shows, this often involves high costs and provides little in return for citizens.

Establishment of Lebanon's Telecommunications System

The establishment of Lebanon's telecommunications system involved considerable political turmoil for the city. The City Council was divided over whether or not to pursue this idea, with some claiming it would lose money and others saying that it would help the city attract businesses and provide citizens with low-cost cable and high-speed Internet. These political battles led to a contentious recall election, a move to fire the city manager, a court battle with rival cable provider Time Warner, and finally the establishment of a city-run telecommunications system.

In the mid-1990s, Lebanon began exploring the feasibility of creating a municipal telecommunications system that would provide its residents with Internet and cable television service.

Initially, this telecommunications system was, in the words of the consultants who conducted a feasibility study for the city,

> to provide communication infrastructure in Lebanon to support the municipal utility as it approaches deregulation in the electric utility industry. This communications infrastructure can also be a significant asset for Lebanon to attract and retain businesses, and to meet the needs of Lebanon's citizens in the information age. (1)

City officials envisioned this telecommunications system as a way to make the city's municipal utility service more competitive in the world of electricity deregulation. Automated meter reading and additional services (such as having the utility turn lights on and off for customers who were on vacation) were included in the plan.(2)

Besides the benefits to the municipal electrical system, the city wanted a telecommunications system that would offer an alternative to the local cable provider, Warner Cable (later Time Warner Cable), and which would provide high-speed Internet access to the city. The city planned on offering lower-priced service than Time Warner. By doing this, the city hoped to gain as much as 90 percent of the cable market.(3)

The city commissioned a feasibility study that was completed in 1996 and the city manager predicted the system would be offering service by March 1998.(4) The City Council approved spending up to $1 million in August 1997 to begin construction of the system.

Opposition to the plan, however, began to develop as some city council members became skeptical of claims that the system would be self-sufficient. For instance, Councilwoman Mary Ann Cole commented that if subscribers cannot support the cost of the system, "it will mean that everyone in the city is subsidizing the cable consumers, whether they take advantage of it or not. And that's not fair."(5)

City manager James Hayward, a leading proponent of the system, also came under fire. Some council members felt that his desire to see the city begin offering these services was compromising his duty as city manager to offer unbiased information about the project and its costs. One of his leading opponents on the city council, Mark Flick, stated at one point; "We've never gotten good data from the city manager on the cable system."(6)

A move to fire Hayward failed, and cable opponents came under attack from community members in favor of the plan. Councilwoman Cole was recalled in May

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1998, and the city council moved ahead with plans to establish the telecommunications system.

During this turmoil, Time Warner did its best to stop the city by lobbying city council members and suing the city. It publicized studies showing the city would lose money on the venture and complained about how its competitor would also be its regulator. Time Warner also sued the city in September 1998, alleging that the city was unsafely installing cable lines on electrical poles. The city claimed that the safety concern was merely a pretext to stop the city's cable plan. The suit was withdrawn later that year.

After all this upheaval, the city-owned telecommunications system began offering cable television and Internet services in the spring of 1999. It began offering telephone service in 2002. The system currently has 3,557 cable subscribers, 2,057 Internet subscribers, and 3,577 phone customers. In comparison, Time Warner has 2,700 cable subscribers.

Unlike the incorporation of a private company, the establishment of the Lebanon telecommunications system resulted in years of political infighting within the town, a recall election, and a lawsuit. Even before the first dollar was spent on the system, Lebanon taxpayers were experiencing costs from the proposal: elected officials diverted from other duties by this issue, taxpayer money used to pay for a recall election, and taxpayer money used to defend the city from a Time Warner lawsuit.

The Use of Government Power to Support the System

As Time Warner feared when the city proposed its telecommunications system, problems arose from having the city serving as both competitor and regulator. Lebanon sued Time Warner contending that it was not living up to its cable franchise agreement with the city. The city also threatened to enforce a little-used city law to prevent Time Warner from going door-to-door and offering same-day cable installation.

In addition to these tactics, Lebanon officials also attempted to impose an additional fee on new construction within the city to subsidize city service. Lebanon failed at these efforts, but their willingness to leverage the coercive power it has as a government to further its business projects points to the danger of letting government compete with private enterprise.

