



The illusion of choice

Telecommunications Pricing Annual Update 1995
produced by **Trefor Jones** for the Communications Law Centre.

About this survey

For this telecommunications pricing survey, we looked at 1994/95 tariffs for Optus and Telstra and set them in an historical context using Telecom data back to 1985 and AUSTEL's carrier performance report for 1993/94. For the first time this year, we compare Australia's pricing position to that of a number of industrialised countries using information from the Bureau of Industry Economics.

Consumers can act in two ways to influence price and service outcomes in the telecommunications industry. The first is to act individually in making buying decisions. To make the best decisions, consumers need easy-to-understand, comparative information. But the complexity and amount of information makes these decisions almost impossible. This report attempts to provide some of this information.

The second consumer influence is over the collective decisions made by governments, regulatory authorities and carriers and services providers. Through price regulation, a combination of price reductions and service improvements are expected to fall into line with concepts of redistribution or equity.

At the same time this regulation must allow the regulated a reasonable rate of return and incentive to invest further. A number of communities around the world have faced this difficulty and the price capping mechanism has been a popular solution.

This report provides examples of these and comparisons are drawn to put the Australian experience into

perspective. In looking at these international comparisons, it is important to consider differences in per capita incomes.

Access costs

According to the Telstra PSTS Tariff December 1994, the Network Connection charge is \$120.

Various other charges are applicable if further work needs to be done to connect the service.

The Annual Service charge (rental) is: Business Service - \$274.80; Non-Business Service - \$139.80. There has been no increase in the network connection charge since December 1994 and the annual business and non-business charges have each risen \$4.80 since 1993. This represents a 1.7% and 3.4% increase respectively.

Under the AUSTEL administered price cap, connection and annual service charges must not rise more than the level of inflation in any one year. Telstra complied with that regulation in 1993-94 and did the same in 1994-95.

The Bureau of Industry Economics reported in its 'Telecommunications 1995' study that except for the US, which was the lowest, countries with competitive industries had relatively high Business User Fixed Charges. These countries include: Canada, New Zealand, Sweden, the United Kingdom and Japan. Australia ranked 18th of the 28, at around US\$220 compared with the US, around US\$30 and Canada approximately US\$485. Countries with very cheap, free or untimed local calls tended to have relatively high rental charges. Australia, with its untimed local calls, compared favourably to the countries with free local calls - New Zealand and Canada. Our rental charges were approximately half and

less than half respectively. When considering the overall affordability, taking into account GDP per capita, Australia compared favourably with all the countries except the US.

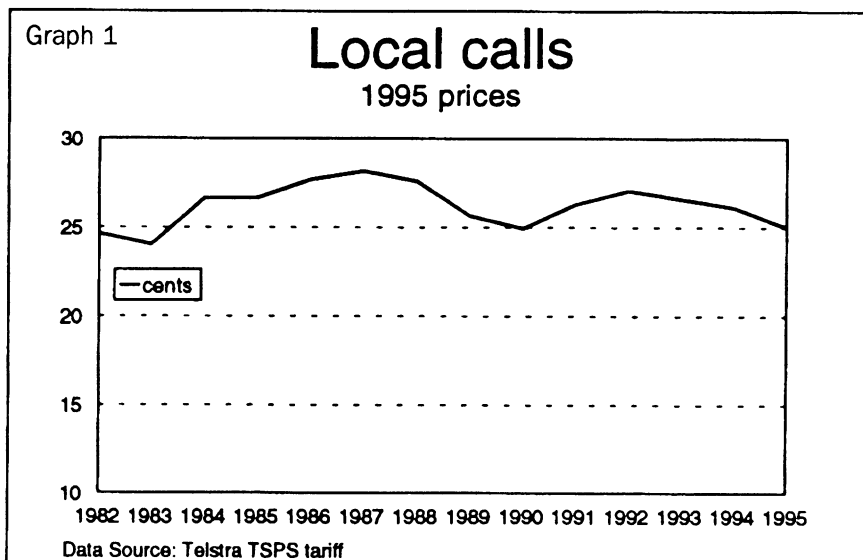
Local calls

The inflation adjusted price of local calls continued to fall as there was no increase in the cost of a call from 25 cents in 1994. Various discounts remain available, such as charging eligible pensioners 15 cents for the first 10 calls in a month.

