

**Toward Cost-Oriented Pricing for Mobile Interconnect:  
Tensions in the Regulatory Environment**

Presentation to

***Workshop on Fixed-Mobile Interconnection***

**International Telecommunication Union (ITU)**

20-22 September 2000

PROFESSOR WILLIAM H. MELODY  
Economics of Infrastructures –  
Delft University of Technology  
Center for Tele-Information –  
Technical University of Denmark  
Editor – *Telecommunications Policy*



**Why is cost oriented pricing important**

- Consumer Access to Services
- Efficient Network Access for Competitors and Service Providers
- Sustainable Market Expansion
- Efficient Allocation of Economic Resources

## **What is included in economic cost?**

- Opportunity Cost Concept
- Payments/Obligations to Attract All Necessary Resources
  - People – Labour, Management and Technical Skills
  - Facilities and Technologies
  - Investment Capital
  - Profit – Cost of Attracting Equity Capital

## **Professional approaches to cost analysis**

- Accounting – Actual Revenues & Expenditures; Financial Statements
- Engineering – Efficient Network Design
- Economics – Efficient Allocation of Economic Resources
- They Often Disagree over Cost Concepts, Data Sources and Study Methods

**Economic reference point:  
Competitive Market Theory**

- Many Competitors – Supply & Demand Determine Market Prices
- Competitors Must Reduce Costs to the Market Price to Prosper
- All Competitors Can Not Set Prices Based on Their Costs
- Market Prices Reflect the Costs of the Most Efficient Competitor

**The problem of monopoly power**

- Prices Remain Above Cost – Sometimes by Large Margins
- Competition is Not Effective in Reducing Prices or Costs
- Can Price Regulation Help?
- Why Not Regulate Prices on the Basis of Costs?

## **U.S. experience: Public Utility Regulation**

- Prices Set on Actual Accounting Cost, including Reasonable Profits
- Achieved Significant Coverage of Population
- Potential Competition Mostly Resisted and Restricted
- Created a Cost-plus Incentive to Inefficiency
- Cost-based Pricing Became Price-based Costing
- The Cost of Costing Became Very High: Continuing Disputes
- Created New Markets for Lawyers, Economists, Accountants, Engineers

## **Experience with network interconnection costing**

- U.S.: Pre and Post FCC “TELRIC”
- Europe and Elsewhere: 57 Varieties of LRAIC
- Modelling and Precision as an Excuse for Delay
- Relevance to Developing Countries?

## **Moving to simpler cost benchmarks**

- Precision Misleading in Dynamic Markets with Technological Change
- The Practical Objective: Continuous Improvement
- Simplified Cost Models More Appropriate
- Benchmark Comparisons Can be Effective
- Standard Costs Can Be Reference Points

## **Benchmarking prices as well as costs**

- The Goal is Efficient Prices
- Benchmark Prices, Costs and Margins
- Linking Common Service Elements: Competitive and Monopoly
- Published International Comparisons: “Naming & Shaming”
- Specifying Indicator Measures Requiring Regulatory Intervention