Cable Franchise Suit

In 1980, Warner Communications received a franchise from the city to operate a cable system for Lebanon. It was renewed in 1996. As is common with franchise agreements, the cable company agreed to a host of concessions in order to sell their services. These included stipulations requiring Warner Communications to remit a portion of their revenue to the city (3 percent in this case) as a "franchise fee," pay a pole attachment fee of $10 per year for each attachment, provide a community access channel with four educational channels, and provide free service to schools (including the school bus garage) and local government offices.(7)

In July 1999, soon after launching its own cable service, the City of Lebanon filed suit against Time Warner for failing to live up to the franchise agreement. Specifically, the suit claimed Time Warner did not provide free service to all schools and local government buildings and that it did not establish a public access channel.

Time Warner claimed that the city never asked for the missing services as required in the franchise agreement and that these issues were settled when the city and Time Warner negotiated their new agreement in 1996. They questioned the timing of the suit, since its filing coincided with the beginning of Lebanon offering their cable services. Lebanon denied they were using the suit to intimidate their business rival.

Time Warner had no comment about the resolution of this suit.

City Attempts to Stop Door-to-Door Solicitations by Time Warner

In December 2000, Lebanon city officials again attempted to use their governmental power to interfere with their rival cable provider. They attempted to enforce a 1964 law that banned "peddlers and solicitors" from selling products on residential property without permission. Enforcement of the law up to that point had been extremely rare.

The city claimed that there had been forty complaints in the previous two months, although the City Attorney said he had no written documentation to back up this claim.(8) The city urged residents who were solicited by Time Warner to notify police.

At issue was the practice of a Time Warner representative who went door-to-door in Lebanon offering interested parties same-day hookup to the Time Warner system. While this may seem to be a consumer-friendly practice, Lebanon decided to combat their rival's tactic by dusting off a little-enforced 36-year-old law.

Time Warner was quick to label this move as anti-competitive. Time Warner spokeswoman Jennifer Mooney stated, "Lebanon is losing customers. It appears that folks are becoming our customers instead of theirs, and it appears that the folks in the (city's) telecommunications system, Mr. Baldwin, is in a panic."(9)

Time Warner fought back and said that in 1984 it had received permission from the mayor to solicit door-to-door. It also claimed Lebanon was trying to infringe on its First Amendment rights by stopping such solicitations. City officials eventually backed down and said they would not enforce the law until they had a chance to review its constitutionality.(10)

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Mandatory Hookup Court Case

In March 2002, the Lebanon City Council passed an ordinance requiring that any new construction in the city must hook up to the city telecommunications system. It also required the collection of a $1,250 fee for residential construction and $2,000 for industrial construction to help fund the expansion of the telecommunications system. Occupants of the new buildings were not mandated to purchase programming or other services from the city.

Homebuilders, viewing this as an unconstitutional taking of private property, sued the city. Time Warner also joined the suit, claiming that the city was using its power to discriminate against them.

The city defended itself by claiming that builders consented to the hookup when they applied for an electrical permit. Even though the city found that their plan to use the telecommunications system for automated meter readings was unfeasible, they said that the telecommunications system might be used for this and other electrical-related purposes in the future. In their view, the telecommunications system hookup was "equipment used in the supply of electricity."(11)

An Ohio Court of Appeals did not find this logic satisfactory. In early 2006 the Court of Appeals for the Twelfth Appellate District ruled against the city:

> . . the city was installing equipment used in connection with the supply of cable television, high-speed internet, and telephone services. While the city may intend to use the telecommunications system "in connection with the supply of electricity" at some point in the future, such use is uncertain. (12)

The city further tried to claim that the fee they were collecting should stand regardless of whether or not the mandatory hookup was permissible. Because the fee lacked a direct connection to the hookup — intended instead for the expansion of the telecommunications network — the city felt they should be able to continue with its collection.

The Court ruled against the city on this point, too, since the wording of the ordinance did in fact stipulate that the collection of the fee was directly tied to the application process for the hookup. The Court failed, however, to rule on the larger question of whether or not the city could collect a fee from new construction to help fund their telecommunications system. It seems that if city officials are so inclined, they can levy whatever fees or taxes needed in order to subsidize their business operations.

Lebanon has shown a willingness to use governmental powers to hurt their rival and obtain funds for the operation of the telecommunications system.