As can be seen from graph 1, prices have fallen since 1992. However, real prices have yet to fall below the level they were in 1982. The productivity advancements made in the 1980s and especially the 1990s should have brought about a reduction.

Certainly the reductions have come in the other services. Such statistics are at the basis of concerns about the slow passing on of the benefits of competition and new technology to the non-business sector. At least the prices in local calls are going in the right direction. The roll out of Optus's cable network is expected to see this area of the market become much more competitive. Telephony is, of course, the major driving force behind this massive infrastructure investment, not pay television. Competition is needed in the local call arena, as Graph 2 demonstrates.

Australia is last among a selection of OECD countries. Qualifying this figure is the fact that pricing regimes differ wildly across countries. Calls are not timed in Australia (the only country not to do so) and local call areas in Australia could be relatively large, although no research was done into this. The untimed nature of local calls tends to push up access charges



simply force up the price of other services as Telstra struggles to cross-subsidise a less profitable local call service. The resulting drop in the local call charge might be marginal at best.

Standard trunk dialling

The STD market has seen a lot more competition and thus more price reduction, service improvements and new product innovation. The price of a Telstra Sydney to Melbourne call fell over 3% in nominal terms and over 4% in real terms. Optus prices have not increased in nominal terms so they have fallen in real terms. Graph 3 (page 9) illustrates the similarity of prices between the duopolists.

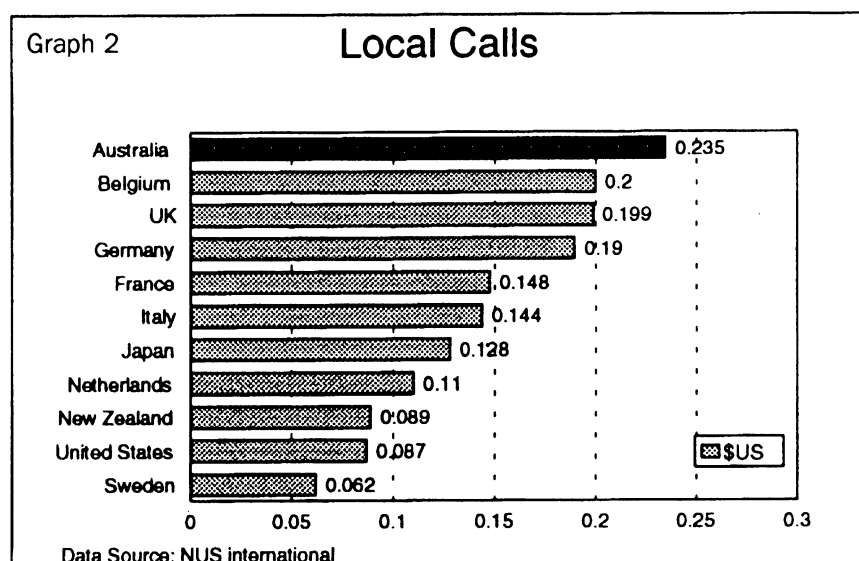
Optus is the cheaper in every market, the differences not dramatic enough for it to grab a much larger market share. Even though STD prices have declined steadily since 1984, they declined even more significantly since the emergence of Optus. Once Optus can establish some economies of scale, further strong competition in this area is likely.

This tendency of duopoly competitors to gravitate their competitive energies towards a narrow region of products is the basis for Telstra's action even under the regulatory constriction of a price cap. The main debate is around Telstra's concentration of reductions in the distance and business markets.

A recent survey in *The Economist* of the world telecommunications market suggested the 'death of distance' as a determining factor in price structures. It was suggested that the marginal cost of a telephone call to Paris from Los Angeles was the same as the cost of a call from Beverly Hills to Hollywood, across town.

But distance is still the main factor in price determination in Australia.

