Chapter 2
Strategic Interaction under Asymmetric Regulation: The Case of New Zealand

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ABSTRACT
Regulation binds incumbent firms to a different set of obligations from their entrant-competitors, thereby creating an asymmetric set of options from which the firms may select the strategies under which they will interact. Whilst most regulatory obligations are specified in law, some take the form of contractual agreements. New Zealand’s ‘Kiwi Share’ obligations bind the telecommunications market incumbent to a set of retail tariff structures and levels that have both restricted its choices and opened up a range of new strategic opportunities for its rivals that have had a significant effect upon the development of the New Zealand industry. This paper examines the specific consequences of the asymmetric tariff obligations and ensuing strategic interaction amongst sector participants on sector development – namely the effect of universal service retail prices and the allocation of the ensuing costs in determining the ongoing regulatory agenda; the role of a ‘free local calling’ obligation on the evolution of New Zealand’s broadband market; and the consequent application of further asymmetric legislative obligations on the incumbent to address apparent ‘problems’ for which the asymmetric tariffs and rivals’ strategic choices provide more credible explanations than the incumbent’s exertion of its dominant position.

INTRODUCTION
All business sagacity reduces itself in the last analysis to a judicious use of sabotage.

– Thorstein Veblen

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In the application of competition law and industry-specific regulation, the obligations upon dominant firms typically differ from those imposed on firms which do not have significant market power. Asymmetric legislative and regulatory obligations undoubtedly influence the strategic actions of the firms concerned and other participants in the markets in which they trade (e.g. Hausman (2002), with respect to the broadband market.
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developments in the United States and Korea). By extension, the contracts that firms enter into may also impose asymmetric obligations affecting subsequent strategic choices made by the firms concerned (e.g. Evans & Quigley (2000), with respect to the different litigation options competition law offers incumbents entering into contracts which may be subject to the exertion of market power).

In 1990, a contractual deed entered into by the New Zealand Government and the newly-privatised incumbent telecommunications provider Telecom New Zealand Limited (hereinafter ‘Telecom’), known as the ‘Kiwi Share’, imposed additional obligations upon Telecom over and above those required under either the Commerce Act or the Telecommunications Act regulatory provisions1 and to which no other firm was bound (Howell, 2008). The ‘Kiwi Share’ bound Telecom to three explicit obligations: that the price of residential telephone rentals would not rise faster than the Consumer Price Index (CPI) unless profits were unreasonably impaired (the ‘price cap’ obligation); that rural residential line rental prices would not exceed urban residential line rentals (the ‘universal service’ obligation); and that residential customers would continue to be offered a tariff with no charges for local calls (the ‘free local calling’ obligation) 2 (Boles de Boer & Evans, 1996).

As the ‘Kiwi Share’ obligations applied only to one firm in a market where the development of competition was an explicit a priori expectation, it would be expected that both Telecom and its competitors, customers, regulators and other stakeholders would take the asymmetric obligations into account when selecting the strategies upon which they would interact with each other. The contract thus formed part of a bundle of asymmetric ‘regulatory obligations’ deriving from all legislative and contractual origins that bind one firm differently from its competitors. The asymmetric obligations will therefore have affected the choice of firm strategies not just in respect of their interactions with each other, but also their interactions with markets (consumers), policy-makers and the technologies that they choose to adopt (as per Figure 1).

This chapter takes the form of a case study, examining the effect of the asymmetric ‘Kiwi Share’ obligations upon strategic interaction between all of Telecom, its competitors, customers and policy-makers in the New Zealand telecommunications sector during the period 1990 to 2008. Section 1 traces the origins of the ‘Kiwi Share’ provisions and places them in their institutional

Figure 1. Telecommunications Sector Interaction (Source Melody (2002:9))
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