Transitioning from Monopoly to Competition and Managing Competition

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Presented at the
ITU Seminar on Establishing New Regulators in the Asian Pacific Region
October 26-27, 2007
Vientiane, LAO P.D.R.

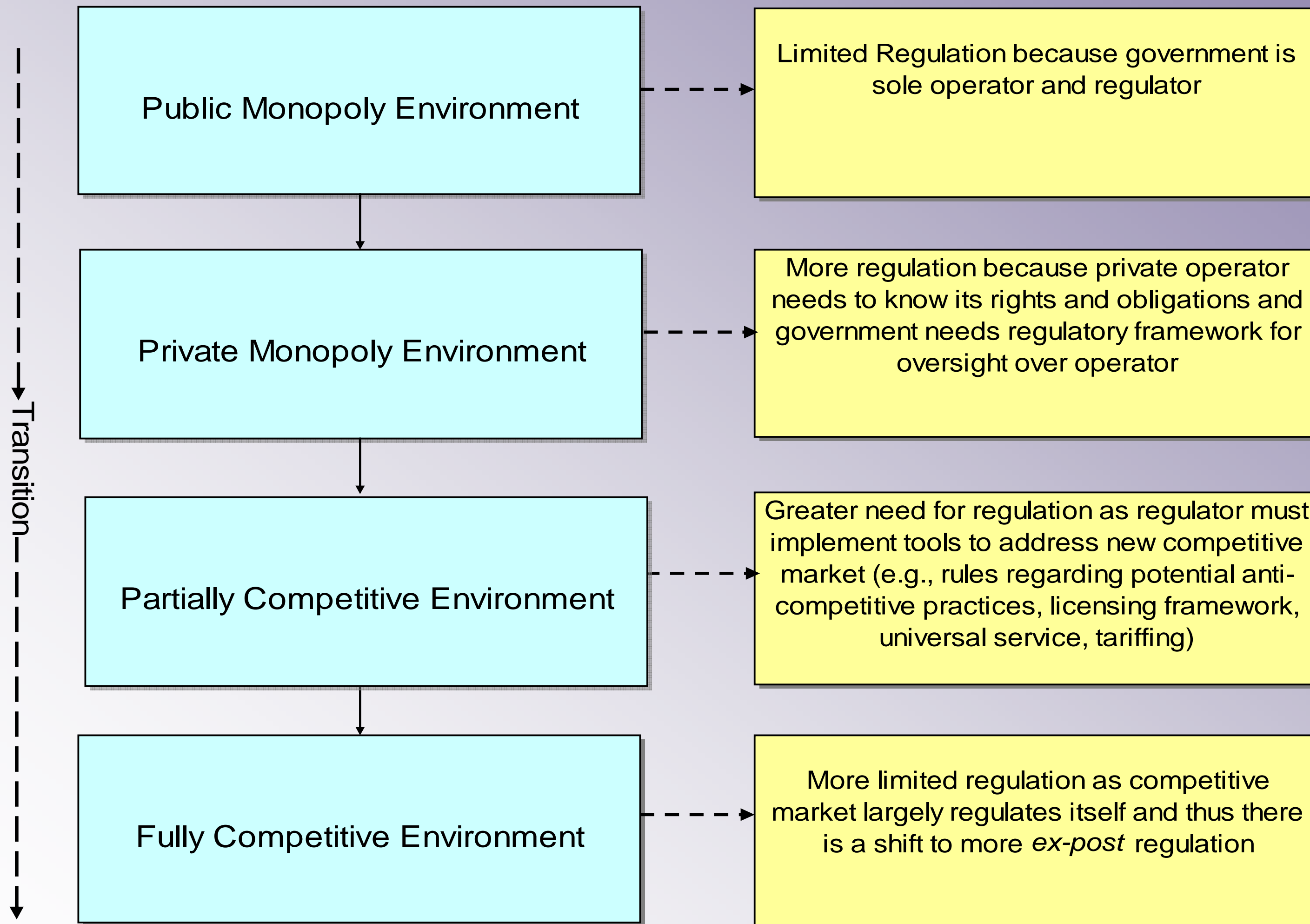
ENSURING TELECOMMUNICATIONS SUCCESS AROUND THE WORLD

Telecommunications Management Group, Inc.

