

Competition and Pricing

OECD Global Conference on Telecommunications Policy for the Digital Economy

Dubai, 22 January 2002

John de Ridder - Economic Advisor, Telstra Wholesale
Tel: 61 3 9634 8096 or john.deridder@team.telstra.com



OECD Global Conference
January 2002

Contents

- Setting the scene
 - The Australian experience and policy evolution
 - Some key differences from developing countries
- Basic access (line rental)
 - Changes in the economics of supply and demand
 - Progress in the rebalancing task and CPI-x
- National long distance
 - Cost structures and competition for calls
 - Movements in call prices and market shares
 - Comments on funding options and pricing positions
- Key messages



OECD Global Conference
January 2002

The Australian Experience

Competition followed development and has evolved

1901-1996 Monopoly/Duopoly

- 1960 Community Telephone Plan → Australia's "Development Plan" which lifted teledensity from 19% in 1960 to 51% by 1996
- 1975 Split from Post
- 1982 Davidson Inquiry
- 1989 Austel, CPI-x established
- 1992 Fixed Duopoly + 3 GSM → Mobiles appeared too late to be a significant development tool
- 1993 Preselection Ballots

1997 - Open Competition

- Over 80 carrier licences issued → Significant duplication of infrastructure emerging eg 5 transmission lines across the Nullarbor desert



OECD Global Conference
January 2002

Australian Policy Evolution

In the move from monopoly to competition, the emphasis of policy has shifted and policy instruments have changed

Monopoly

- Social charter (1975 Act)
- Internal cross-subsidies*
- No regulator until 1989
- CPI-x to force efficiency
- Non discriminatory prices

Competition

- Separation of social policy
- Corporatisation and USO regime
- Austel (later the ACCC) regulates
- CPI-x to pace rebalancing
- Specific conduct law (Part XIB)
- Interconnection (Part XIC)



OECD Global Conference
January 2002

* Calls to access, metro to country, business to residential

Key Differences in Context

Competition policy has to recognise different country contexts

A Developed economy

GDP/head > US\$20,000

Teledensity * > 50%

- Policy focus “choice & efficiency”
- Broadband focus
- Established network so entrants seek to rely on existing CAN
- Fixed network focus
- Mass demand for communications
- Country can afford duplication

A Developing Economy**

GDP/head US\$1,000

Teledensity 2.5%

- Policy focus “build-out & WTO”
- Narrowband focus
- Little network so entrants expected to build customer access network
- Mobiles a new option for build-out
- Affordability a major issue
- Country poor in CAPEX and FX



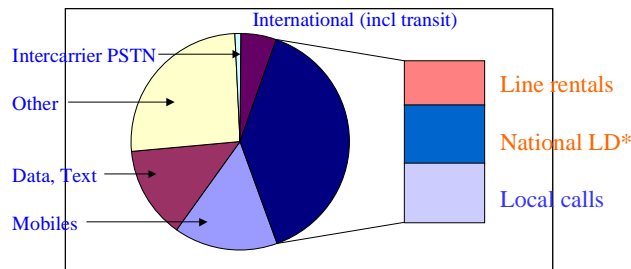
OECD Global Conference
January 2002

* Fixed lines per head; incl. mobile “lines” teledensity is > 100
Australia

** Indonesia - see appendix 1 on how it was drawn from ITU Data

Our Focus on Key PSTN Products

The interplay between competition and regulation mainly impacts the pricing of PSTN basic access and NLD calls



- PSTN revenues account for 45% of \$18.6bn total sales revenue in 2000
- The two main PSTN products we look at account for 25% of sales



OECD Global Conference
January 2002

* Includes fixed to mobile call revenue
Source: Prod.Comm (p84)

Calls to Access Subsidy Unsustainable

Under monopoly, access and calls are joint in supply and demand but under competition they are not*

Under Monopoly

Supply

NLD
Calls,
Access
Line



Demand

NLD
Calls, Access
Line

Under Competition

NLD
Calls



NLD
Calls



Competitors **

NLD
Calls

Access
Line



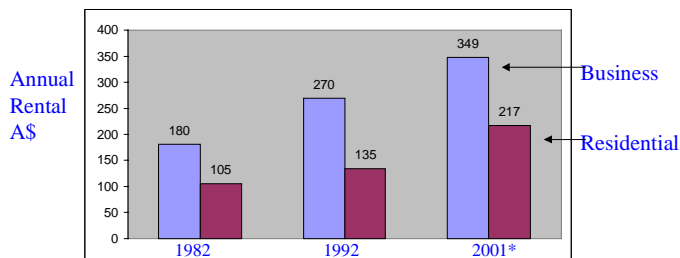
Access
Line



OECD Global Conference* Unless only terminating access is mandated - explained later
January 2002 ** Competitors may build access too (eg CBD fibre loops)

Australia Still Raising Line Rentals...