The Perils of Government "Competition"

These actions by the city of Lebanon were only available because it is a government entity. They had power over rival Time Warner because federal law requires that a cable company enter into a franchise agreement with a municipality before it can offer service in that area. Without this power, the city could not sue over the franchise agreement. The city also had at its disposal a police force to threaten Time Warner when its business practice of selling door-to-door displeased the city. And without governmental taxing power, the city could never levy mandatory fees to subsidize the telecommunications system. In the short time that its cable system has been operating, Lebanon has shown a willingness to use governmental powers to hurt their rival and obtain funds for the operation of the telecommunications system.

This should be troubling for consumers in Lebanon as well as residents in other communities facing similar situations. When a private business is threatened by rivals, it must respond by offering better prices, better services, or both. When a government runs a business, as the Lebanon experience shows, and that business is threatened, the government has another alternative – using its power to intimidate rivals.

For instance, consumers were the beneficiary when Time Warner was offering same-day hookup by door-to-door sales. Lebanon officials alleged that they had received numerous complaints about Time Warner's customer service over the years. However, when Time Warner attempted to better serve consumers by offering a more convenient connection, they were threatened with legal action by the city.

Who loses? Time Warner, obviously, but also consumers who might have benefited from the better service offered by Time Warner.

Financial Condition of Lebanon Telecommunications Fund

As illustrated above, there are hidden costs to government "competition" with private enterprise. These costs may be seen in higher fees for other government services to help expand the government business. Or they may cost consumers by having the government threaten its rival when the rival is offering better customer service than the government entity. Or, as this section will examine, it may be in direct costs to taxpayers to subsidize the government's business.

Over the course of its existence, Lebanon's telecommunications system's expenses have been $77,830,369. The system has brought in only $18,944,123 in business revenue to pay those expenses. If you count revenue from city-backed debt, transfers from other government funds, and mandatory permit revenue, it has generated $75,227,039. As you can see, the system is much more adroit at borrowing money and finding money from other government services than it is at generating business revenue. Without the taxpayer-backed debt and other revenue available to it solely because it is a government entity, it is likely this system would have filed for bankruptcy.

When proposed, some on the city council expressed concern that the city-run telecommunications system would run a deficit and that city taxpayers would subsidize the system. Time Warner also claimed that the city would lose money on the venture, estimating that it would lose $200,000 to $300,000 annually.(13) City officials acknowledged that the system would run a deficit in the beginning, but expected it to be able to become profitable and repay the city at a later point for the expenses incurred in establishing the system.(14)

Unfortunately for the city's taxpayers, the prospects are very dim for the telecommunications system ever repaying them for the costs incurred to establish the system. Barely breaking even most years, and with fierce price competition from Time Warner, it is doubtful that the municipal system will ever make enough money to repay the bonds backed by the city to build the system. The taxpayers of Lebanon will be stuck with the costs. This was foreseen by the consultants hired to study the feasibility of the plan:

> Existing communication providers may offer new and enhanced services, and may choose to compete at lower rates. While this could significantly benefit the citizens of Lebanon, it could also erode the economic return for a municipal communication utility.(15)

This appears to be exactly what has happened. While the city based its economic assumptions on a static competitor, these assumptions reflected either naiveté of the realities of market competition or an effort to sugarcoat these realities to push the project through. Time Warner cut their rates to compete with Lebanon and the city-owned system never approached the incredibly optimistic 90 percent market share some predicted.

It is also interesting to note that the city-owned system receives financial benefits arising from the fact that it is a government department. As the city of

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Table 1: Revenue Sources for the Telecommunications System

	1998	1999	2000	2001	2002	2003	2004	2005
Business Revenue	0	257,267	1,033,006	1,450,143	1,969,692	3,708,842	4,951,167	5,574,006
Telecom Permits	0	0	0	0	213,891	376,500	285,250	0
Transfers	0	0	0	1,004,099	111,866	83,916	0	0
Borrowed funds	3,500,000	10,850,236	16,500,000	14,250,000	1,750,000	1,754,355	1,749,035	1,753,881
Advances	0	0	0	0	574,404	1,050,483	0	475,000
Total	*3,500,00*	*11,107,503*	*17,533,006*	*16,704,242*	*4,619,853*	*6,974,096*	*6,985,452*	*7,802,887*

Lebanon said in its 2002 cable system financial statements:

> The Cable System receives exemptions by reason of its status as a political subdivision. If not for the exemption, it is estimated that the Cable System would incur a franchise fee of $55,000, a pole attachment fee of $15,000, property taxes of $8,000 an a personal property tax of $67,000.

