Caribbean Economics and Financing Workshop

Competition Policy on the Caribbean

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Reasons for Sector Reform

- Evidence linking competitive telecommunications markets with private capital participation to faster growth and innovation which had the result of serving consumers better.

- Evidence mounted that the competitive sector model based on private capital greatly expands ICT diffusion, reduces prices, improves service and stimulates economic activity.

- Reform can take several forms: It can involve
  - restructuring of the industry through introduction of competition and removal of barriers to entry;
  - operational recalibration in the form of rule making that constrains natural monopolies and enforcement; and
  - privatization of state-owned enterprises.

- Of these three principal reform options, consensus holds that the establishment of competition can be expected to bring optimum benefits in productive, allocative and dynamic efficiency.

- At the same time it was also recognized that competitive markets required regulatory intervention. Since without it, at least in the medium term, viable competition was not likely to emerge.

Components of Competition Policy

- Requires "good" regulation and good governance to become an effective catalyst for ICT headcount diffusion.
- Requires changes in industry structure, ownership and behavior.
- Requires that an independent regulatory body is established prior to sector reform: this will set the conditions for sector participation.
- Requires laws that limit vertical and horizontal ownership.
- Requires the legal foundation that provides security to investors who are needed to fill the developing country investment gap.

Goals of Competition Policy

- Make regulation an important component of competition policy in the context of telecommunications by pursuing a “light touch” since regulation per se has the propensity to reduce economic growth.

- Make regulation a stimulator of increased investment inflows, reduce investment risk and realize larger revenues from privatization, better services at lower prices to consumers and high quality services with expanded options to businesses.

- Improve country economic performance and productivity growth through ICT investments by increasing headcount and diffusion.

Caribbean Competitive Landscape

- Almost all countries and foreign possessions in the region have promulgated legislation and formed regulatory agencies between 1998 and 2005.

- Equally, countries have introduced sector reform, either by fully or partially liberalizing the market during the 1998 to 2005 period.
  - Success has been most visible in mobile communications where country markets boast on the average three or more operators.
  - In the fixed line market segment the incumbent operators continue to dominate.
  - For ISPs it has been a mixed bag at best because of the lack of viable competition in the access network; hence profitability remains elusive and prices for users high.

- Regulatory oversight has generally been not as successful as hoped in curbing the residual market power of the incumbent operators. This is not surprising given the shortage of expert professionals in key areas and the favorable provisions of the incumbent operators' new license agreements, which were often a prerequisite for setting aside existing exclusivity licenses.

Headcount Comparison: Wireless

	1993	1997	2001	2005
Caribbean Wireless Subscribers (000)	148	689	4331	12400
Caribbean Wireless Penetration	0.4%	1.9%	11.3%	35.1%
North America Wireless Subscribers (000)	17346	59594	139268	218235
North America Wireless Penetration	6.1%	19.8%	44.1%	66.0%

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Headcount Comparison: Wireless

	1993	1997	2001	2005
Australia Wireless Subscribers (000)	690	4578	11132	18420
Australia Wireless Penetration	3.9%	24.6%	57.4%	90.3%
Russia Wireless Subscribers (000)	10	485	77500	120000
Russia Wireless Penetration	0.07%	0.3%	52.8%	83.6%

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Headcount Comparison: Wireline

	1993	1997	2001	2005
Caribbean Wireline Subscribers (000)	3160	3980	4790	4770
Caribbean Wireline Penetration	8.1%	10.9%	12.5%	12.1%
North America Wireline Subscribers (000)	165900	191200	211400	196300
North America Wireline Penetration	58.0%	63.6%	66.9%	59.4%

Headcount Comparison: Wireline

	1993	1997	2001	2005
Australia Wireline Subscribers (000)	8300	9500	10500	11500
Australia Wireline Penetration	48.3%	51.1%	54.1%	56.8%
Russia Wireline Subscribers (000)	23500	28300	33300	40100
Russia Wireline Penetration	15.9%	19.2%	22.7%	27.9%