The national rate graph (graph 4) highlights Optus's favourable comparison to Telstra across all markets. These



as well. Services such as Directory Assistance are free in Australia whereas in other countries they can be quite expensive. A directory assistance call in the UK can cost £1.80, which is roughly \$4.00 Australian. Such services may tend to be over-used in Australia, as a result.

Local call regulation

On 1 August, 1995, the Government announced its intention to continue to impose price controls on Telstra at least until the end of 1998. Under the new controls, a more stringent overall price cap of CPI-7.5% per annum will apply to a revenue-weighted bas-

ket of Telstra's main services from 1 January, 1996 to 31 December 1998. (see page 16).

Connections are similarly regulated. AUSTEL, the body responsible for carrying out this regulation, found that in 1993-94 Telstra actually reduced the local call charge by 1.88%. However the majority of the reductions came from specials, volume discounts and Flexiplans, making up some 1.33%. Telstra was deemed to have complied with the regulatory requirements. While it is true that regulation has a redistributive or equity function, excessive extension of the price cap to force more dramatic reductions in the price of a local call could



are standard peak rates for a five minute call. The 20 per cent of customers taking advantage of the various volume discounts available would pay somewhat less. For the purposes of comparison, the ranges are from Telstra. Optus has 0-49km, 50-99km, 100-749km and over 750km.

Graph 5 of the inflation adjusted STD prices over the past 10 years (not including intercapital rates) shows that longer distance rates have come down a lot further than the short distances. All prices have reduced to some degree.

Looking at the international comparisons, Australia ranks towards the middle. Again cross-subsidies and different pricing regimes distort the ranks somewhat. Assorted volume discounting schemes also reduce the reliability of the figures. A broader comparison of prices across 26 countries placed Australia 16th.

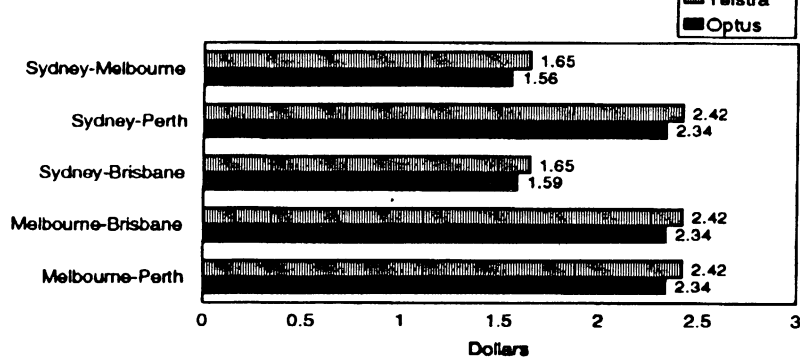
STD regulation

The AUSTEL-administered price cap provides that STD prices must not rise more than CPI-5.5%. This requirement, in the current period of low inflation, has meant prices have actually fallen. Telstra fulfilled the requirement in 1993-94 with a 5.4% reduction in prices, beyond the required 4.12%.

The standard price of an STD call remained unchanged although reductions due to specials, volume discounts and Flexiplans, brought average prices down. The same pattern will be repeated in this year's report, due for release in November.

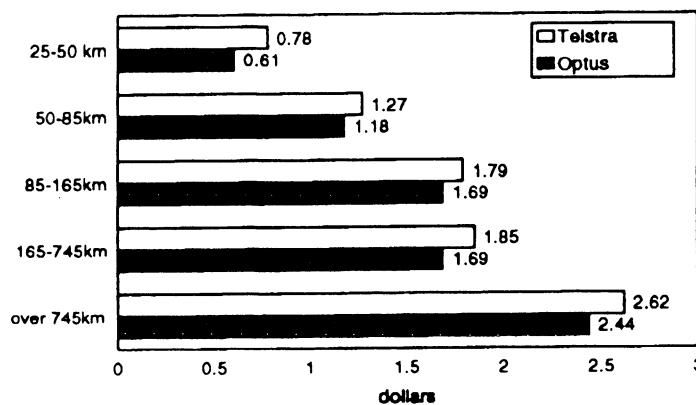
AUSTEL noted in its 1993-94 report that most price reductions came before 1993-94. This is consistent with the traditional hypothesis of duopoly price competition. Furious price competition usually gives way to non-price competition such as advertising.

