Comments on TRAI Consultation Paper on 'Tariff issues of telecom services'

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13th March, 2020

The Consultation Paper (CP) on Tariff Issues of Telecom Services (No. 22/2019 of December 17, 2019), seeks comments on the proposed imposition of floor prices for various telecom services.

1 Analysing the rationale for the proposed intervention

The objective of the proposed regulatory intervention i.e. institution of floor prices, is unclear. As noted in the CP, any regulatory intervention must address a demonstrable market failure. The market failure in this case, is the purported inability of the market to arrive at the equilibrium price for services due to fierce competition. Telecommunication Service Providers (TSPs) claim that they are unable to increase prices for services in the current market. However, "fierce competition" by itself cannot be classified as a market failure.

Should the need for the proposed regulatory intervention be occassioned by the presence or fear of anti-competitive behaviour (predatory pricing) by firms, the regulator can act against such behaviour based on evidence thereof. The regulator must in any event, ensure that no TSP indulges in anti-competitive practices by regularly examining the tariffs offered to consumers and the underlying costs involved in provision of services. Accordingly, regulatory intervention of the nature proposed by the CP is unwarranted.

2 Economic theory does not support introduction of floor prices

Economic theory recognises that any form of government intervention in terms of mandating floor prices or price ceilings can inhibit the market's ability to find an equilibrium price and allocate resources efficiently (Morton, 2001) and (Coyne & Coyne, 2015).

Specifically, fixing of a floor price for telecommunications services can lead to the following economic inefficiencies and distortions in the telecommunication market:

- *Mandating a floor price results in a surplus and higher prices for consumers:* Economists argue that a government mandated floor price will result in a surplus, where suppliers produce more than consumers demand, in order to take advantage of the profitable higher prices (Coyne & Coyne, 2015). This is inefficient as it leads to excess production and does not serve consumer interest well as it results in higher prices for the consumers (Goodwin, Harris, Torras, Nelson & Roach, 2014).

- *Price floor creates dead-weight loss and benefits producers over consumers:* Price floors tend to convert a consumer-surplus into a producer-surplus, thus benefiting producers at the cost of consumers. Apart from being against consumer interest, fixing a floor price also leads to a net dead-weight loss to the economy, resulting in the loss of productive efficiency in the economy (Goodwin et al., 2014).

- *Floor price may prevent entry of new players into the telecom market:* It is pertinent to note that a new player effectively utilized promotional strategies such as offering free/discounted data services to enter into and consolidate its place in the Indian telecommunications sector since September 2016 (Parsheera, 2018). Setting of floor prices by the regulator at this point will therefore insulate incumbents from similar competitive pricing by new entrants and may inhibit the entry of new players altogether.

- *Floor prices may also create indirect distortions in the telecom market:* Mandating of floor prices can cause indirect distortions in the market, for instance by: (a) leading to the replacement of market competition by political competition, atleast partially i.e firms may divert some of their focus from the consumer to influencing the political process that determines how controls are implemented and enforced; (b) prompting uncertainty as firms must not only predict what their customers want but also have to factor in any foreseeable change in regulatory behaviour; and (c) masking the true underlying problems of the market (Coyne & Coyne, 2015).

One of the primary functions of an independent regulatory authority is to protect and promote competition in the concerned industry. This, however, does not entail protecting the industry's players by fixing minimum tariffs. The CP succinctly highlights the negative impact of fixing floor prices — it leads to inefficiencies, insulates TSPs from the vagaries of competition, creates entry barriers and is anti-consumer. In essence, while the proposed intervention may benefit the TSPs, it is anti-competitive and may harm consumers.

3 Market conditions do not require fixing of floor prices

Contrary to claims made by the Cellular Operators Association of India (COAI) in its representation to TRAI (Annexure IV to the CP), the hyper-competition and tariff-wars that were seen in the sector after the entry of Reliance Jio into the market have subsided, with the Indian telecom industry witnessing a period of consolidation over the past few years. Consolidation in the sector has meant that competition pressure on firms is reduced compared to 2016-17, when Telecom Regulatory Authority of India (TRAI) previously decided not to institute floor prices.

As recognised by TRAI in the CP, the sector has seen across the board tariff hikes of a significant nature in the recent past. Further, there is no reason to believe that TSPs cannot increase tariffs going forward. In fact, recent media reports indicate that this may indeed be the case with some TSPs planning further hikes to data tariffs in the coming months (Sheth, 2020) and (India Today Tech, 2020).

While the demand for regulatory intervention may be borne out of genuine financial stress in the Indian telecom industry, helping TSPs earn more revenue through fixation of floor prices does not address the root cause of this stress. Not only are business decisions by TSPs a major reason for the current state of the industry's finances, regulatory failure is also a relevant factor. Rather than institute floor prices, a measure which is both unecessary and that could potentially harm growth of the digital ecosystem, TRAI and DoT may consider revisiting structural issues such as auction design, spectrum pricing methodology and principles for calculating AGR dues to address concerns of the industry.

4 Capacity constraints

As recognised by TRAI in the CP, it can be extremely difficult to set appropriate pricing levels, particularly given the different technologies and business models used by different TSPs. The regulator may need to carry out significant de novo research (in the form of surveys, etc.,) as well as formulating an appropriate methodology to determine the floor price level. Any such exercise would likely require significant expertise, time and resources of the regulator, particularly should there be a need for periodic revision of the floor prices.[1]

One could also envisage the possibility of disputes on account of (allegedly) improper price fixing. One only has to see previous experience in the context of price setting attempts by TRAI to recognise that the proposed intervention could in fact lead to regulatory uncertainty and hinder development of the sector. For instance, TSPs challenged the access facilitation and co-location charges for landing stations fixed by TRAI in 2012. The issue took nearly 6-7 years to resolve and involved several rounds of litigation before various adjudicatory fora (Telecom Regulatory Authority of India [TRAI], 2018).

5 Costs v. Benefits

From the analysis above, it is clear that no significant benefit will be achieved through the proposed intervention. As noted, the state of the market indicates that TSPs are indeed in a position to increase their prices. Further, the existence of any anti-competitive practices by any TSP (such as predatory pricing) can be dealt with through normal processes in this regard.

Any benefits that the proposed intervention could bring (such as aiding TSPs in view of their financial state) can be achieved through more appropriate and targeted measures. Assuming that such an objective ought to be met at all, the regulator and the government ought to adopt measures that address the real source of the problem.

At the same time, fixing of floor prices may have an adverse effect on consumers - particular those at the bottom of the consumer pyramid / those belonging to more vulnerable sections of society. A significant proportion of mobile subscribers in India use pre-paid subscriptions. Such consumers are typically more sensitive

[1] We note that regulatory cost has been recognised as a relevant factor in determining policy interventions, as seen for example in the context of TRAI's Prohibition of Discriminatory Tariffs for Data Services Regulation of February 2016.

to changes in price than users of post-paid services. Instituting a floor price could therefore affect how a large proportion of subscribers access and use telecom services in India. The Indian telecom sector is also far from mature and has scope for further growth. Given the continued potential for growth of the data economy in India and the fact that access to telecom acts as a driver of economic development, we believe institution of floor prices to be unadvisable in the foreseeable future.

Finally, one may also consider the possible reputational damage to the regulator. A move to institute floor prices could be seen as the government/regulator looking to unduly assist private sector companies at the cost of the consumer.

In view of the arguments made above, we believe that TRAI should not diverge from its existing policy of forbearance when it comes to setting telecom tariffs.

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