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Headcount Comparison: Internet

	1999	2001	2003	2005
Caribbean Internet Subscribers (000)	528	1224	4331	12398
Caribbean Internet Penetration	1.5%	3.5%	8.8%	12.3%
North America Internet Subscribers (000)	113000	156400	179300	205100
North America Internet Penetration	40.2%	54.6%	61.3%	68.7%

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Headcount Comparison: Internet

	1999	2001	2003	2005
Australia Internet Subscribers (000)	5600	7200	11300	14190
Australia Internet Penetration	29.6%	37.1%	56.8%	70.4%
Russia Internet Subscribers (000)	1500	4300	12000	21800
Russia Internet Penetration	1.0%	2.9%	8.3%	15.2%

Post-Sector Reform Challenges

- Throughout the reform process regulation and regulatory governance play a major role.
- In the wake of the many negative outcomes of privatization and competition in developing countries it is now recognized that policymakers need to make the "right" reform decision.
  - Reform should include changes in industry structure, ownership and behavior.
  - Regulatory body needs to be established prior to sector reform in order to sets the conditions for sector participation, and that body needs to be independent.
  - Laws need to be promulgated that limit vertical and horizontal ownership.
- Policymakers have come to the realization that sector reform needs the legal foundation that provide security for private investors who are needed to fill the country investment gap.
- Policymakers need to remain cognizant that privatization and private investments may not jumpstart demand from the poor. This implies that unless service obligations and ability to pay constraints are built into regulatory decisions, there is a reasonable risk that the distribution of the benefits from reforms will reflect the current distribution of wealth since per capita GDP is an important predictor of ICT diffusion.

Post-Sector Reform Challenges

- Policymakers need to address market reality: competition may be technically possible, but new entrants require the co-operation of the incumbent operator, which often has a de facto monopoly, especially of the access network.

- But, an incumbent has no incentive to co-operate, and every incentive to exercise its market power at the expense of new entrants. It is the need to curb the residual monopoly power of the incumbents that requires governments to implement regulatory regimes. In the absence of such oversight it is unlike that competition will flourish.

- Is regulation effective? In the ideal world, economic regulation is intended to correct market failures. But in the real world regulation can also end up primarily benefiting the regulated firm because of absence of information, skills, or independence; thus leading to regulatory "capture".

- In such a case, regulation can become a vehicle not for maximizing total or consumer welfare, but for protecting the firm's monopoly and profits.

Post-Sector Reform Challenges

- It is easy to understand why regulatory failure can happen, even assuming a benevolent regulator. If it happens, it is only the incumbent that benefits!
  - Operators always have more information about their cost structure than does the regulator, making evaluation difficult.
  - Operators can strategically control the information available to the regulator in order to increase the probability that decisions are in the their favor.
  - Regulators may impose entry barriers, either out of the belief that entry would be harmful or, if truly "captured", simply to protect the incumbent.

- The principles of good regulation are transparency, accountability, proportionality, consistency and targeting.

- The objectives of regulation are
  - increases in efficiency and quality of service;
  - reductions in operating and investment costs;
  - reductions in prices to final consumers; and
  - enforcements of competition policy and to prevent market abuse.

Post-Reform Sector Challenges

- For regulatory agencies to be effective a well-designed sector structure is crucial since “good” regulation cannot overcome “bad” sector/market design.

- Arrangements between operator and regulator must be based within an effective governance framework, because effective regulation cannot take root in corrupt systems, or ones where the law courts are unreliable.

- Developing countries’ problems of governance and corruption are well documented: the net effect of regulation remains therefore unclear: regulatory agencies may be crucial in encouraging market entry, but the track record is not good.