Graph 3 Inter-Capital STD rates
5 min Peak 1995



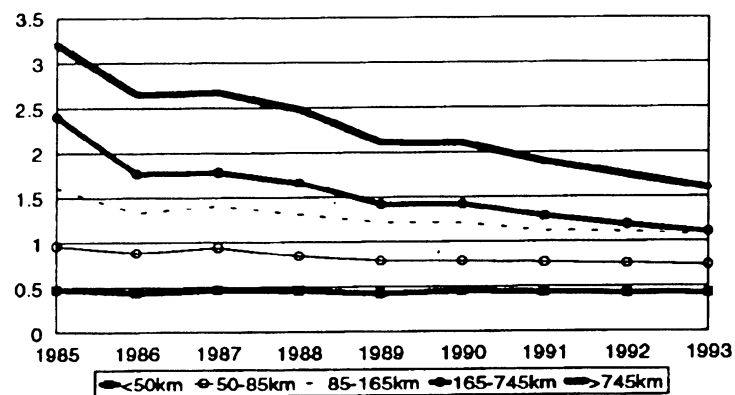
Source: Optus and Telstra

Graph 4 STD Rates
Peak 5 min call in 1995



Source: Optus and Telstra

Graph 5 Telstra STD Prices
1995 Prices



Data Source: Telstra

National business basket

The National Business Basket (graph 6) is a weighted average of the prices paid by business for STD and local call services. This statistic, compiled by the OECD, first establishes the

percentage of total telecommunications expenditure for each service. Real price movements are then calculated based on these weightings. When considering the figures, one must keep in mind that it is an index. So, whatever the relative price posi-



tions were in 1990, all countries' prices are made equal to 100. Such an index is a measure of relative change.

Change comes about in this industry with the application of new technology and the reform of industry structures. A great deal of change has occurred in the Australian system since 1990. It is interesting, therefore, to observe that Australia, in terms that exclude international call savings, has performed worse than the averages of Competitive, Non-Competitive and overall OECD countries. This does not mean that Australian business is burdened with higher charges than the average, just that the pace of reduction in domestic charges is slower in Australia than in many other countries.

International calls

Optus is again cheaper across a selection of destinations (graph 7). Distance seems less of a determinant of prices, rather demand for certain routes, including the USA and the UK, allows operators to organise agreements with local suppliers. These routes are typically described as thick, whereas a route such as Mexico would be described as thin. Competition in this market is lower and price reductions are not as great. The overall movement in prices has been down. Prices have remained stable in nominal terms, thus they have declined in real terms.

Despite the lower prices, or maybe because of them, graph 8 shows that Optus had 20% of the market in 1994. Telstra had 75% and the rest went to resellers and callback operators. Resellers buy a portion of time from the carriers at wholesale and then retail to the consumers. This is a lucrative business for both the carriers and the reseller taking advantage of volume discounting and cheaper rates in other countries at off peak times.

Over the years prices for international calls from Australia have fallen quite significantly. Graph 9 depicts