That adds up to $145,000 in expenses that the system does not incur that its rival, Time Warner, does. Even with this economic advantage, though, the cable system has difficulty making money.

Revenue

Lebanon relies on an interesting mix of revenue to fund its telecommunications system. Throughout its history, it has received money from selling its various services – cable television subscriptions, advertising on cable television, Internet services, and phone service – but also from sources such as city-mandated telecommunications permits (discontinued when these permits were deemed unconstitutional), transfers from other city divisions, and city-backed debt.

The fact that the government of Lebanon runs the telecommunications system gives it an advantage over traditional telecommunications companies because it can tap the taxpayers of Lebanon for revenue shortfalls. Without this ability, the telecommunications division would be in even worse financial shape than it is now. It also means that money for traditional government services is being diverted to help subsidize the television viewing of Lebanon's cable subscribers.

Table 1 shows the revenue from business operations (telecommunications services, advertising income, interest income, etc), the revenue from transfers from other government departments, and the amount of money borrowed by the city to help support the telecommunications system.

Lebanon's Telecommunications system relies heavily on revenue obtained from sources other than its business services, although this trend is less pronounced in more recent years.

Government Revenue

The business revenue above is revenue that the city's telecommunications fund collected from customers of its services. Since this revenue was not enough to sustain the telecommunications system, the city

Table 2: Revenue Transfers from other Government Funds

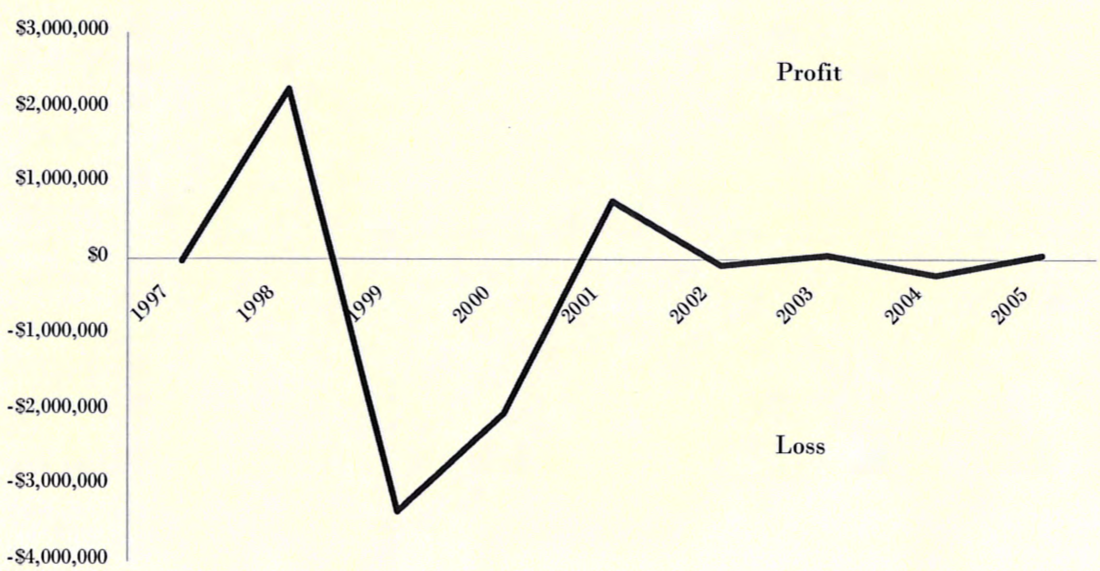
	2001	2002	2003
Electric Fund	900,000	0	0
Water/ Sewer Fund	83,916	106,681	83,916
Fire Fund	15,000	0	0
General Fund	5,183	5,185	0
Total	*1,004,099*	*111,866*	*83,916*

supplemented those funds by obtaining revenue from the taxpayers of Lebanon. The following costs were borne by all Lebanon taxpayers, regardless of whether or not they purchased telecommunications services from the city. This revenue would not have been available to prop up the telecommunications fund if it were not a government entity.

Government-backed debt: The city borrowed a significant amount of money to pay for the set-up of the telecommunications system. These funds were borrowed on the expectation that they would be repaid with future revenue. If revenue continues to be low and expenses continue to be high, it is unlikely this debt can ever be repaid. The taxpayers of Lebanon will be forced to pay this debt.

