# Competition and Pricing

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# 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

# 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)

* 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

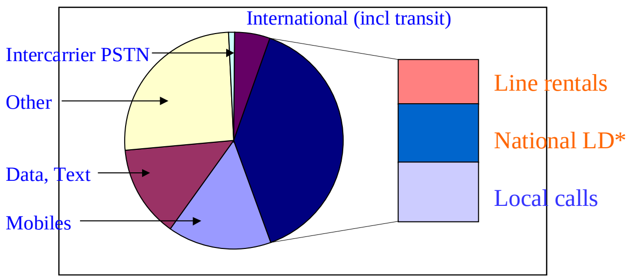
* Fixed lines per head; incl. mobile "lines" teledensity is > 100% in Australia

** 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

* 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

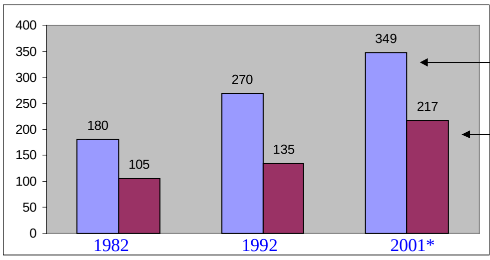
Access Line → Access Line



* Unless only terminating access is mandated - explained later
** 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




Annual Rental A$

Business

Residential

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



* 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** | | | |
|---|---|---|---|---|---|---|
| | | | HomeLine Complete | HomeLine Plus | HomeLine Part | HomeLine Ne |
| 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 |



* 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

**CPI - 0**
Connection service

**CPI - 5.5**
Mobile, line rentals, fixed line connections, leased lines, local calls, NLD, IDD

**CPI - 0**
Local calls, line rentals

22 cents basic untimed local call GST inclusive; 40 cents payphones

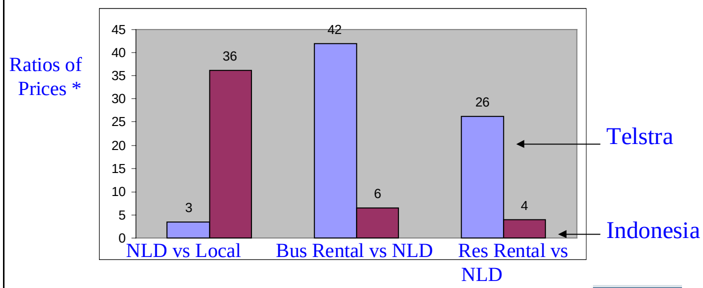
Urban - metro parity in price of local call
CPI - 1 on bottom 50% preselected customers bill
CPI - 0 on bottom 10% preselected customers' bill (ie options exist to prevent increase in real terms)

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



# Some Countries Just Beginning Task

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



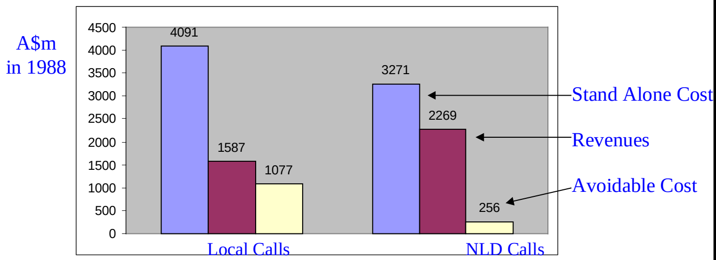

- These ratios are indicators of the relative size of cross-subsidies
- Over 25 years ago, Telstra's NLD/Local call ratio was over 30

* in last two comparisons, the number of NLD calls per month of rental where NLD call is 3 minute Melbourne-Sydney and equivalent for Indonesia



# Cost Structures for Calls

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

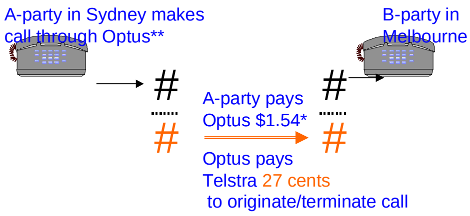



- NLD calls made over $2bn contribution to access deficit and shared costs while overall company EBIT was only $0.8bn

Source: H Ergas, 1994 using 1987-88 USO costing data

# Competition for Profitable Calls

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



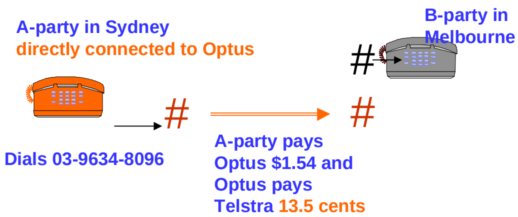

- Optus estimated to make over $1 on this call***
- This competitive model provides no incentive to build CAN

* 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
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*

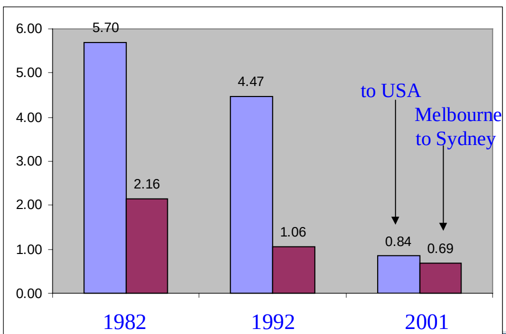
* Or, if terminating access rate is attractive, likely to receive calls (eg ISPs)



# Long Distance Call Prices

Long distance prices have fallen with competition

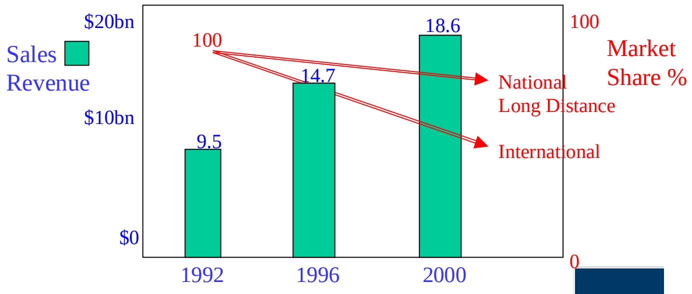
A$ per 3 min call




- Similar trends are found with average product prices

# And Market Shares Have Fallen Too

Yet, Telstra's total revenues are still growing




• Competition has stimulated market growth
• Total industry revenues in 2000 were $30bn



# 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



* 0.69 of the 1.53 cents per minute ACCC rate for 2000

# 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