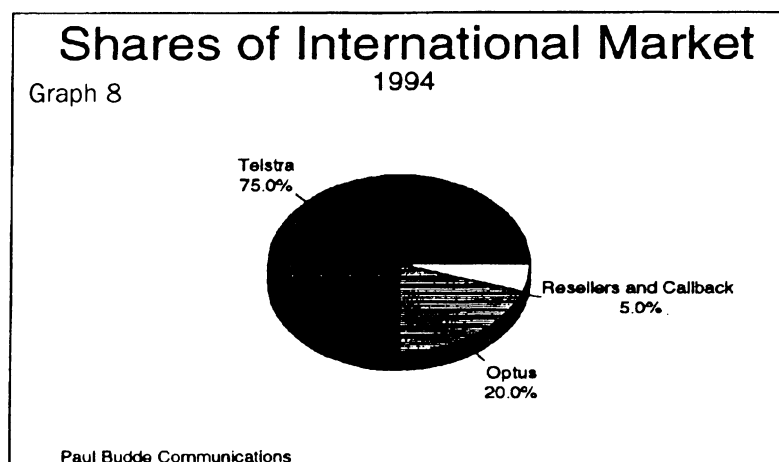
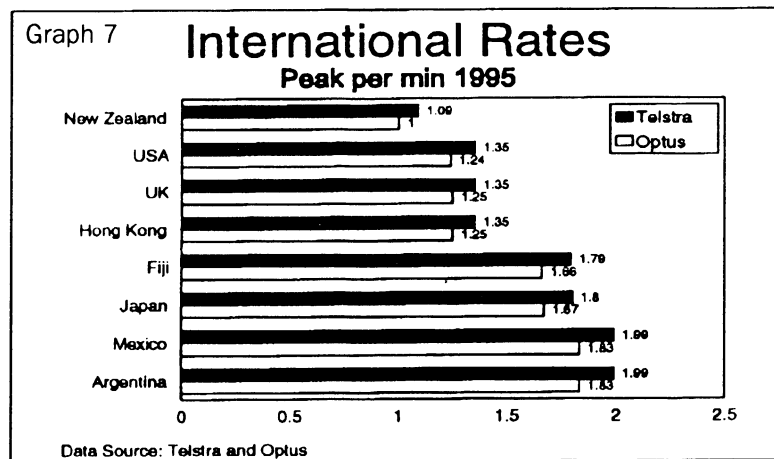
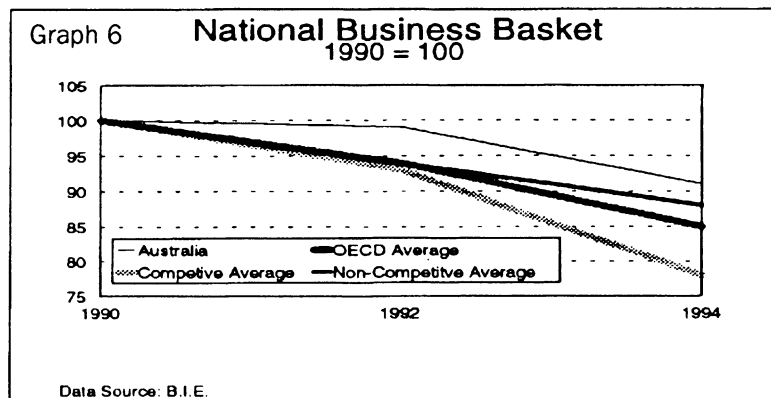
the inflation adjusted prices for Telstra from 1981 to 1993.

Australia has the lowest charges for international calls in the industrial world (graph 10). This position has been held for some time. The relative reduction of prices in this country has been less over the past four years than over previous years. Price reduction does, however, remain strong every year.

Graphs 10 & 11 are constructed by the OECD. They are based on country pairs, which represent the

relative price of making a call from one country to another, expressed as a percentage of the price of the same call in the opposite direction. The calls are weighted by population size of the terminating country, as a proxy for the likelihood of calling that country. Individual country averages are then expressed as a percentage of the OECD average.

Graph 12 (page 12) is the most instructive in showing the relative performance of Australian prices. Australia is progressing more slowly





than the OECD average, even with substantial yearly reductions in prices.

International call regulation

Telstra is obliged not to increase prices by more than CPI-5.5%. In 1993-94 this required a reduction of 3.48%. Telstra met these requirements with a 1.69% reduction in the standard price and an 8.66% reduction, including specials and other discounting. Such a performance is expected to be repeated this year.