Business lines are close to the \$346 pa cost determined by the ACCC but CPI-x is constraining completion of this task



• But, would such significant increases in fixed charges dampen take-up of telephone service in developing countries ?

OECD Global Conference
January 2002

* Excludes (GST) tax of 10%

...Local Service Packages Introduced

Residential (and Business) local service packages segment market; partly to address loss-leading local call competition

	1992	2001 - Residential Options**			
Line Rental per month	\$11.25	\$19.90	\$21.90	\$19.90	\$16.90
Local Call	25 cents	22 cents	18.5 cents	22 cents	19 cents
Neighbourhood Call*		15 cents	15 cents	18 cents	19 cents
		Homeline Complete	Homeline Plus	Homeline Part	Homeline No

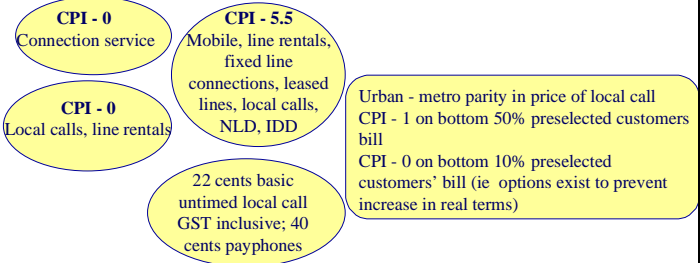
OECD Global Conference
January 2002

* A sub-set of local calls

** All prices include GST of 10%

CPI-x Price Controls

The current regime has become more complex as more political constraints have been added



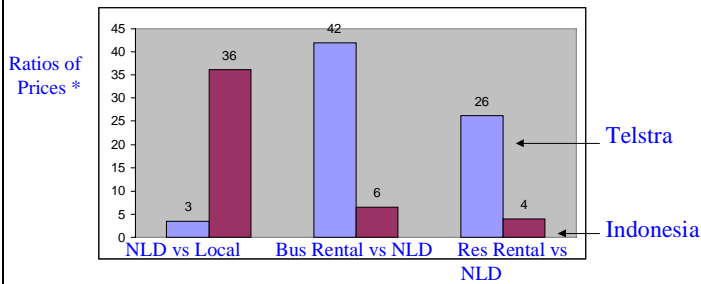
- Developing countries are also concerned about the pace of rebalancing
- A "time table" for rebalancing could increase CAN investment
- Other complexities may arise eg:
Lack of TFP measures, volatile exchange rate

OECD Global Conference
January 2002



Some Countries Just Beginning Task

Indonesia may be typical of the size of the rebalancing task ahead of developing countries



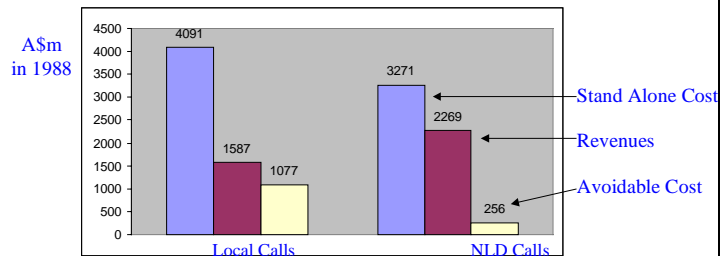
- These ratios are indicators of the relative size of cross-subsidies
- Over 25 years ago, Telstra's NLD/Local call ratio was over 30

OECD Global Conference
January 2002



Cost Structures for Calls

The cross-subsidy to basic access comes not from all calls, but especially from national long distance calls



