HOW TO MAKE EFFECTIVE COMPETITION SUSTAINABLE

The telecoms sector shows this is easier said than done

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Implicit in many policy and regulatory decisions is a forward-looking assessment of the sustainable level of competition in different parts of the value chain or different geographic areas. In many regulated sectors there is relative clarity on the boundary between where effective competition is sustainable and where the market tends to monopoly and utility-style regulation is required.

In telecommunications there was a paradigm shift in the mid-1980s. A belief that markets were a natural monopoly gave way to a view that most parts of the value chain could be competitive on a sustainable basis once they were liberalised and appropriate regulation was put in place.

The process of liberalisation spurred rapid improvements in service availability and quality at affordable prices. It also sparked a wave of innovation supporting the new digital world. Access to communications is no longer restricted to a minority of the world's population. Waiting lists for a basic telephone line are a thing of the past. The variety of services has also increased enormously. Consumers across the globe now have access to broadband services offering a huge range of applications both at home and on the move.

However, while competition has clearly delivered huge benefits, these gains have not been evenly spread. And not everywhere has sustainable competition flourished.

In some countries there has been limited 'infrastructure-based' competition for 'the final mile' of fixed-access networks to deliver broadband services to residential and small business customers. In these countries, any retail competition is often 'access-based', with rival providers using regulated access to the incumbent's network to serve end users. Even where there has been infrastructure-based competition, it has been concentrated in urban areas. In the absence of competition to drive investment in upgrading networks, the quality of fixed services will typically be worse for customers in rural areas than in towns.

EXEC SUMMARY

Competition is (nearly) always a good thing, but creating and sustaining competition through regulation is not possible in all markets. In some markets, regulation intended to stimulate competition may do more harm than good. The task of making the distinction falls to regulators. In a fast-changing sector like telecommunications, they have a difficult job.

Similar issues arise with mobile networks but, thanks to greater infrastructure-based competition, they are less serious. There are also spill over effects, with mobile customers expecting a good quality of service when they move between town and country, meaning competition drives investment across the country. In addition, policymakers can exert more influence over the scope of competition in mobile networks by attaching rural coverage and quality requirements to spectrum licences. However, experience in recent years shows there are limits to relying on spectrum licencing alone to increase the number of competitors or to meet specific policy objectives. As a consequence, policymakers and competition authorities have permitted increased infrastructure sharing between competing network operators. This allows for a more rapid and fuller roll-out of new technologies such as 5G, while the spillover effect from urban areas ensures that the overall impact on competition is limited.

Policy responses to a lack of fixed infrastructure-based competition have varied widely. Some countries have scrapped or limited regulations promoting access-based competition in the expectation that infrastructure-based competition would develop as retailers invested to gain an edge over their rivals. At the other extreme, some countries, such as Australia, New Zealand and Singapore, have opted for national broadband programmes. Under this model, a single wholesale network is established with a de facto monopoly on infrastructure, with retail competition depending solely on access regulation. Between these two opposites, many jurisdictions have adopted mixed models combining infrastructure-based and access-based competition.

To implement a mixed model, the scope for sustainable infrastructure-based competition needs to be assessed and appropriate regulation put in place. For example, the European Electronic Communications Code requires regulators to collect information on the current and forecast scope of infrastructure-based competition.

Sub-national assessments can then group customers into different categories:

- Those who already have an effective of choice infrastructure-based broadband providers;
- Those who are likely to have an effective choice of providers in the foreseeable future; and
- Those who can expect to continue to have a monopoly provider of fixed infrastructure for the foreseeable future.

For example, Ofcom in the UK has grouped residential premises into Areas 1 to 3 corresponding to the categories above.

When assessing the scope for sustainable infrastructure-based competition at either national or sub-national level, regulators need to bear in mind that uncertainty over future developments could lead to areas being wrongly classified. Errors could arise as a result of either:

- Determining that sustainable infrastructure-based competition is possible in areas where there is no realistic prospect of competition; or
- Assuming that infrastructure-based competition is not feasible, when in fact the prospect of entry is realistic.

In the first case, if regulation is relaxed to take account of (or incentivise) prospective competition which will not materialise, there is a risk of consumer harm as a result of the incumbent being given more freedom to benefit from their market power. Regulation could potentially be reimposed if it becomes clear that competition will not develop, but that could take several years during which time consumers may suffer from higher prices and poorer service.

In the second case, consumer harm arises from the loss of the dynamic benefits that infrastructure- based competition can bring. This loss can occur in two ways: implicitly, if some of the regulations which promote infrastructure-based competition are relaxed; or explicitly, if a single network is given special and exclusive rights which act as a barrier to potential entrants. This policy may not be easily reversible if sunk investments by the single network deter competitors from entering and providing a better service.

In both cases there are risks of sub-optimal competition and a slide back towards the poor outcomes that consumers experienced before liberalisation. These risks can be mitigated to an extent. For example, in cases where competition is anticipated backstop regulation can be put in place so that the incumbent is constrained if entry does not occur. Where sustainable infrastructure-based competition is not considered possible or appropriate, a degree of competition 'for the market' by tendering the right to operate the network can deliver some of the benefits of competition.

The experience of the telecommunications sector can provide lessons for other areas where policymakers hope to deliver benefits by encouraging competition through regulation, such as digital markets. Many of the gains in telecommunications markets over the last 35 years can be seen as the result of liberalisation of parts of the value chain with low barriers to entry, albeit with a degree of regulation to ensure this liberalisation is effective. However, when it comes to fixed infrastructure the barriers to entry are high. That means there are few examples of sustainable infrastructure-based competition resulting from post-liberalisation entry (rather than from upgrading existing networks). Indeed, a number of jurisdictions have chosen to return to de facto monopolies.

Determining where competition is possible in a dynamic sector like telecommunications is challenging. Even if policymakers judge that a degree of sustainable competition is possible, they need to take account of the cost of imposing inappropriate regulation if their assessment turns out to be wrong.

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