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**A Short Note on the
Philosophy and Economic Rationale Underlying “Glide Paths”
for the Regulation of Mobile Termination Rates**

by

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Introduction

1. This short note serves to clarify the concept, philosophy and economics rationale underlying the regulation of mobile termination rates in Europe.

Glide paths for the regulation of mobile termination rates in Europe

2. In its common position on symmetry of fixed call termination rates and symmetry of mobile call termination rates the European Regulators Group (ERG) noted that asymmetries “exist between termination rates of network operators within a single country. In the past, in countries with existing asymmetries, NRAs [national regulatory authorities] have sometimes justified them on a temporary basis.”¹

3. It is also noted that “economic principles tend to recommend a unique and uniform termination rate, determined with reference to costs incurred by an hypothetic efficient operator, i.e. a termination rate which does not depend on costs effectively incurred by the operators or on their market shares. This efficient termination rate level indeed is the right signal to give incentives for productive efficiency, less efficient operators trying to overcome their inefficiency (in lowering their costs to avoid losses which ultimately result in market exit) and more efficient operators realizing profits over regulated prices, investing and innovating. Gains in productive efficiency put pressure on final services’ prices and contribute to end-users welfare” (ERG, 2008, p. 4-5).

4. The ERG then continues to note that “unlike a unique efficient termination rate level, asymmetric TR pricing does *a priori* not favor productive efficiency. In particular, even if it ensures every type of operators (efficient or not) to recover their incurred costs, it imposes a constraint on more efficient operators to subsidize the relative inefficiencies of their competitors. Consequently, incentives to deal with inefficiencies may be reduced and passed on to downstream markets, which is detrimental to the end users” (ERG, 2008, p. 5).

5. However, two examples are given by the ERG for situations in which asymmetric termination rates may be justified. This is, first, the case of asymmetric spectrum allocation, and, second, “to encourage the development of a new entrant on the market, which suffers from a lack of scale due to late market entry” (ERG, 2008, p. 5). Hence, asymmetric regulation is viewed as a tool to encourage and to support market entry. In virtually all cases I am aware of this implies that the entrants’ termination rates exceed the incumbents’ termination rates.

6. The ERG also notes that “when choosing this entry encouragement intervention, the regulator must be able to commit itself on a sunset clause” (ERG, 2008, p. 5). Therefore, glide paths are used to reach symmetric MTR regulation. In Europe, the use of glide paths is therefore a commitment to a convergence timetable in order to reach more symmetric regulation. It is not used in order to protect incumbents against market entry. In fact, the opposite is the case: If glide paths are used they are designed to encourage and to support entry, but certainly not vice versa.

7. As the ERG (2008, p. 28) explains “in some countries symmetry is reached after a so called ‘glide path’. This implies that OAO’s tariff at time ‘t’ are set higher than incumbent’s tariffs and are subject to decrease at a predetermined rate or through a predetermined ratio/mark-up, such that they will be equal to the incumbent’s tariffs in year ‘(t + x)’.

¹ ERG (2008), Common Position on Symmetry of Fixed Call Termination Rates and Symmetry of Mobile Call Termination Rates, ERG (07) 83 final 080312, p. 3.

8. In summary, the entire ERG document is rather plain and clear that the idea of using glide paths is to support late entrants and to achieve a glide path towards symmetry, slowly reducing asymmetries between MTRs over a transitory period. The idea of using glide paths in Europe is certainly not to protect incumbents against entry. Instead, glide paths are viewed as a temporary measure to support entry. However, the ERG also clearly notes that there are costs associated with this kind of entry assistance, namely that asymmetric MTRs induce inefficiencies to be passed on to downstream markets and that asymmetric MTRs may enhance productive or allocative inefficiencies (cross subsidies between operators), which might be detrimental to welfare.

9. In line with this reasoning the European Commission has stated in its recent guidance on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (of 7 May 2009) stated that it has drawn upon the ERG Common Position and envisages that a timeframe of four years for phasing out asymmetries as it expects to take three to four years after entry to reach minimum efficient scale.²

10. In addition, the explanatory note accompanying the recommendation also refers to the use of glide paths as a method to progressively reduce the difference (asymmetry) between the termination rates of the incumbent and of an alternative operator, so that both become equal (symmetric) at a given point in time.³

11. This reasoning is entirely in line with the academic literature on asymmetric termination rates. Authors such as Martin Peitz (2005) and Paul De Bijl and Martin Peitz (2002)⁴ have suggested to temporarily use asymmetric termination rates to encourage entry and to strengthen competition (through entry), but certainly not to soften competition by giving incumbents a break.

Conclusion

12. Neither academic literature nor European practice suggests that glide paths should be used to protect incumbents against competition. Instead, the entire logic behind the use of glide paths is to protect and to encourage entrants by granting them higher MTRs than incumbents. As asymmetric MTRs are associated with inefficiencies themselves, however, they should, if at all, only be used as a temporary measure. In order to phase out these asymmetries, glide paths are used by some European regulators.

² See European Commission, Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (of 7 May 2009), p. 6.

³ See European Commission, Commission Staff Working Paper Accompanying the Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (of 7 May 2009), p. 12.

⁴ Peitz M. (2005), "Asymmetric Access Price Regulation in Telecommunications Markets", *European Economic Review*, 49: 34-358; De Bijl, P. and Peitz, M (2002), *Regulation and Entry into Telecommunications Markets*, Cambridge University Press: Cambridge.