Comments on Consultation Paper No. 22/2019

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These comments relate to the Consultation Paper No. 22 of 2019 circulated by the TRAI for deliberation by stakeholders. While the regulator has put forth a discrete set of questions, the comments in this paper address them together, as most of them are linked together.

The central query that the TRAI deliberates on through these queries is a move from forbearance in tariffs to a regime where tariff floors (and possibly caps) are set by the regulator. The response to this question is that, in my opinion, this move will not address the core issue of financial stress that is besetting the private TSPs in the sector in present times. Hence, there is no clear justification for why the regulator should adopt a floor and ceiling fixation policy. At the same time, some modifications are necessary to the current regime of passive forbearance of the present times need some corrections. The appropriate balance for the regulator should be one of *alert watchfulness as an essential ingredient of its forbearance policy*. The rest of the paper elaborates the reasons for this recommendation. Different paragraphs are numbered and are labelled according to themes which add to the reasoning for the prescribed appropriate stance of the regulator:

1. **Primary reason for telecom sector losses is not due to forbearance:** We have argued (refer to the paper Saha and Saha (2018) titled `Spectrum Allocation in India: The Post 2G Scam Era'[1]) that mispricing of spectrum in India has led to the phenomenon of private TSPs of substituting expensive spectrum for less expensive spectrum by capital expenses on the network. This explains the poor service quality in wireless services that use the spectrum extensively: these services increase linearly with increased expenditure on spectrum but improve only with second-order effects if the TSP replaces this expenditure by investments in its own network. At the same time, these investments are financed by debt adding to the financial burden of the private players, without effectively improving the quality of service that matters for the end-consumer. If anything, the scenario of the telecom sector in the past two years has been marked by hyper-competition and as mentioned in the

[1] Available at http://premierpublishers.org/irjtit/270620188085.pdf?view-type=inline

consultation paper, the tariffs by the private players have been kept at an absolute minimum. The reason for losses is a vicious combination of debt available for some of the private players for financing their capital costs along with over-priced spectrum. A side result of the mispricing of spectrum has been the inefficient substitution of expenditure away from spectrum towards infrastructure investments which have led to quality deterioration along with burgeoning debt for private TSPs.

Note that none of these relate to the forbearance policy of the regulator. At the same time, there is some role that the tariff reporting policies of the TRAI that have had an effect on financial performance of private players. This is addressed in the next point.

2. **Predatory pricing in telecom sector in recent times in India need modifications in the forbearance policy of the regulator:** This relates to the concerns addressed through the 63rd Amendment of the Telecom Tariff Order (No. 1 of 2018) which relates to predatory pricing in the telecom sector in India, where I had mentioned the following points:

   (i) Provide to all stakeholders a common definition of predatory pricing which is in consonance with the Competition Act, 2002.

   (ii) On a monthly basis, TRAI should conduct an exercise, where it checks the Average Variable Cost (AVC) of each TSP against its price offering for the relevant service category (product market) for each LSA (geographic market).

   (iii) If the AVC is found to be less than the relevant price mentioned in the tariff order of the TSP, the regulator should invite the TSP to its offices to explain the reason for this low pricing. If the answers of the TSP are not found satisfactory by the regulator, the TSP must be warned and asked to withdraw its tariff order with immediate effect.

   (iv) The immediate swing effect on consumer demand due to a low pricing below AVC by a TSP can be checked through the incremental addition in the subscriber base over the previous month's data and by checking the differential of origination and destination calls. Any substantial increase in this swing effect (more than 30 per cent), should be questioned by the regulator as this is likely to end in appreciable adverse effect on competition (AAEC) in the market.

(v) All free offers of services should be justified to the regulator (the business plan for break-even by the TSP offering such free services). Along with promotional offers, these free offers should have an upper cap of a month in order not to affect competition adversely in a dynamically changing market.

Of all of these points, the last point implies some modification of the forbearance policy of the regulator. ***Instead of a price floor, a better method can be to regulate the number of free promotional offers that are made in a month by a single TSP. This cap can be decided on the basis of the reported tariffs of the TSPs to the regulator for the last five tariff cycles.*** The reason for concern regarding predation is two-fold:

i. In platform markets, it is very difficult to identify predatory pricing from optimal pricing which subsidizes one side of the platform (mostly the consumers) to retain market share. In an era of converging technologies, platform-based pricing is evident in telecom. In this situation, it will be empirically very difficult to narrow down predatory pricing. Any TSP can use the logic of platform pricing and still engage in predation. It will be very hard for the regulator or the competition authority to pin down anti-competitive behaviour in the form of hyper-competitive predatory pricing by any private player. Given that the cost for data services will remain tied to the sunk cost of spectrum and most calling service costs will be determined by interconnection charges which are variable, the overall costs for a service provider offering both kinds of services will be a combination of both of these sunk and variable costs. It is infeasible that a TSP will be able to sustain zero prices for any offering in the long-run and this is seen in the tariff revisions of most TSPs at present. At the same time, platform pricing policies indicate that the private player can break even on any one of the two services (voice or data) and offer zero prices for the other loss-leading service as a part of business strategy. In this complicated scenario, I do not feel that the regulator should intervene with any sort of floor price setting for a single service like voice telephony or data services. The private player can simply defeat such a strategy by a clever application of platform pricing on the service without the price floor. Setting a simultaneous price cap on all services is not going to be feasible given the differentiated offerings by the service providers at present.
ii. A related concern is that of financial market imperfections that keeps alive the theory of deep pockets and potential for predation by some private players in telecom. Here, the sectoral regulator like TRAI has no handle to address the problem. Nonetheless, the very existence of the possibility of predation by some players with preferential access to finance

3. **Bundled tariff offerings are difficult to be made subject to floor price regulations:** This relates to the observation made in the previous paragraph as well as in the consultation paper. At present, due to convergence of technology, a single TSP offers a continuum of services in both voice and data. Segregation is not financially sustainable in the presence of strong network externalities in consumption. Bundled tariffs which address the highly differentiated product bundle that a TSP offers (this can be defended on grounds of efficiency: non-linear pricing should be optimal for most TSPs and bundling is the appropriate strategy) are not easily amenable for floor price regulations. The strategy of platform pricing indicates that the manner in which the TSP will break even over voice and data services are highly fungible and hard to determine exante. Any form of prior regulation through price floors is inadvisable given the lack of appropriate benchmarks.

With these observations, I end my comments to the regulator regarding this consultation paper.