Mobile services

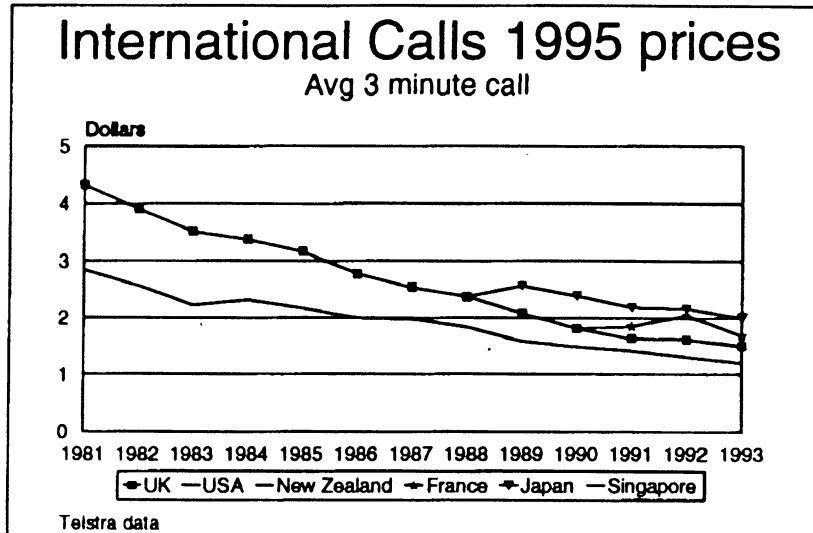
Telstra and Optus prices followed each other closely with marginal differences. The general movement has again been downward. A large proportion of users are on a plan provided by one of the carriers. Vodafone, the third licensed mobile carrier does not sell mobile telephony services directly to the public. Instead, it sells capacity to 13 service providers who, in turn sell to customers. Vodafone provides digital mobile services only whereas both Optus and Telstra provide analog and digital mobile services.

A standard plan (digital and analog) from Telstra costs \$35 per month. Local calls (under 165km) cost 29c for the first 30 seconds and 19c for each additional 30 seconds. STD calls (over 165km) cost 40c for the first 30 seconds and 30c for each additional 30 seconds. Off-peak charges are half these rates.

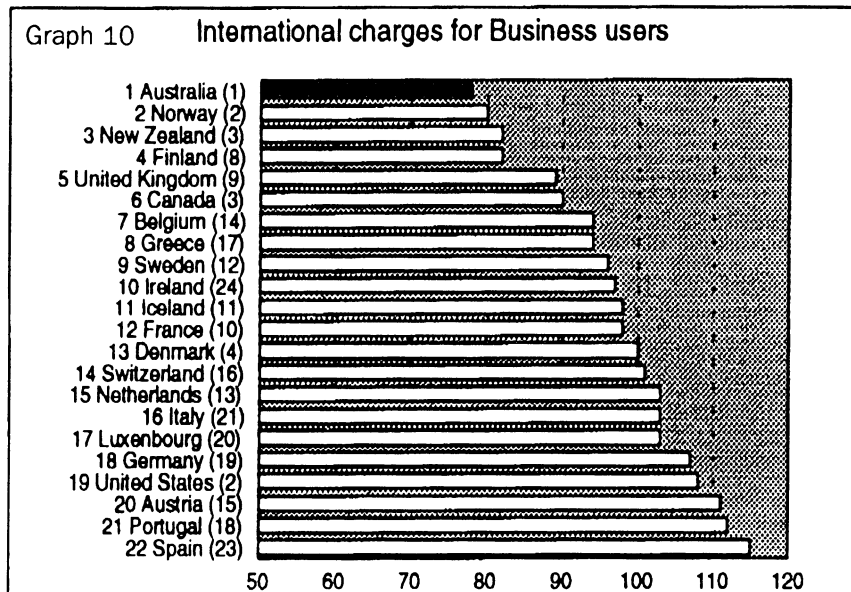
Optus has a \$35 per month plan (digital and analog) where local calls are 20c and 10c per 30 seconds, peak and off-peak respectively. Long distance costs 30c peak and 15c off-peak per 30 seconds.

These plans mean that a 5-minute peak local call costs \$2 for both carriers and a 5-minute long distance call costs \$3.10 and \$3.00 for Telstra and Optus respectively.

