How effective has competition been in the telecoms market over the past 25 years. Kevin Power looks at ways of using consumer welfare to measure competition

Back to basics on telecoms prices

A survey found that mobile call termination charges were 40%-70% higher than justified by an economic cost approach. Picture: Siemens

It is tempting to conclude that any competition is intrinsically good. That certainly was the thinking when Mercury was initially setup to compete with BT in the UK in the early 1980s. The reality, however, was far different, as the services offered were essentially the same with some initial variation on price.

The duopoly survived intact with minimal service differentiation until the issue of additional licences in the UK in the late 1990s.

It has become increasingly difficult to describe a truly competitive market with the standard tools used by policymakers in the new "flat world" created by technology and competition, and by the flood of investment in the fixed and wireless telecommunications infrastructure that has occurred since 1995.

Lower prices are a good starting point but have proved not necessarily to be the endgame for providing consumer value.

Long-term consumer value will ultimately depend on investment in the sector, and in Europe, like elsewhere, that has required the intervention of national regulators.

Regulatory benchmarks

At the European Competitive Telecommunications Association, where I was chairman from 2000 to 2006, we recognized early on the need to deliver and communicate a set of sound regulatory policies that would attempt to set a level playing field to encourage competition and more importantly the investment required to create competition.

In 2002, we moved early on the issue of regulation of the mobile industry with an ECTA-sponsored study conducted by the consulting firm Analysys to measure the fixed-to- mobile interconnect rates that were then prevalent in the market.

It had been a hot button issue for ECTA members, primarily fixed line operators, since the interconnect rate for terminations of calls from incumbent-owned networks to their own mobile arm was substantially lower than for terminating fixed line calls from other competitor networks to the same mobile network.

The resulting price squeeze was rightfully identified and addressed on the issue of equivalent access.

Shortly after, ECTA began tracking progress toward competition across all EU markets with our DSL and broadband scorecards. It soon became an effective tool for communication to policy makers in Brussels and at the national level to show the results of their policies compared to other more deregulated jurisdictions.

During the past several years, ECTA has refined its policy arguments to incorporate the idea of a broadband "ladder of investment".

The idea that a truly competitive landscape is one in which alternative operators have an incentive to invest at each stage of the ladder to enable them to realize a full return on their investment and a chance to secure the long-term commitment of the customer.

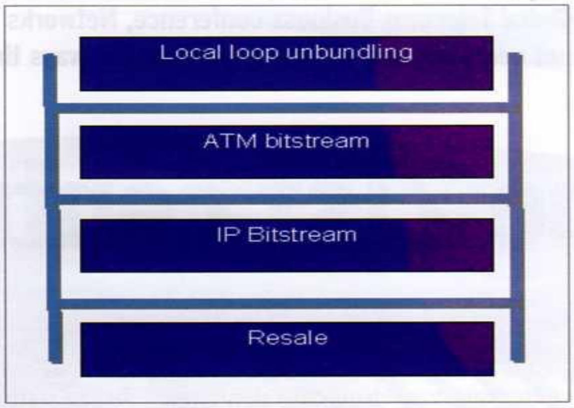
It requires access to incumbent networks to complete its service offering and the preservation of access in the event of a technology upgrade by the incumbent, such as next generation networks.

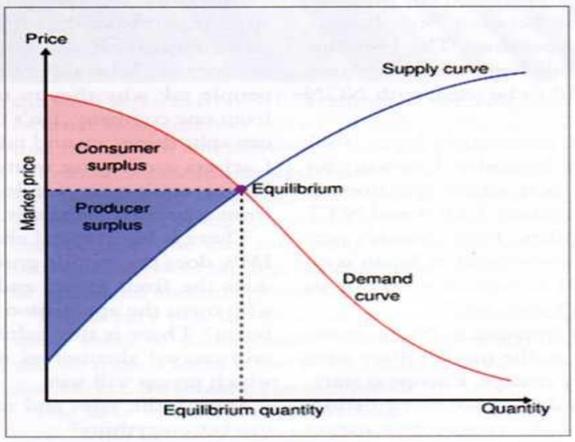
The simple resale rung allows for customer acquisition, and the follow on investment intended to connect at more network points and gain increasing control over the service. Local loop unbundling ultimately offers the most flexible approach to service offering.

Consumer welfare

In addition to regulatory strategies intended to keep markets open to competition, there is another equally

ECTA's broadband ladder of investment





valid way of measuring competition in the market for telecommunication services.

Microeconomic theory measures how individuals, households and firms make decisions to allocate limited resources in markets where goods or services are being bought and sold. In microeconomic theory, consumer welfare relies on a monetary measure of the gains and losses experienced by consumers when prices change.

Using the goal that an efficient allocation of resources requires equilibrium between supply and demand, microeconomic theory can measure surpluses accorded to either producers or consumers at different price levels — see graph.

The area above the market price line in red is called the consumer surplus because the consumer would be willing to pay a higher price than the market price. To the extent that he can buy at a lower price — for example, because of competition — he realizes a surplus between what he was willing to pay and the actual price.

I don't think anyone would argue that the telecommunications market is one characterized as having a consumer surplus.

The area below the market price line in blue is called the producer surplus because producers benefit by selling at a market price that is higher than they would be willing to sell for.

This is more of an issue for consumers in the market. Indeed, the Analysys study conducted for ECTA in 2000 measured the producer surplus for mobile interconnect charges and estimated that they were 4.5 billion for the then EU countries plus Norway and Switzerland.

Mobile call termination charges were found to "some 40% to 70% higher than those determined by the economic cost approach, making due allowance for the allocation of common costs and allowing for the mobile operators to recover a fair return on investment".

The mobile market is technologically constrained for call terminations, as consumers do not have a choice for the termination of calls: hence artificially high termination costs

The recent decision by the European Parliament to impose retail price caps on charges levied by European mobile phone operators in the 27 EU member countries is a further step, although a modest one, in reducing the producer surplus enjoyed by mobile operators, and thus moving towards a point closer to where consumers may ultimately enjoy a surplus.

Mandated MVNO competition in each EU market would possibly have the largest impact on the overall cost of roaming and termination costs, but the political will may be lacking for some time.

In early July, the French regulator Arcep picked up the baton on termination charges by calling for a reduction in the difference between mobile call termination charges and fixed-line equivalents.

Using the compelling logic of convergence, the regulator wants to eliminate artificial differences between the two. According to Paul Champsaur, head of Arcep, "There is no longer any objective reason for mobile call termination levels to be set in a significantly different way from those of fixed call termination."

So, how do we measure consumer welfare? Well, in the absence of all of the underlying cost data and data on consumer price preferences, one can assume that the consumer would want lower prices, and that the current prices are still too high for many consumers.

One way to assess welfare would be to measure the purchasing power of consumers over time for service offerings.

The idea of a retail basket of telecom goods for a fixed price could be used to measure not only the progress in securing more value over time (that is, more services in the basket) but also across geographic boundaries.

What does this mean for service providers? The competition is always for the consumer spend and to the extent that one provider can offer more for the same amount of spend, he should have an advantage in winning customers.

To take just one example, France, one of the more competitive markets in the EU, 30 now buys the consumer a triple play offering consisting of IPTV, 20 megabits a second broadband and VoIP.

In future issues, I will look at how competitive operator service offerings measure up against each other and provide the telecom basket of goods with increasing value. ■

Kevin Power was has over 25 years of experience in the telecom industry and was chairman of ECTA from 2000 to 2006. He currently advises technology and telecommunications companies on finance, M&A, strategic planning and operations, as well as serving as an independent director.