

"Letter to Hong Kong"
by Emily Lau of the Frontier
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In a week's time, the Hong Kong government's two-month public consultation period on the licensing of third-generation mobile telephone service will come to an end. Later this year the Office of the Telecommunications Authority, or OFTA, will invite applications. The plan is to grant four to six third-generation or 3G licences.

In the past few weeks, OFTA has been criticised for proposing to give away valuable radio spectrums for free. Last month, the British Government netted US\$35 billion from its auction of five 3G licences. The money raised in the London bidding was 10 times more than what was expected. The spectacular outcome has put pressure on Hong Kong to adopt a UK-style auction.

However in spite of the UK's lucrative experience, OFTA is not convinced. Instead OFTA prefers to select 3G operators by a process of evaluation based on merit. This will be done by considering the right mix of companies, the best networks and cheapest service for consumers – a process of weighing business plans known as a "beauty contest".

OFTA regulators do not favour spectrum auctioning because they think it will increase operating cost, and such costs will eventually be passed on to the consumers. Another argument against holding auction is that smaller companies which can provide innovative and advanced services may not be able to win. In a "beauty contest", these companies may receive special consideration.

Although auctions could bring significant revenue to the government coffers, OFTA is concerned that such additional upfront costs to 3G operators would greatly increase their business risk. This in turn could adversely affect the development of the next generation of telecommunications and Internet services in Hong Kong.

Officials at the European Commission have voiced similar concern. They feared if UK-style auctions are repeated in other countries, the high bidding cost could hold back the development of advanced mobile services and push up prices for consumers.

However I do not think this argument is very sound. Regardless of how the licences are to be awarded, operators are likely to price their services according to how much the customers are willing to pay, and not according to the cost of providing such services.

Companies which have over-stretched themselves will suffer, some may even go bankrupt. But other companies will bid for their

licences and carry on. This is capitalism at work and should not harm the development of the industry.

Furthermore, the so-called "beauty contests" have serious drawbacks. Besides forsaking billions of dollars of revenue, this approach is prone to abuse. Government officials making the decision could be accused of favouring certain companies over others.

Last week the "Economist Intelligence Unit" published its latest business environment rankings. Hong Kong, which was ranked as the best place to locate over the last five years, has been relegated to sixth place. This is because the changeover to Chinese rule in 1997 has adversely affected business operating conditions.

One glaring example of disturbing developments is the government's decision last year to award the Cyberport project to a company controlled by tycoon Mr Li Ka-shing's son without going to public tender. Mr Li was one of the first businessmen to publicly pledge his support for Mr C. H. Tung to become the Chief Executive of the Hong Kong Special Administrative Region.

The government's preferential treatment has helped to launch Mr Richard Li's Pacific Century Cyber Works, which is planning to take over Cable and Wireless Hong Kong Telecom. The Cyberport fiasco was a show case of cronyism and Hong Kong cannot afford to make a similar

mistake with the 3G mobile telephone licences.

There is little doubt that there will be keen competition for the 3G licences and the government stands a good chance of reaping huge benefits. The question is whether the money should go to the government or remain in the pockets of business tycoons. On such a controversial subject, there is strong argument that the decision of who should get the licences should be left to the market.

In the UK auction, Hutchison Whampoa, one of the companies controlled by Mr Li Ka-shing, teamed up with a Canadian partner and won a licence with a US\$6.8 billion bid.

However Hutchison's group managing director, Mr Canning Fok, said auctions can hurt consumers who may have to pay higher fees to defray the astronomical start-up sums paid by licensees. Mr Fok said intense price competition could even hobble the industry's development.

In spite of Hutchison's reservations, they have put their money where their mouth is. The company and its Canadian partner have shelled out almost US\$7 billion to get a UK licence. This indicates their confidence in the industry and in the company's ability to make money with the licence.

Besides the UK, Germany, Switzerland, Austria, the Netherlands and possibly Belgium are set to auction their 3G mobile phone licences.

On the other hand, Spain and Finland have already awarded 3G licences through beauty contests, and countries such as Sweden, Portugal and Denmark have indicated they would follow that route.

Caught between "beauty contests" and auction, Hong Kong may consider adopting the hybrid process chosen by Italy and Ireland. This is a two-stage process combining a prequalification "beauty contest" with competitive financial bids. This process can give a chance to small but innovative operators which are in danger of being priced out in a straight auction.

Faced with mounting pressure, the Director-General of OFTA, Mr Anthony Wong, told the Financial Times last week that alternative criteria for awarding 3G licences were being considered. He said bidders could be selected on factors such as being able to offer the lowest price to the consumer, the lowest interconnection charges and the highest investment in the network.

Mr Wong's remarks showed the government may be prepared to consider other options. I urge the Administration to weigh carefully all the views submitted during the consultation period. I hope Mr Wong and his colleagues recognise that a lot more than money is hanging in the

balance. Apart from gaining billions of dollars of additional revenue, auctions could save officials from damaging charges of favouritism and cryonism.