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Finding Effective Competition: A Look at the Wireless Telecommunications Market

Introduction

The FCC will soon be releasing its annual report on wireless competition. One key question, of course, is whether the market is competitive. Proponents of regulation seem to believe that consumers are automatically endangered when there are only a few competitors. But accepted economic literature and empirical research finds no evidence that market concentration, by itself, answers questions about market performance. The issue of market structure and the impact on consumer welfare is far more complex than that. A reflexive look at market structure, such as the number of competitors, is not an indicator of market failure. Indeed, if the market performs well – exhibits high growth, low prices and a never ending expansion into new technologies and devices – then a focus on market structure is irrelevant. This appears to be the case for the wireless services market.

Perfect Competition is Not Perfect

One of the first mistakes made by those seeking additional regulation of wireless services is viewing the market through the lens of "perfect competition" and assuming that it is a workable model for all markets. Nothing could be further from the truth. The model of perfect competition is a useful construct for students of economics, because it permits a good understanding of how markets produce desirable outcomes and react to changes in price, supply or other factors.

Perfect competition is a textbook model that assumes that all goods are exactly identical – so there is no product or service differentiation; it assumes that competitors are "price takers," which means that consumers receive no discounts, sales or price cuts; and there are no patents for innovation or technological change. There are no economies of scale that would favor mass production and limit the number of competitors that a market could sustain. In short, perfect competition is not a useful model for network economies or innovative technologies, such as wireless and broadband technologies.

In the real world, some concentrated markets can have much lower costs and consumer prices than markets with many competitors, because of economies of scale and scope. This means that if policymakers or regulators require more firms to serve a market, consumers could end up paying higher prices, not lower prices. Regulators do not know the minimal optimal scale.

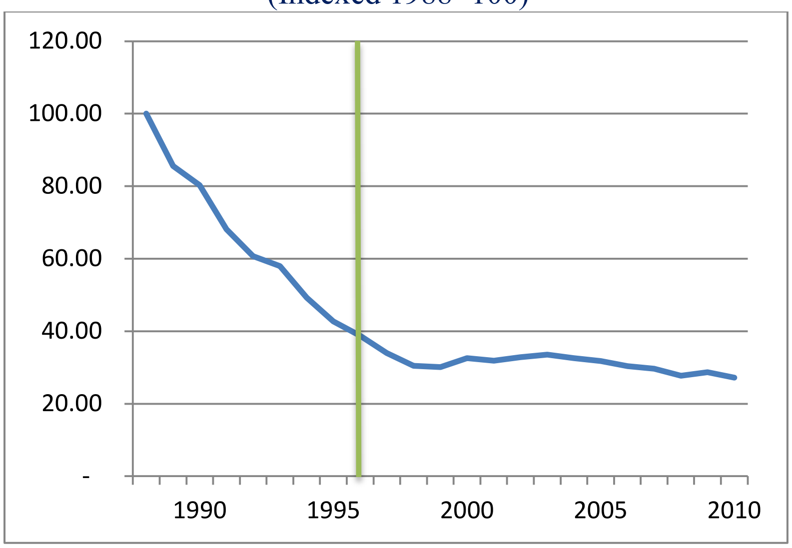
Intense Competition – Direct and Intermodal

Whether choosing from three wireless providers or three dozen, the core question for consumers is whether market forces are sufficient to provide them with the services they want, a fair price, a variety of plan options, and the ability to influence provider behavior by moving their business to a rival. Evidence shows that wireless providers have sufficient incentive to attract customers by offering innovative handsets and other devices, and pricing. In addition to such traditional carriers as Sprint, AT&T, Verizon, MetroPCS, T-Mobile, Leap, Cellular South, U.S. Cellular and many resellers, there's also the possibility that newer competitors such as Clearwire and LightSquared (or future entrants) will enhance competition in a marketplace that continues to evolve rapidly. Device makers and developers of operating systems, such as Google, Microsoft, Rim and Apple also may affect the market's dynamics. In addition, there are other competing products for wireless broadband and voice services – in other words, intermodal competition, such as Wi-Fi networks, satellite and cable that offer voice, data and video communications. Internet applications and cloud computing now support voice communications, teleconferencing, messaging, video conferencing and voice mail – at little or no costs. And, there is Google Voice and directory information services. So simply concluding that the market is in the hands of a few competitors is overly simplistic. Competition is intense.

