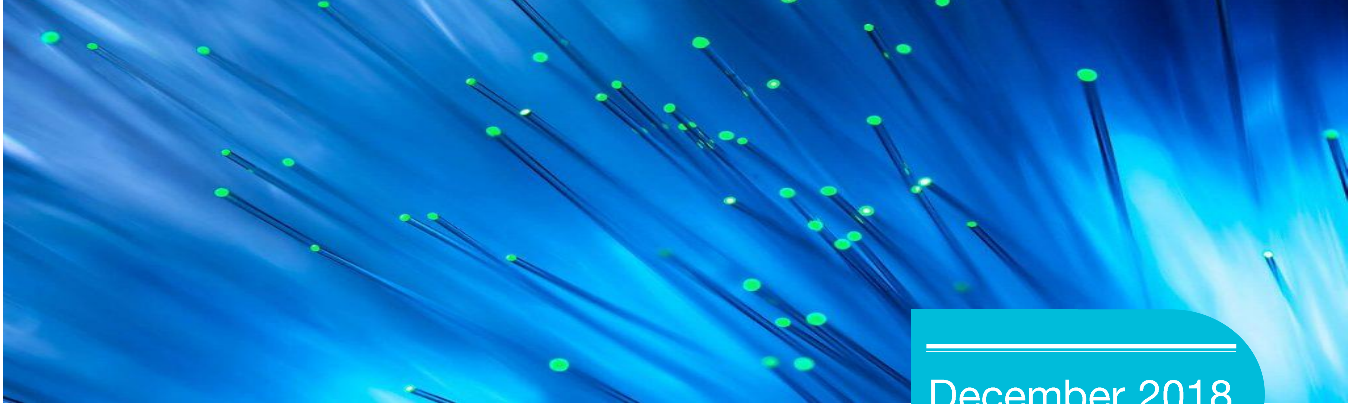

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# The retail price is not the only thing that matters.

## When price is given top priority in the cellular market, over other economic considerations, there is a price to pay.

For many years now, the cellular market in Israel has been in a state of paradox: the higher the level of competition, the more inferior the quality of the network becomes, as compared with Israel's counterparts in the Western world.

Indeed, theories of competition economics assert that an increase in competition primarily leads to an improvement in price, in quality and in other parameters, and this has also been expressed in judgments and in decisions of the Israel Antitrust Authority. Nevertheless, if this were indeed a basic axiom, then why, in the cellular market in Israel, does the increase in competition only affect the price, which has been steadily going down from year to year, and it does not affect the quality of the network which has, already for some years now, being "stuck" at 4G, and does not show signs of moving forward, as opposed to most countries of the Western world? How can it be that Israel, which is such a technological and innovative power, is lagging generations behind (in communications terms) its counterparts?

One possible answer to this paradox was recently provided by a letter written by a Senior Deputy Director-General of the Ministry of Communications, Haim Garon, which was published in the media. According to Garon, in the communications market, there is a built-in contradiction between competition over price and the encouragement of investments. In other words, the lower the price, the more a negative incentive is created to investing in modern infrastructure.

Garon calls for re-calculating a new track, including in the form of imposing control on minimum retail prices. A seemingly similar opinion is held by Dr. Ofer Raz-Dror, Director of the Economic Administration at the Ministry of Communications, who said, in an interview with Globes, that the level of prices in the cellular industry does not allow for investments in the long-term, and that it would not be a bad thing if the monthly revenues of the cellular companies from a customer were to go up by a few shekels, for the benefit of the consumers in the medium term and in the long term.

The position of the two Senior Deputy Director-Generals reflects the understanding that the current level of profitability in the cellular market is actually reducing the incentives for the companies to invest in infrastructure, and that the measures that have been taken in recent years to increase competition in the retail price, and, in particular, the entry of new operators into the market, have come at the expense of incentives to invest in infrastructure.

We are facing a classic collision between the consumer's welfare, which is reflected in the price of the service, and the aggregate welfare, which is reflected in investments in infrastructure. Are these indeed values that clash with one another? Is it necessary, at the present time, for the Ministry of Communications to change direction and to give priority to the aggregate welfare, thereby placing it above the consumer's welfare?

The dilemma with respect to the prioritizing of competition considerations regarding price and consumer welfare over other considerations, such as considerations of economic efficiency and increasing the aggregate welfare, is nothing new. This is an issue that the competition authorities have been grappling with for many years now. One of the main claims against weighing up considerations of economic efficiency is that its advantages are not certain, whereas the harm to the consumer is more certain. Due to this reason, and others, it was determined in the instructions of the Israel Antitrust Authority that even where there are grounds for weighing up considerations of economic efficiency in the course of the examination of mergers, still, this should be done in cases in which it is proven that the efficiency will ultimately give rise to an increase in the consumer's welfare – whether by a drop in price or by an improvement in the quality of the product or the service – and this will arise from the merger itself.

In our opinion, the cellular market is, apparently, one of those exceptional cases in which it would also be worth weighing up considerations that go above and beyond price, and in particular, the public interest in the encouragement of investments in infrastructure. It is possible that in the cellular market, maximum efficiency will be achieved by a smaller number of operators who maintain an independent infrastructure, and only in that way will it be possible to make adequate investments in improving the quality of the cellular infrastructure in Israel.

If this is indeed the situation, then the solution to the stagnation in investments cannot be expected to be found by way of adding regulation, such as control on minimum prices, but rather, by way of deregulation, such as the removal of regulations that would prevent anticipated mergers in the cellular market and the consolidation of infrastructure.

At the present time, it appears that an introduction of fresh thinking on this matter is required and to free ourselves from the “monopoly” which the regulators have given to the price of the service, as if it were the only relevant aspect. In view of possible mergers in the industry, which, in our opinion, will be inevitable sooner or later, a test point is expected to arise, with respect to the regulators’ position, and this will also provide, hopefully, an opportunity for changing the trend in anticipation of the return of the required investments in this sector, and Israel’s return to its appropriate leading position, in this industry as well.

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- The authors represented Golan Telecom in its application to merge with Cellcom.
- This client update is based on the authors opinion piece for "Globes" Magazine (20.12.18).
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