ABSTRACT

Nineties have been the decade of liberalization in telecommunications markets across the globe. Since January 1998 major European countries, including Germany, have opened their telecommunications markets to competition. If we look at the first order effects, liberalization has been a success: Prices are down, volume is higher. Nevertheless, it remains puzzling that incumbents charge significantly higher prices, yet command large market shares. In Gemany, competition has gained a foothold especially in international, long distance calls and internet connections. Nevertheless Deutsche Telekom, DT, serves about half of long distance calls at more than double the typically available per minute prices. In this paper, I suggest that the dominance of the incumbent, DT, at higher prices is sustained because consumers *face costs of using alternative carriers.* I develop an approach to measure these perceived cost of using alternative carriers by means of a structural model of carrier/duration choice based on a unique data set created using telephone bills of households from Northern Germany. In order to account for unobserved heterogeneity, I exploit the panel nature of the data set and estimate a random parameters model. The estimation results imply a population distribution for cost of using alternative carriers with a median of 30 cents. This rather high cost, naturally, allows the incumbent to sustain much higher prices than that of competitors.