Telecom permits: As mentioned above, in 2002 the city of Lebanon decided to raise money for the telecommunications fund by mandating that all new construction connect to the system and pay up to $2000 to acquire the necessary telecommunications permits. Although this

Chart 1: Operating Loss/Income from the Telecommunications System 1997-2005



was found to be unconstitutional in 2006, the city did collect substantial revenue from these telecommunications permits for three years: $875,641.

Transfers from other city funds: From 2001 to 2003, the city supplemented the revenue of the telecommunications system by transferring money into it from other city funds. These transfers were ostensibly for the purpose of these other funds reimbursing the telecommunications funds for services performed. This is questionable, however, because these transfers often vary from budgeted amounts and in three years were large enough to disguise a potential deficit.
It should also be noted that in 2002 and 2003, the telecommunications system was also supported by advances in revenue from the Electric Fund in the amount of almost $1.6 million. Unlike transfers, this money will ostensibly be repaid to the Electric Fund. In 2004, the telecommunications fund paid back $45,000 of that amount. In 2005, however, it once again received an advance from the Electric Fund, this time in the amount of $475,000.

Expenses

In most years the city's telecommunications system runs at a deficit. In those few years when it has run a surplus, it is either due to the inclusion of city-backed debt as revenue (1998) or because of revenue obtained from the fact that it is a governmental entity. For instance, in 2001 the system reported net income of $766,194. However, the system also received $1,004,099 as a transfer from the city's Electric Fund that year. Similarly, in 2003 the system reported net income of $47,522, but it had an $83,916 transfer from the Water and Sewer fund and $376,500 from telecommunications permits to help produce this income. Once again, in 2005, the system reported $56,645 in net income, but that was only because the Electric Fund advanced it $475,000. Without government revenue, the telecommunications system would never have a surplus. Even with this revenue, it often ends the year with a loss.

Table 3: Telecommunications System Expenditures and Total Revenue

	1997	1998	1999	2000	2001	2002	2003	2004	2005
Expenditures									
Expenses	21,391	200,662	624,233	1,167,045	1,399,420	2,319,105	3,587,693	4,579,759	4,913,397
Capital	8,822	1,045,313	7,538,217	1,491,062	995,193	1,344,409	1,545,763	839,618	1,032,964
Debt Service	0	9,343	6,289,597	16,912,449	13,543,435	1,043,327	1,793,118	1,785,153	1,799,961
Total	30,213	1,255,318	14,452,047	19,570,556	15,938,048	4,706,841	6,926,574	7,204,530	7,746,242
Revenues									
Total Revenue	0	3,500,000	11,107,503	17,533,006	16,704,242	4,619,853	6,974,096	6,985,452	7,802,887
Difference									
Loss/Net Income	*(30,213)*	*2,244,682*	*(3,344,544)*	*(2,037,550)*	*766,194*	*(86,988)*	*47,522*	*(219,078)*	*56,645*

Cost Savings from Competition in Lebanon

One of the reasons given for establishing a city-run telecommunications system was to provide lower prices for cable and Internet service through competition. In proposing the system, the city claimed that its prices would be 30 percent lower than those of Time Warner.(16) While this has not happened (Time Warner's prices are, in fact, lower than Lebanon's), city residents have seen savings as a result of competition from the city's telecommunications system.

Currently, the city charges $9.99 for Lifeline service, $35.75 for Deluxe, and $49.99 for Digital. Movie channels cost $11.49 to $12.49.

Time Warner offers a wider variety of packages. Its Basic service is $5.99, Standard is $19.21, and it offers additional tiers of digital service at $29.99 $39.98, $48.92, $62.90, and $69.80. Movie channels are $9.99.

The real cost savings can be seen when one compares Time Warner's Lebanon prices with those in other towns. For instance, in Hillsboro, Basic service is $9.60, Standard is $36.67, and digital tiers start at $52.49, $62.94, $77.39, $88.49, and $98.49. Movie channels are $12.45. The story is similar for other cities.

Lower Prices, but at What Cost?

Undoubtedly, competition has improved prices for the roughly 6,200 cable subscribers in Lebanon. However, the question to ask is whether or not the savings for these 6,200 people is worth the high costs the system imposes on all Lebanon taxpayers.

When it was proposed, there was a tremendous amount of political turmoil on the city council, with one member being recalled. During the setup of the system, the city spent millions of dollars – which have not been repaid – to make it operational.