Falling Prices; Growing Demand

On April 9, 1981, the Federal Communications Commission (FCC) decided that wireless telecommunications services would operate with two competitors. More competitors were added during the period of late 1994 through January 1997. Using the annual data available from the wireless association, CTIA, the average wireless phone monthly bill, adjusted for inflation, fell by 61% from 1988 to 1996, or a decline of 11% per year in real terms, as shown in **Figure 1**.[1]

Figure 1: Real Wireless Local Monthly Bill
(Indexed 1988=100)



The decline in prices reflects, to a large extent, the economies of scale achieved by two competitors. These economies of scale resulted in a reduction in per unit costs for the industry. Because of competition between the two original wireless providers, these reductions in per unit costs were passed along to consumers in the form of lower prices. Of course there are more wireless providers today and prices continue to decline, particularly in terms of revenue per

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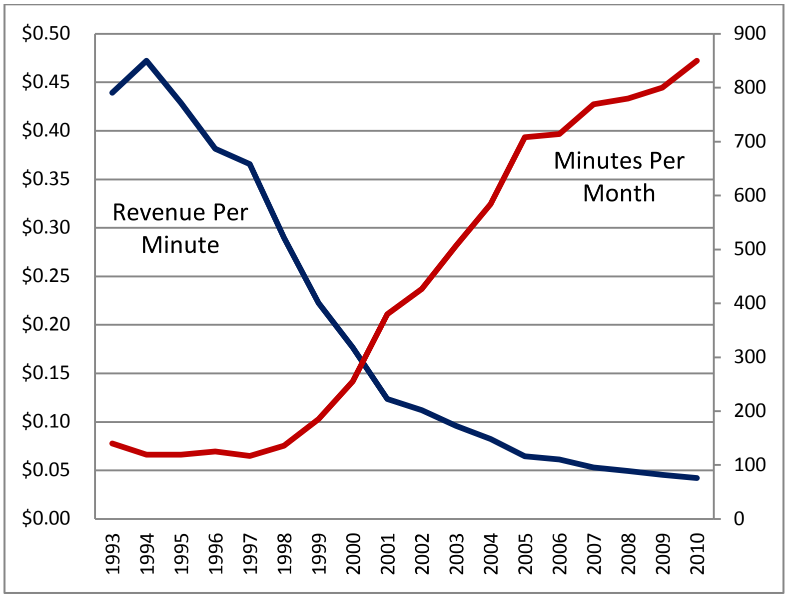
[1] The revenue per subscriber data comes from CTIA's Semi-Annual Survey at www.ctia.org. We use the annual average local monthly bill data (June 1985 to June 2010), and deflate using the CPI-U for all items (www.bls.gov).

minute. **Figure 2** (below) shows the continued decline in nominal price, coupled with the sharp increase in average subscriber minutes per month. The combination of higher usage and lower prices means that consumer welfare has increased significantly – not what would be expected from a "failed market."

Figure 2: Consumers Talking More, Paying Less



As the charts show, wireless prices in the United States have declined steadily over the past two decades. Indeed, at four cents a minute for cell phone calls (according to estimates from Merrill Lynch/Bank of America), U.S. consumers enjoy one of the lowest calling rates in the world. According to the FCC's 2010 report on competition, only Hong Kong offers better rates. Consumers in Britain, Canada, Germany, and France pay more than twice the U.S. rate, and calls cost about 22 cents per minute in Japan. From December 2007, data from the U.S. Bureau of Labor Statistics shows that wireless prices fell by 40 percent. An April 1 report from Bernstein Research concluded that Americans also enjoy good prices for data, consuming 2 or 3 times the wireless bandwidth as Europeans, but paying 2 or 3 times less per megabit. Certainly, wireless consumers have benefited from continuous innovation that has expanded available services from voice only to include texting, Internet access, broadband service and streaming video. The arrival of 4G technology promises more benefits ahead.

Those concerned with the affordability of wireless communications services should take a hard look at the relatively high rates of taxation on wireless consumers. For instance, a recent report by economist Scott Mackey showed that government taxes and fees on wireless communications services are three times the rate of general sales taxes. If affordability is an issue, ending discriminatory taxes on these services would provide a boost for wireless consumers.

The fact is that effective competition – as reflected in innovation, fast growing demand and pricing trends – can be achieved with a variety of market structures and differing numbers of competitors. In the face of falling prices, today's wireless demand has soared to approximately 300 million wireless telephone subscribers. The old theories of regulation would have predicted restricted supply and high prices – an outcome that has not happened in the wireless market. Therefore, there is no basis in theory or fact to justify new regulations in the wireless market. With the Department of Justice's role of preventing market collusion and anticompetitive acts, there are already safeguards in place to protect consumers.

Summary

With the FCC report on wireless competition expected to be released soon, hopefully the FCC will take a broad view of the marketplace and resist the temptation to impose needless regulations on a competitive industry. Consistent with accepted economic theory and empirical evidence, the FCC's focus should be on market performance, and not market structure. The FCC should be asking such questions as whether prices are in line with inflation, whether innovation is continuing to boost quality or create new services, and whether service providers are working vigorously to win customers. "Yes" answers to these questions suggest that the wireless market is yielding competitive outcomes and consumer welfare is increasing. If that is the case, additional regulatory remedies are unwarranted.