- This becomes clear when looking at wireless subscriber growth. There appears to be little difference between countries that have implemented sector reform and have a regulator, and those that have neither. And neither does the level of corruption appear to make any difference in growth rates. All this leads to the conclusion that the wireless sector has reached a critical mass in terms of subscribers and profitability that bribes are seen simply as a cost of doing business.

Post-Reform Sector Challenges

- Where the principals of “good” regulation have been implemented, evidence has shown it to be beneficial in providing higher investment and larger revenues from privatization, as well as better services at lower prices to consumers according to World Bank studies.

- It is not only a question of implementing “good” regulation, it is also important to find a balance between regulatory oversight and laissez-faire. Excessive regulatory involvement affects economic performance and creates barriers to infrastructural investments.

- In most developing countries regulations are often not intended to correct market failures, but are more consistent with a regulatory “capture” *per se.*

- World Bank research finds that heavy handed regulation strongly correlates with lower headcount, and when controlling for factors such as income, infrastructure, ubiquity of PCs, and time trends, countries that require formal regulatory approval for ISPs have fewer Internet users and Internet hosts than countries that do not.

Post-Reform Sector Challenges

- A World Bank study concluded that regulation tends to reduce growth: for telecommunications, ICT and investments boost productivity; thus, countries with heavy regulation will reduce economic growth.

- However, the quality of regulation – as captured by the overall institutional framework – makes a big difference. In most instances, the study finds that better institutions help mitigate, and even eliminate, the adverse impact of regulation on macroeconomic performance.

- In the final analysis, however, commercialization has to be accepted as the basis of service provision, including pricing which avoids implicit subsidy since the political economy of pricing reform has had the habit of destroying many reforms and regulatory systems, and threatens many more. If it is absent than is will not bring the desired results.

Challenges of Convergence

- For operators convergence will reduce opex and investment costs, but are the operators ready to meet the challenge to scale up and produce new revenue streams? Doubtful!

- For developing countries convergence will allow the leapfrogging from the voice age into the information age; hence erasing the digital divide, but will governments stand in the way, or allow it to happen? Not likely!

- For service providers convergence will bring companies that used to be in separate industries into the same business, but are they ready for strategic re-think? Probably, because they have no other choice!

- For OEMs, this means to come to terms with the fact that equipment is less and less equipment and more and more software and services, but higher margins are not assured. Will OEMs be ready for the challenge? Most likely!

- For regulators this means regulating less while increasing competition enforcement and drawing up new rules for a converged world, but will vested interests allow it? With difficulty!

- For governments this means the risk of losing billions of dollars in taxes when operators move their voice traffic to IP networks, but can they accept it? As a last resort!

Competitive Market Prerequisites

- Requires "good" regulation and "good" governance for fast-paced ICT headcount diffusion. Its principles are transparency, accountability, proportionality, consistency and targeting.
- Requires an independent regulatory body that will set the conditions for sector participation, including laws that limit vertical and horizontal ownership and define sector structure.
- Requires the legal foundation that provides security to investors who are needed to fill the local investment gap.
- Requires that commercialization is accepted as the basis of service provision, including pricing which avoids implicit subsidy since the political economy of pricing reform has had the habit of destroying many reforms.
- Requires an assessment of the market reality: competition may be technically possible, but new entrants require the co-operation of the incumbent operator, which often has a de facto monopoly, especially of the access network who has no incentive to co-operate.

Competitive Market Pre-requisites

- For regulatory agencies to be effective it requires well-designed sector structure is crucial since “good” regulation cannot overcome “bad” sector/market design.

- For regulators it is not only a question of implementing “good” regulation, it is also important to find a balance between regulatory oversight and laissez-faire. Excessive regulatory involvement affects economic performance and creates barriers to infrastructural investments.

- For the regulatory arrangement to function it must be based within an effective governance framework, because effective regulation cannot take root in corrupt systems, or ones where the law courts are unreliable.

- For developing countries it requires a solution to the problems of governance and corruption whose net effect on regulation is negative. The track record here is not good.