Since it became operational, the telecommunications fund has struggled to break even. Because of stiff competition from Time Warner (and, if current national telecommunications legislation is passed, competition for cable services will soon include telephone companies such as Verizon), Lebanon is unlikely to ever make sufficient money to repay the city's taxpayers for the money they laid out to construct the system.

For example, in 2005 the telecommunications system only posted a $56,645 in profit. This is after the system received an infusion of $475,000 in an advance from the electric fund. Without this advance, the telecommunications system would have had a loss of $418,355 for the year. This is not a formula for becoming self-sufficient, much less for repaying the taxpayers of Lebanon for the investment they have made in the system.

This trend of losing money will likely become worse as more companies enter Lebanon's cable market. With advances in technology and a potential rewrite of national telecommunications laws, there will likely be a move by companies such as Verizon and AT&T to provide video services. While this may not happen in the next five to ten years in a town the size of Lebanon, it will happen eventually. When it does, it will cut into Lebanon's customer base and further reduce its revenue.

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The Future of Competition in Lebanon

Congress is considering legislation that would eliminate many of the barriers to entry into the cable market. If such legislation is enacted, Lebanon and other towns would see a significant increase in competition. One of the main areas of such competition comes from phone companies such as AT&T and Verizon, which offer video services over fiber optic lines.

A complicating factor with this type of service for Lebanon is that the city partnered with the local Bell telephone company to offer telephone service to the residents of Lebanon. With the government selling phone service, the question arises about how it will react if competition to its cable service is coming over these phone lines. Would Lebanon deny phone companies use of its lines to offer fiber optic video services? Perhaps not, but Lebanon has shown a willingness to use its governmental power to give itself a competitive advantage. The fact that this question comes up is another indication of the danger of having government competing in this area.

Recommendations for Policymakers

Lebanon's experience with a city-run telecommunications system points to a few recommendations for policymakers:

City-run businesses are bad for consumers and taxpayers, and should be rejected by city leaders.

Municipal officeholders tempted to use city resources to compete with private industry need to consider the lessons of Lebanon. It is a mistake to think that a city-run business can compete with a large multi-national corporation. As Lebanon's consultants foresaw, Time Warner has cut prices and improved services for Lebanon's consumers. This has resulted in the city-run telecommunications system losing money or barely breaking even and unable to pay back the city taxpayers for their initial investment. Consumers have also lost out as the city has used its police power to harass Time Warner when they offered innovative services.

The way to encourage cable competition is not to use city resources to compete with the incumbent cable provider, but to reduce regulations to allow other companies to compete.

As mentioned, the city's entrance into the cable market has resulted in lower cable prices for consumers. This could have been achieved much more easily, and at no cost to taxpayers, by Ohio enacting cable franchise reform laws along the lines of Texas or Indiana. These states have set up a system where a company that wishes to provide cable service needs only get one state-wide franchise to do so. Currently in Ohio (and most other states) a company that wishes to offer cable service must apply to every municipality it desires to serve and pay a percentage of its revenue to these municipalities. Besides being time-consuming and expensive, this process also allows municipalities to extract a variety of "free" services from a cable company. This process usually throws up so many barriers that potential cable competitors simply do not provide services and ultimately raises the cost of services for consumers.

At least one city, Anaheim, California, has unilaterally done away with franchise fees in order to attract competition. While the city is losing fees that come with franchise agreements, it is certainly helping consumers by encouraging competition.

The benefits of reforming video franchise laws can be seen clearly in Texas, which enacted statewide video franchise reform in 2005. In one town, Keller, where Verizon began offering fiber optic television to compete with incumbent cable provider Charter Communications, prices dropped dramatically. Before competition, Charter offered 240 cable channels at $68.99 per month. They dropped the price to $50 a month and added free high-speed Internet access when faced with competition from Verizon. Verizon, for its part, offered a 180 channel service for $43.95.(17) Consumers benefited from competition there, and the city of Keller did not go into millions of dollars of debt to produce that competition.

Policy makers should take the following steps to create similar consumer friendly competition:

- National leaders need to create video competition statewide by eliminating requirements that video providers seek franchise agreements with every municipality they wish to serve.

- In the absence of national legislation, state lawmakers should follow the lead of Texas and Indiana and enact statewide franchising legislation which eliminates the need for separate local agreements.

- If national and state leaders fail to act, city officials should follow Anaheim's example and announce that companies that want to compete for their residents' cable dollars no longer need to negotiate with the city for a franchise agreement.

