

**Comment on Lars Hultkrantz: Telecommunications liberalisation in Sweden: Is “intermediate” regulation viable?**

**Thomas P. Tangerås\***

In his essay, Lars Hultkrantz describes the various stages in the history of telecom deregulation in Sweden, from passive regulation at the outset until the more active regulation today. In this respect, it is of particular interest to note the strong involvement of Televerket (Telia since 1993) in the liberalization process. The dual role of Televerket as the incumbent operator and regulator until 1992, may account for the “ultra-light” approach to regulation initially taken in Sweden. A flexible design of a price cap on consumer prices coupled with unregulated interconnection charges permitted Telia to effectively block entry on the domestic fixed-line market for years, while allowing it to pursue business opportunities across a liberalized Europe. One almost gets the impression that regulation was tailor-made to fit Telia’s business strategy. Although now exposed to competition, Telia has managed to keep its dominating position in the fixed-line market segment in Sweden until this day.

With the dismantling of the regulatory authority from the national operator and the emergence of new market segments, in particular mobile telephony and Internet services, Telia lost its hold on the regulatory process. Subsequently, the pendulum seems to have swung from light-handed to heavy-handed regulation. First, the Swedish regulatory authority has introduced rate-of-return regulation of interconnection charges on operators deemed to have significant market power (among them Telia). Second, operators of mobile networks are now under the obligation of providing access to any potential entrant requiring access. Third, UMTS licences were distributed to whichever operator promised to fulfil certain universal-service obligations. In Hultkrantz’s words: “Political decision-makers and the regulation authority thus seem to be catching-up for the loss of control of the industry during the initial steps of the liberalisation process.”

*\* Thomas Tangerås is a research fellow at the Research Institute of Industrial Economics.*

Hultkrantz argues that the interventionist solutions pursued in these cases could probably have been replaced by market-based solutions without any significant loss of efficiency. First, targeting intervention toward reducing switching costs and consumer lock-in weakens the operators' potential for collectively increasing interconnection charges and thus has a similar effect as price regulation. Second, the unbundling of capacity and price regulation of access would most likely be fruitless since network operators have numerous other possibilities for excluding downstream providers from entering. Third, beauty contests are a less efficient method for evaluating the social value of UMTS licences than auctions.

It is probably correct that spectrum rights are better auctioned off than handed out in beauty contests, but it is less obvious that a fully competitive approach to interconnection charges best serves the objectives set out by the European Parliament. Article 8 of the Frame Directive 2002/21/EG requires that means to further effective competition be given particular attention by the national regulatory agencies. In his analysis of a market-based versus regulatory approach, Hultkrantz takes a short-term view. Unfortunately, short- and long-run objectives are sometimes in conflict. Reductions in switching costs would, as Hultkrantz argues, most likely lead to a reduction in short-term market power. However, operators with little else to look forward to besides fierce price competition for end-users, could be expected to be reluctant towards undertaking socially beneficial infrastructure investments.<sup>1</sup> The reduction of short-term market power may thus be in conflict with long-term goals of dynamic efficiency. In a market with otherwise homogeneous products, some degree of consumer lock-in and market power may be desirable from society's point of view, so as to protect the returns to investment. In view of this problem, the question naturally arises of what constitutes the optimal degree of short-term market power, and would a fully deregulated environment lead to the optimal amount of investment and eradication of *long-term market power*?

In a long-run perspective, market power is restricted by potential entry. Long periods with supra-normal profits would spur entry into the market in the absence of significant entry barriers. In a fully deregulated environment, the incentives and possibilities for erecting

<sup>1</sup> The threat of intense price competition may, in fact, constitute an effective entry barrier. Potential entrants would infer that they be met with fierce competition by the incumbent, which might be sufficient to prevent entry.

entry barriers would probably be substantial. Entry requires access to the network. Potential entrants would have to pay for access, the value of operation providing an upper bound on the willingness to pay. The value of operation is, to a large extent, determined by the entrant's ability to steal customers from its competitors, including the access provider itself. An integrated monopolist would have no incentive for granting access. Things are a bit more complicated in an oligopolistic market with interconnected operators. Most likely, it is better to attach an entrant to one's own network than to find him attached to that of a competitor. In the first case, the network operator recovers at least parts of its profit losses through the interconnection charge. Hence, it might be profitable to grant a service provider access to one's own network if the expected alternative is to have the entrant connected elsewhere. If, on the other hand, each operator expects every other operator to refuse access, it would most likely be individually rational to refuse access. This coordination problem creates a joint interest among incumbent operators in preventing entry. One way of doing this would simply be to agree on refusing access. Another would be to collectively raise access prices.

Some kind of regulation, for example the unbundling of capacity and the regulation of access charges, may be required in order to secure long-term competition. Naturally, the incumbents may still try to restrict entry by other means than price, but in homogeneous goods markets, such as voice telephony, competition is mainly through price. It remains an open question whether sector-specific regulation is required or an application of competition legislation would be sufficient to secure access to the market for potential competitors. Nevertheless, it probably remains an uncontroversial statement that the market for telecommunications requires close scrutiny by one authority or the other in the foreseeable future. The identification of entry barriers and the development of methods for reducing them deserve our attention.