Means not ends: Deterring discrimination through equivalence and functional separation

BACKGROUND

- In many circumstances, a vertically integrated firm, which has a monopoly on an essential input, has an incentive to damage its downstream rivals through non-price discrimination.
- The aim of functional separation is to increase the likelihood that such discrimination will be detected and, therefore, deterred. Under this arrangement, the upstream firm is required to provide wholesale inputs on equivalent terms ('equivalence of inputs') to both internal and external customers and to put in place various organisational changes.

METHODOLOGY

- The author asks if functional separation as implemented in the UK is well-designed to overcome the problem of discrimination and therefore to promote competition and innovation in the retail market. The analysis is focused on the broadband market.
- The author draws on interviews with key actors in the UK communications market to gain insights to the implementation and effectiveness of equivalence and functional separation.

KEY FINDINGS

- Although not perfectly implemented, equivalence and functional separation have reduced discrimination and have helped to create the right conditions for dynamic efficiency gains in access and downstream broadband markets.
- Findings suggest that establishing an anti-discrimination regime in which all downstream operators have to be treated the same, coupled with an organisation of the vertically-integrated firm which encourages equal treatment, can deliver superior outcomes.
- However, there have been little or no spill-over benefits in product markets not covered by the equivalence requirement.
THE CCP

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