Municipalities should be prevented from competing with private companies.

Soon after Lebanon's city-run telecommunications service started, there was talk in the Ohio General Assembly of enacting a law that would have made it more difficult for municipalities to compete with private cable providers. While this law was not enacted, legislators should consider similar laws that will make it more difficult for cities to enter the cable business, or even ban such practices completely. As shown by Lebanon, municipal leaders often ignore accurate predictions of failure raised when these municipal ventures are broached. They also tend to give credence to claims that private investors would immediately question, such as the prediction that a city system, within a few years of start up, could gain a 90 percent market share against an established monopoly incumbent. Understandably, the immediate payoff of "doing something" about a "problem" is attractive. Legislators can pre-empt this sort of thinking and simply end the ability of cities to enter into these kinds of businesses. Taxpayers will benefit greatly if their local elected officials are unable to waste their money in these quixotic ventures.

Lowering the barriers to entry in the cable market is a much more efficient way of providing lower cable prices for consumers

Conclusion

Lebanon's experience with a city-run telecommunications business illustrates exactly why governments should not be involved in these businesses. They are a drain on taxpayer resources and they unfairly compete with privately-owned businesses. The major public policy lesson from this experience is that municipalities should stay away from competing with private businesses, especially when it comes to a highly competitive and dynamic industry such as telecommunications.

Contrary to the claims of Lebanon officials, city residents have not benefited from the city-run system

The initial reason to establish a city-run telecommunications system was to help the city-run utility system compete in the age of energy deregulation. This rationale, however, is no longer discussed. The city-run telecommunications system has little effect on the utility system and none of the technological marvels (automated meter reading, for instance) are commonplace in Lebanon.

The secondary rationale — providing the citizens of Lebanon with advanced communications — has now become the primary reason for the city-run telecommunications system. While high-speed Internet service was not widely available in cities of Lebanon's size during the mid-1990s, this is no longer the case. The Federal Communications Commission reports that high-speed Internet access is available in 98 percent of zip codes. This indicates widespread availability of high-speed Internet access, overwhelmingly provided by private companies. The rationale that Lebanon needed the government to provide such service is simply untrue.

The only benefit from the telecommunications system, as mentioned above, is lower cable television rates. The cost to the city and its taxpayers to provide these marginally lower rates is difficult to justify. Furthermore, changes in the telecommunications industry are increasing the competition among cable companies. Much of the reason that there is little competition for cable service is because governmental franchise laws prevent companies from competing with local cable providers. These laws, however, are being examined by state legislatures and Congress.

Lowering the barriers to entry in the cable market is a much more efficient way of providing lower cable prices for consumers. As was done in Anaheim, Lebanon could simply eliminate cable franchise requirements and allow any cable company to serve its citizens. While it would forgo the money that comes with these franchises, it would certainly be less expensive than the millions of dollars it has spent on its money-losing telecommunications system.

Contrary to the claims of Lebanon officials, city residents have not benefited from the city-run telecommunications system. Their tax dollars have gone to subsidize city officials' quixotic quest to compete in the telecommunications field. Without its citizens' tax dollars and its governmental powers, the city of Lebanon would never be able to compete in this market. It is best for the residents of Lebanon if the city were to focus on the business of governing the city instead of trying to run a telecommunications business, and the best actions at this point for the city would be to extricate itself from the market as soon as possible and open the community to true competition.

Footnotes

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(3) Keilman, John. "Lebanon in Cable Tug of War." *Dayton Daily News, February 12, 1998.*
(4) Thompson, Richelle. "Future on Way in Test." *Dayton Daily News, December 17, 1997. p. 1B.*
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(6) Bennish, Steve and Joanne Huist. "Cable Venture Under Fire," *Dayton Daily News. March 4, 1998. p. 1B*
(7) Stanley Consultants. "Municipal Telecommunications System Feasibility Study: City of Lebanon." December, 1996. p. 2-5.
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(12) Ibid
(13) Keilman, John. "Lebanon in Cable Tug of War." *Dayton Daily News, February 12, 1998.*
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(15) Stanley Consultants. "Municipal Telecommunications System Feasibility Study: City of Lebanon." December, 1996. p. 1-6.
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(17) Arrison, Sonia and Vince Vasquez. *Cutting the Cord: Streamlining the Video Franchise Process.* Pacific Research Institute, April 2006. p. 11.

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