BALLOT PROPOSITION #108
Arizonans for Consumer Choice and Fair Competition

Publicity Pamphlet Fiscal Impact Summary

Proposition 108 would amend the Arizona Constitution to allow telephone companies that provide local service to set their own rates and charges in areas of the state where competition exists. It is not possible to determine in advance the impact of the Proposition on Arizona's economy and on state government tax revenues. As a general practice, deregulation of an industry leads to more competition and lower prices than in the previously regulated market. Moreover, increased competition is often associated with additional business spending and employment growth, which in turn tend to raise the general level of economic activity and state tax revenues.

In this particular circumstance, however, we cannot accurately predict the extent to which the telephone industry would become deregulated under the Proposition. Once the magnitude of deregulation becomes known, the fiscal impact will become easier to determine.

Finally, subsequent to deregulation, the responsibilities of the Corporation Commission and another state agency, the Residential Utility Consumer Office (RUCO), relative to rate setting should decline, and their budgets will need to be evaluated at that time.

	FISCAL YEAR		
	2001	**2002**	**2003**
STATE REVENUES/EXPENDITURES	*	*	*

* The ballot initiative's estimated impact on state expenditures and revenues cannot be determined in advance. For more details, see *Analysis* section below.

FISCAL ANALYSIS

Description

Proposition 108 would amend the Arizona Constitution to allow telephone companies that provide local service to set their own rates in any city, community or other area in this state where the Arizona Corporation Commission determines that such service is available from competing providers. The Commission would make such a determination in an area only if local telephone service is available from two or more providers to a majority of residential or business consumers within that same area. (Note that such determination would be made separately for residential and business customers.) If the Commission determines that the criteria for local telephone competition in a designated area are not met, it would retain the authority to set rates in that area.

Proposition 108 also includes a provision that would require a local telephone company in a competitive area to offer the same rates for comparable services to all its customers, even if some live in a location that has only one choice of provider. In addition, the Proposition also requires the Commission to establish a "simplified and expedited" process to allow consumers to enforce their rights to those comparable rates.

Estimated Impact

The fiscal impact of Proposition 108 on the State General Fund cannot be determined in advance. For a detailed explanation, see *Analysis* below.

Analysis

State Revenues
As a general practice, deregulation of an industry leads to more competition and lower prices than in the previously regulated market. Moreover, increased competition is often associated with additional business spending and employment growth, which in turn tend to raise the general level of economic activity and state revenues.

At this point, it is difficult to determine in advance the amount of competition generated by the Proposition and the effect on Arizona's economy and state revenues. According to the Corporation Commission, over 100 companies have registered to provide local telephone services in Arizona. However, the number of telephone companies is not the only indicator of local competition. The market share of competing providers is also an important measure. Anecdotal information suggests that besides Qwest (formerly US West), most competitors are relatively small. This makes it difficult to predict how soon and to what extent the proposed deregulation would result in more competition and economic growth in the state.

We also surveyed other states to determine if their experiences would be helpful. Local telephone deregulation in other western states appears to be limited. For example, Nebraska law allows some rate deregulation. A local telephone provider in this particular state is free to increase its rates by 10% or less. However, any rate increase above this threshold is subject to a waiting period to allow protests from subscribers and can only occur after a Public Service Commission hearing. Furthermore, Nebraska law allows the incumbent telephone provider to raise some rates while lowering others as long as such rate changes do not result in additional revenues to the company. The Proposition, however, would not place such rate restrictions in competitive areas and is therefore not directly comparable.

While there is little direct evidence of the effects of telephone deregulation, we can at least provide some of the possible theoretical impacts on different state revenue sources. In terms of property taxes, this ballot initiative would not have any direct effect on the valuation and taxation of property owned by telecommunications companies operating in Arizona. Under current law, the valuation methodology for real and personal property is the same for all competitors. Subsequently, a change from non-competitive to competitive status in an area, as determined by the Arizona Corporation Commission, would not directly affect the existing property tax base and hence the state and local revenues generated from it.

If local telephone rates decrease as a result of the Proposition, tax revenues could be adversely affected in at least two ways. First, total sales tax collections deposited into the General Fund from businesses that provide intrastate telecommunications services could fall. Second, receipts from the telecommunication services excise tax levied on telephone and telecommunication service providers to pay for emergency calls and telecommunications devices for the deaf could also decrease. (The tax base for both these taxes is the gross proceeds of sales or the gross income derived from the business.)

Depending on consumers' response to a potential rate decrease, the initial loss of state revenues could be recouped, partly or fully, for two reasons. First, lower rates might induce some individuals to consume greater amounts of local telephone services than before. Second, many consumers are likely to spend their savings from local telephone rate reductions on other goods and services. In the aggregate, sales tax collections could even increase as a result of the proposed deregulation. However, without actual data, the total impact of this initiative on state revenues cannot be assessed.

According to anecdotal information, most of the existing competition among registered local telephone providers in Arizona is for business rather than residential customers. Since the Proposition prescribes that the competitive status is to be determined separately for business and residential consumers in an area, it is possible that only rates for the former category would become deregulated, whereas rates for the latter group would remain regulated. While this could lower local telephone rates for businesses in that area, the same might not be true for residents.

The possibility that some rates could decrease and others increase adds further uncertainty as to how state revenues would be affected in the aggregate. Given these and other uncertainties, the JLBC Staff cannot determine the state revenue impact at this point.

State Expenditures
The fiscal impact to the Arizona Corporation Commission's operations is unknown at this time. The Commission's budget would need to be re-evaluated once the full extent of deregulation in the state becomes known. We would expect the Commission to reduce the resources devoted to ratemaking activities. Ratemaking is a significant and costly portion of the Commission's activities. This is not a constant activity, but fluctuates as local telephone service providers request rate adjustments. The Commission will lose ratemaking jurisdiction in some areas of the state, but retain it in other parts. The

Analysis (Continued)

initiative creates additional duties for the Commission upon request of local telephone providers. First, the Commission must establish procedures for determining whether local telephone service is generally available from competing providers. Second, the Commission must establish a simplified and expedited process by which consumers may enforce their rights as established under the initiative. In some states where local telephone service has been partially deregulated, regulatory agencies report increased workloads after implementation.

The Residential Utility Consumer Office (RUCO) has the statutory authority to research, study and analyze residential utility consumer interests. Additionally, RUCO may prepare and present material on behalf of residential utility consumers in ratemaking proceedings involving public service corporations before the Corporation Commission. As mentioned previously, the Commission will almost certainly lose jurisdiction in some ratemaking cases. Consequently, RUCO will lose its statutory venue to represent the interests of residential local telephone consumers residing in competitive areas. As with the Arizona Corporation Commission, RUCO's budget would need to be re-evaluated once the full extent of deregulation becomes known.

State government agencies also purchase local telephone services. In FY 1999, the state made payments exceeding $25 million to providers of local telephone services. Competition within the market for local telephone services would have an effect on amounts paid for those services.

Local Government Impact

A portion of sales tax collections on telephone and telecommunications services is currently distributed to counties and cities in the state. Local tax collections on property owned by telecommunications companies in Arizona will not be directly affected by the proposed deregulation. Local governments also purchase local telephone service and will be affected by changes in rates due to deregulation.

7/14/00

A.R.S. § 19-123 requires the Joint Legislative Budget Committee Staff to prepare fiscal impact estimates for ballot initiative measures. This estimate was prepared by Hans Olofsson and Paul Shannon (602-542-5491).