

Policy Brief

Banded Forbearance: A New Approach to Price Regulation

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Background

As a result of deregulation, privatization and liberalization, telecom markets around the world have become more dynamic and competitive. These changes, coupled with new developments in technology, have resulted in the increasing uptake of telecom services at all levels of society. With innovative new services on offer and growing heterogeneous demand for the same, operators and regulatory authorities have had to restructure the way they approach the market. While the former have had to focus efforts on marketing and capturing niche markets with the provision of innovative and cutting-edge services, the latter agents have had to re-think the way they regulate the market.

Focusing on tariff regulation, it is evident that in many countries around the world still rely on regulations from the monopoly era. While there are several applications of asymmetric regulation, where only the Significant Market Provider (SMP) is required to file tariffs and obtain approval for every tariff plan prior to issuance in the market, there is a growing trend to move to regulatory forbearance. Here regulators refrain or forbear from intervening or imposing controls in a market, unless necessary. This less intrusive means of tariff regulation has proven to be successful in India, where it has been shown that telecom operators charge some of the lowest tariff rates for mobiles in the South Asian region.

However, this kind of 'deregulation' and relinquishing of responsibility by the regulator cannot be implemented in any telecom market. The prerequisite for effective and successful application of regulatory forbearance is centered on the level of competitiveness prevailing in the market, and given that India has extremely high competition, it is understandable why this type of regulatory approach has worked so effectively. Unfortunately, this is not the case in many other telecom markets around the world.

Additionally, the tools used to regulate SMPs in asymmetric regulation, have thus far been based on intricate computations for Rate of Return (ROR) regulations or price capping. These are based on dated, inflexible and complicated methods for the regulation of tariffs and are more suited for use in less fast paced market environments.

It is, therefore, important for authorities to be better equipped in order to effectively regulate tariffs in the telecom sector.

What is 'banded forbearance'?

It is recommended that the regulator employ '*banded forbearance*' for regulating tariffs. Based on benchmarking regulation and using the principle of regulatory forbearance, it is proposed that the regulating body:

- Define a benchmarking methodology, such as an adaptation of the OECD basket methodology, including peer countries and weights;
- Define a band of allowed variance above and below, what is likely to be a moving benchmark (driven by prices changes and exchange-rate movements), within which prices will be fully forborne; and
- Specify competition-related criteria that will be used to evaluate price movements above the upper band and below the lower band (e.g., limited to tests on predation and price squeeze). Time limits and default outcomes can also be specified.

Why '*banded forbearance*'?

- Equitable regulatory tool, compared to asymmetric regulation, since it applies to all operators in the market.
 - Reduces opportunities for rent-seeking within the regulatory agency.
 - Does not breed discontent among service providers, especially SMP operators.
- Does not rely on tedious and complicated calculations for ROR regulation or RPI-X.
- Creates efficiency within the regulatory authority.
- Allows more dynamism and enables quicker responses to tariff changes in the market.
- Is less intrusive than existing types of tariff regulations.
- Gives operators more flexibility, with the use of bands, for deciding on their tariffs rates. Operators are encouraged to use innovative marketing strategies, while retaining safeguards that may be important in markets with few competitors and possibly significant control over essential facilities by incumbents.
- Reduces the opacity of pricing for consumers.
- Most importantly, it enables intelligent and responsible regulation.

Caveats

It must be noted that for banded forbearance to be applied effectively, there is a need for accurate and timely operator-level data, such as minutes of use per month, call distributions by destination and time, etc. The data also has to be comparable to ensure the trouble-free computation of the benchmark value around which the band is centered on. Without these prerequisites, the application of banded forbearance will be a challenge.