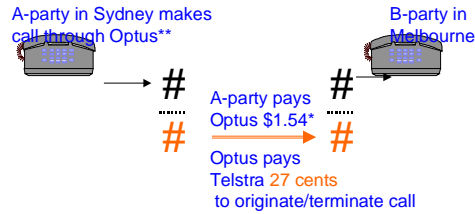
- NLD calls made over \$2bn contribution to access deficit and shared costs while overall company EBIT was only \$0.8bn

OECD Global Conference
January 2002



Competition for Profitable Calls

Competition targets lucrative long-distance call markets means Telstra exchanges \$1.66 retail revenue* for \$0.27



- Optus estimated to make over \$1 on this call***
- This competitive model provides no incentive to build CAN

* 5 minute call, excl discounts for both Telstra and Optus

** Either by over-ride code or by preselecting Optus

*** Optus own costs for transmission and billing appx 10 cents

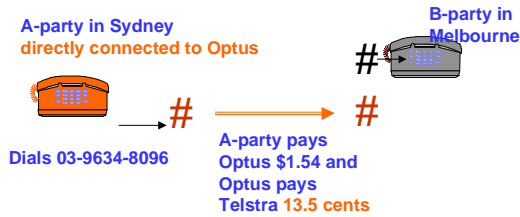
OECD Global Conference
January 2002

Source: BIE Conference, November 1995



With Only Terminating Access

New entrants have to provide access to provide calls



- This looks just like mobiles competition
- Mandating only terminating access provides a strong incentive to build lines to people likely to make calls*

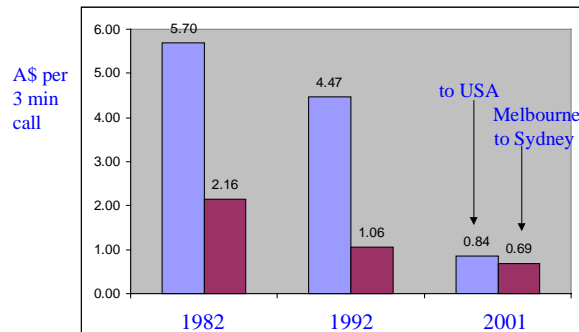
* Or, if terminating access rate is attractive, likely to receive calls (eg ISPs)

OECD Global Conference
January 2002



Long Distance Call Prices

Long distance prices have fallen with competition



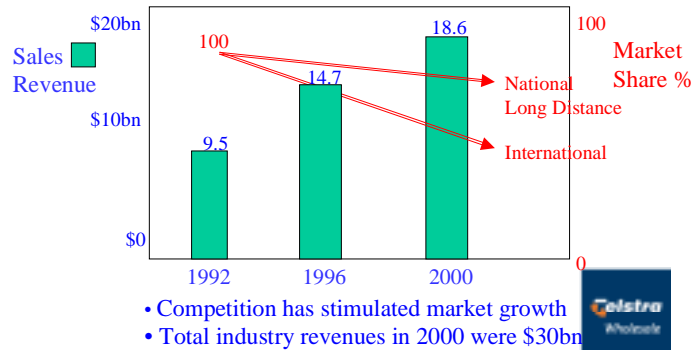
- Similar trends are found with average product prices

OECD Global Conference
January 2002



And Market Shares Have Fallen Too

Yet, Telstra's total revenues are still growing



Other Options For Discussion

If competition undermines the calls to access cross-subsidy and line rentals cannot be increased to recover access costs,

- **Government funding** - text book approach to pricing for large fixed/shared costs is subsidy. In the “green fields” developing country context this could be as capital grants subject to tender
- **Industry funding** - in Australia, the access deficit is part-funded by a surcharge* on the interconnect fee and the USO is funded by a levy on carriers according to their revenues
- **Internal funding** - seek contributions to fixed costs from products subject to demand elasticities (Ramsay pricing), price controls and competitive pressures

OECD Global Conference * 0.69 of the 1.53 cents per minute ACCC rate for 2000
January 2002

Key Messages

- Rebalancing access and call pricing is urgent and inevitable
Use CPI-x to set time frames and manage expectations
The rebalancing task is great and will take time; **start now**
- Adapt existing models to local circumstances
Consider terminating access only model
Offer capital grants (subject to tender) to extend networks
- Focus on mobiles as platform for development
Existing competitive models fixated on fixed networks
Prepaid mobiles attractive given affordability, billing issues
- Do not confuse competition policy and social policy
Separate instruments for economic and equity objectives

OECD Global Conference
January 2002