Pro-competitive Measures Remain Essential in Canadian 5G Spectrum Auctions

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I have been asked by Shaw Communications Inc. to comment on the continued use of pro-competitive measures in spectrum auctions undertaken in Canada by the Department of Innovation, Science and Economic Development (ISED). This report supplements Shaw’s brief to the House of Commons Standing Committee on Industry, Science and Technology, as part of its Study on the Accessibility and Affordability of Telecommunications Services, and provides a rebuttal to a recent op-ed that pro-competitive auction measures are no longer needed in Canada (Crandall 2020). As disclosed in the op-ed, Crandall is an advisor to Telus, and Crandall’s arguments are familiar to me from the ISED filings and public statements of Telus and other Big 3 incumbent wireless providers in Canada against set-asides, which I will collectively refer to as “the Big 3 Position”.

The Big 3 Position that set-asides represent misguided regulatory policy is premised on false assertions that mobile markets are fully competitive in Canada and that set-asides for small carriers penalize rural Canadians and raise prices. As shown below, each of these arguments is a myth.

On the contrary, Canada’s spectrum policy has proven effective at developing competition in a country whose vast territory and low population density makes competitive entry challenging. Set-asides have been and continue to be critical to the advancement of long-term competition in Canadian wireless and are necessary to ensure competition in 5G. With competition, consumers enjoy lower prices and the benefits of more choice, while the overall economy benefits from heightened investment, including in more remote regions of Canada, and increased innovation. In the current context of Canada’s wireless market, set-asides add significant economic value.

Myth 1: Set-asides are no longer needed

The Big 3 Position argues that Canadians are enjoying quality service at competitive prices, and therefore set-asides are no longer needed. This is a strange argument. One should not abandon a successful policy simply because it is working. Yes, the set-asides have increased competition and reduced prices for Canadians. Whether set-asides are desirable going forward hinges on whether the set-asides will strengthen the competition that is emerging. In the case of the upcoming 5G auctions, the answer is “yes”, as I have argued previously (Cramton 2019).

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The Big 3 Position highlights the fact that, globally, set-asides have declined in use in recent years. This has occurred in countries where set-asides would be ineffective at strengthening competition. If the economics of entry are too challenging and a viable entrant does not appear, then set-asides are ineffective. Where set-asides are most effective is in instances, like in Canada, where there is a clear foreclosure risk. In spectrum auctions, the foreclosure risk refers to the likelihood that dominant incumbents, such as the Big 3, will be driven to pay a premium for spectrum to confine viable competitors to a poor spectrum position to keep otherwise strong competitors out of the market. The foreclosure occurs not because the small carrier fails to bring value to consumers, but because the dominant incumbents benefit from foreclosing competition.

Myth 2: Set-asides harm rural Canadians

There is such a compelling case that competition from small carriers improves prices and services where they operate that the Big 3 Position attempts to misappropriate the challenges of rural broadband access for its own ends. They allege that set-asides harm rural Canadians, who are not currently enjoying the benefits of competition from the small carriers. This argument fails on two grounds.

First, the rollout of networks occurs over years. Rationally, the most economic areas, urban centers, are built out first with rural areas coming later. Thus, it may take some time for competitive entry to occur in rural areas. Whereas the Big 3 have had decades to build out their networks, Shaw only entered the wireless market in 2016.

Second, and more importantly, limited service in rural areas has nothing to do with the availability of low- and mid-band spectrum to the Big 3. The main problem in rural areas is lack of coverage. Does a set-aside to small carriers preclude this? The answer is “no”. Consider a rural area that can only be served economically with low-band spectrum. Because the signal of low-band spectrum propagates further and more reliably around and through obstructions, cell towers can be spaced further apart, dramatically reducing the cost of providing service. Low-band spectrum is extremely scarce, but the set-aside does not destroy the spectrum. Carriers simply need to think of more creative ways to use this scarce resource. Sublicensing of underutilized spectrum is not only possible but often occurs.

Going forward, spectrum auctions should not be thought of as the final allocation of spectrum. Supply and demand imbalances are inevitable. Carriers should work to support a secondary market for spectrum, much like other commodity markets have spot markets to align real-time demand and supply. ISED is already seeking to develop the secondary market through deployment conditions that promote sublicensing (ISED 2019). Secondary markets address the Big 3’s concern much more effectively than spectrum auctions, which cannot solve supply and demand imbalances in real time.

Myth 3: Set-asides lead to higher retail prices and harm consumers

This is one of the more absurd claims in the Big 3 Position. It is well understood in economics, and in mobile communications in particular, that competition determines prices, not spectrum auction prices (Kwerel and Strack 2001). To the extent set-asides are successful in increasing competition by promoting the entry and success of small carriers, they lead to lower prices.
There is ample empirical evidence in many countries, including the U.S. and Canada, that competition lowers retail prices and that small carriers are especially effective in this dynamic (for example Chipty 2019). Recent data from the CRTC show that mobile prices have steadily declined across all market segments since Shaw entered the market in 2016 (CRTC 2020). This is precisely why the Big 3 are so insistent on this issue. The Big 3 are harmed by the strong competition from regional carriers.

References