Contents

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

Overview of the Transition



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

Traditional Model of Supply: Monopoly

- 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

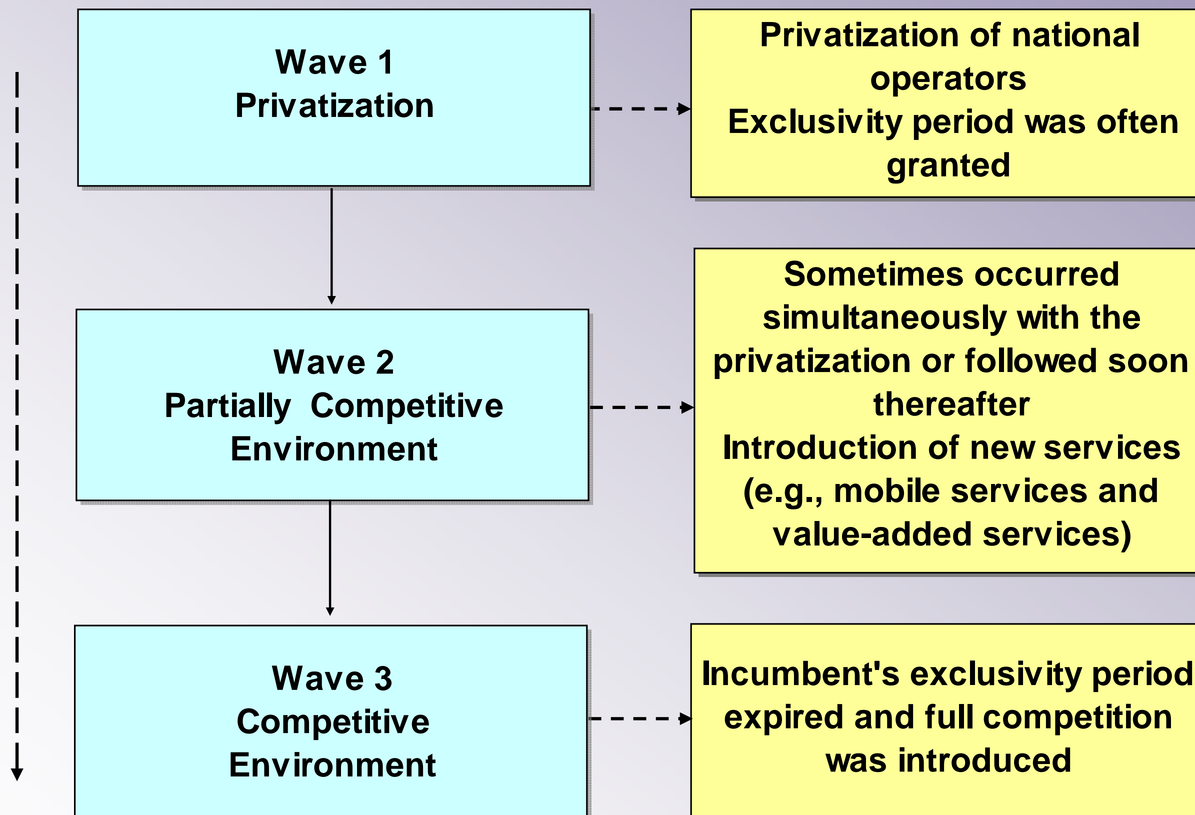
- In developed countries, the decrease in tariffs undermined the system of cross-subsidization, initiating the reform process

- 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

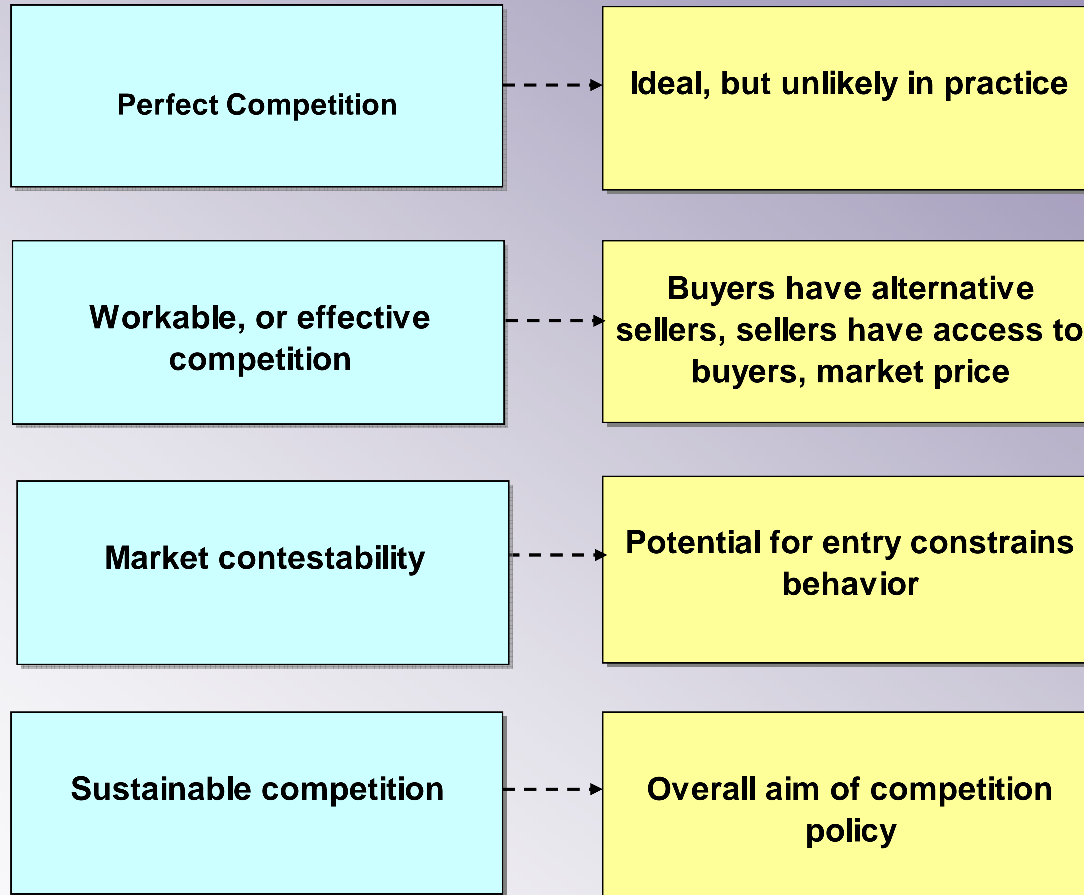
- Partly as a result of national, regional and multilateral efforts, many countries introduced successive waves of liberalization:



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



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

- Regulation is useful where market don't function properly and market failure occurs
- Regulation attempts to prevent socially undesirable outcomes, and to direct market activity toward desired outcomes

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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