Transitioning from Monopoly to Competition and Managing Competition

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Contents

• Overview of the transition
• Traditional model of supply: Monopoly
• The need for a change
• Waves of liberalization
Overview of the Transition

Public Monopoly Environment

Limited Regulation because government is sole operator and regulator

Private Monopoly Environment

More regulation because private operator needs to know its rights and obligations and government needs regulatory framework for oversight over operator

Partially Competitive Environment

Greater need for regulation as regulator must implement tools to address new competitive market (e.g., rules regarding potential anti-competitive practices, licensing framework, universal service, tariffing)

Fully Competitive Environment

More limited regulation as competitive market largely regulates itself and thus there is a shift to more *ex-post* regulation
Traditional Model of Supply: Monopoly

- Telecommunications services before the decade of the 1980’s were supplied mainly under monopolistic market structures.

- The principal justification for this was that telecommunications services, particularly voice telephony, were believed to be a natural monopoly.

- This broadly meant that due to high sunk costs and increasing returns to scale, demand could be satisfied at lower cost by a single provider.

- Hence, competition was discouraged as it would amount to socially wasteful expenditure of resources.
Traditional Model of Supply: Monopoly

- In most of the **developed countries**, the monopolistic operator was a state-owned enterprise, while a few countries opted for the system of issuing licenses to private and/or state monopolies on a territorial basis.

- This model worked particularly well for many years in the more developed economies, where long-distance and international tariffs, which had stayed high despite technological changes, subsidized were decreasing in cost as opposed to the initial phases of their exploitation.

- In the more developed economies, this model enabled the development of near ubiquitous networks and of teledensity and the sectorial industrial development.

- Even within this context of decreasing tariffs, this income still subsidized local and regional telecommunications and even the establishment of rural telephony.

- Additional financial sources for sector development and for the provision of universal service, in particular, were obtained from the government budget.
In less developed countries, the scenario of cross-subsidization worked less well and operators started having difficulties in providing new services and in keeping up with technological changes.

Financial resources were obtained in some cases from multilateral lending or donor agencies or from bilateral government or other government-sponsored sources.
Public/Private Monopoly Environment

- **Public Monopoly**: Limited regulation because government is sole operator and regulator

- This classic model of supply generally concentrated policy-making, regulatory, frequency management and network operating responsibilities in a single entity

- **Private Monopoly**: Greater need for regulation because private operator needs to know its rights and obligations and country needs regulatory framework to oversee the operator
Need for Change

• In the 1980’s several factors started to undermine “traditional” thinking about the telecommunications sector:
  – Technological advancement
  – Perceived need to lower certain tariffs
  – Desire to increase the range of services available to the consumers and generally to bring tariffs in line with costs
  – Desire to expand businesses

• Since the late 1980’s (except for the US and UK, where the process started even earlier), a liberalization and reform process took place in the telecommunications sector in many countries across the globe

• The process started in the US with the break-up of the Bell system and this was followed by the UK, Japan, Australia and New Zealand, amongst others.
Need for Change

• In developed countries, the decrease in tariffs undermined the system of cross-subsidization, initiating the reform process.

• In developing economies the funding sources, which were essential to the development of the sector either dried up or were drastically curtailed:
  – Income from cross-subsidization of activities alone was insufficient to guarantee a proper service, and
  – With donor agencies more reluctant to foot the bill -- private local and foreign sources of funding became more and more the norm.

• To access these new resources and complement the little available public and institutional resources, a wave of major changes took place and liberalization became the norm in many countries and regions across the world.
Waves of Liberalization

- Partly as a result of national, regional and multilateral efforts, many countries introduced successive waves of liberalization:

  Wave 1
  Privatization

  Wave 2
  Partially Competitive Environment

  Wave 3
  Competitive Environment

  Privatization of national operators
  Exclusivity period was often granted

  Sometimes occurred simultaneously with the privatization or followed soon thereafter
  Introduction of new services (e.g., mobile services and value-added services)

  Incumbent's exclusivity period expired and full competition was introduced
Why Rely on Competition?

• Competition is the most efficient mechanism for organizing, operating, and disciplining economic markets

• Competitive markets distribute resources efficiently without any need for a single centralized controlling authority

• Competition maximizes benefits to society at large:
  – Allocative efficiency: resources, products, and services are allocated to the person or persons who value them the most
  – Productive efficiency: market participants are forced to use scarce resources as productively as possible
  – Dynamic efficiency: market participants are encouraged to innovate, and to invest in new technologies at the best time
Competitive Scenarios

- **Perfect Competition**: Ideal, but unlikely in practice
- **Workable, or effective competition**: Buyers have alternative sellers, sellers have access to buyers, market price
- **Market contestability**: Potential for entry constrains behavior
- **Sustainable competition**: Overall aim of competition policy
Starting Point: Significant Asymmetries and High Entry Barriers

• Incumbents have first-mover advantages over entrants in newly liberalized markets:
  – Control of 100% market share
  – Accumulated assets, economies of scale, and experience in the telecommunications market
  – Ownership of vital networks and privileged used of public rights of way

• High entry market barriers:
  – Sunk costs
  – Scale and Scope economies
  – Essential facilities
# Regulation in Competitive Markets: Objective

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<tr>
<th>Objective</th>
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<td>Regulation is useful where market don’t function properly and market failure occurs</td>
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<td>Regulation attempts to prevent socially undesirable outcomes, and to direct market activity toward desired outcomes</td>
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Regulation in Competitive Markets: Objective

- Regulation should focus on removing or reducing barriers to entry and exit, and enabling the market itself to prevent the incumbent from exercising market power.
- For example, telecommunications regulation is widely used to promote prices that reflect efficient costs and promote universal access to basic services.
- These include addressing issues such as:
  - General prohibitions of anti-competitive behavior,
  - Mergers or acquisitions that would reduce competition,
  - Specific rules designed to encourage competition in the sector, such as interconnection requirements or unbundling policies.
Regulation in Competitive Markets: Costs

- No matter how capable and well intentioned regulators are, they will never be able to produce outcomes as efficient as a well-functioning market.

- Regulation has potentially high costs:
  - Time consuming process, and
  - Requires considerable expenditure of resources.

- Regulation can have unintended consequences, that may be detrimental to customers and the "public interest".
Regulation in Competitive Markets: Scope

• Regulation should only focus on those parts of the sector where effective competition is not feasible
• Regulation should only be a temporary measure
• The aim is to establish or restore the conditions that provide for effective competition on a sustained basis
• Once this is achieved, regulation should be withdrawn
Thank You

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