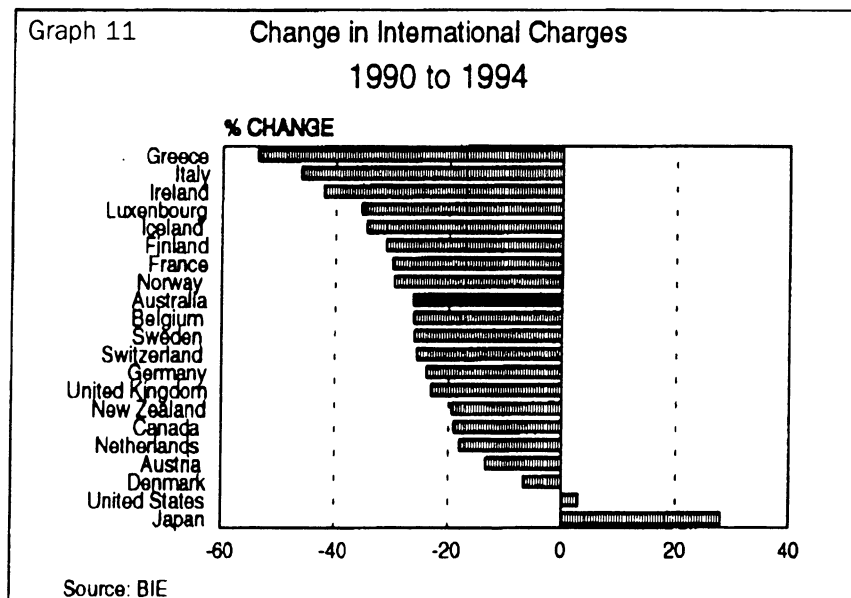
Graph 9



Graph 10 International charges for Business users



Graph 11 Change in International Charges 1990 to 1994





AUSTEL noted that in 1993-94 the weighted price reduction in mobile charges, including the effect of savings due to plans and off-tariff benefits, was 7%. A similar result is likely this year.

Internationally, Australian progress in the past four years has been quite good. The graph below shows that Australian prices for a basket of mobile services have dropped further the averages of competitive, non-competitive and overall OECD countries. This also demonstrates the greater capacity of competitive industry structures to move prices down in the higher technology markets. The exception to this rule is Germany which, with a monopoly (DBP), has halved its prices since 1990.

In an article in *The Australian* (7/11/95), Stewart Fist analysed analog mobile prices over the past few years and found that they had been artificially inflated to maintain price parity with the loss-making digital services. He found it difficult to compare costs over time because of the confusion of different access plans, connection fees, and arguments about the duration of an average call.

The pattern of prices

The pattern of competition in Australia broadly falls into line with the standard theories of competition in a duopoly although economics has, over the years, stumbled in attempting to analyse this most complex of industrial structures. Price, service and innovation competition tends to become centred in the area of the market where there is the greatest demand and the greatest profit. Choice, it may seem, is only an illusion. Game theory suggests that this commonly held industry position will see prices fall to a stalemate at the lower price end of the market. This pattern will be repeated when cable-based local calls extend the duopoly into this end

of the market. However, what has been evident in the Telstra/Optus competition is the rigidity of prices in certain sections of the market. □

Special thanks for source material provided by:

- John Houghton; Senior Economist, Bureau of Industry Economics (BIE), Telecommunications 1995; International Performance Indicators March 1995. (All source material emanating from the OECD can be found in the BIE Report above.)

- Meredith Briggs, Telstra Corporate Pricing Division, Telstra PSTS Tariff 1994, 1993 and 1992 editions, as well as some time series data.

- Chris Bell, AUSTEL, Competitive Safeguards and Carrier Performance 1993-1994 (399 Report).

- Optus Communications: Long Distance Pricing Schedule, Regional; Mobile Pricing Schedule, Oct 1995.

- Consumers' Telecommunications Network (CTN), *For Whom The Phone Rings*, Residential Consumers and Telecommunications Competition April 1995.

