

Are Telstra's prices right?

Now is not the time to be winding back retail price controls, says Gerard Goggin

As Professor Bill Melody suggested in a 1997 essay, *Price Regulation and Its Implications*, the reasonableness of prices for essential services, such as telecommunications, will always be a legitimate topic of concern for regulators and governments - not to mention citizens. As the pressure builds around the government's second Telstra sale, it is not surprising that this is an appropriate time for the expression of concern about whether or not we are paying reasonable prices for the services of our, in turn reviled or loved, but majority publicly owned national carrier.

To decide what was necessary after the 1996-98 price controls on Telstra, the government adopted the tack taken by its predecessor: to commission a secret consultancy from Access Economics and keep its deliberations absolutely inhouse, with only the most perfunctory of consultations. To be sure, the consultants in preparing his report would graciously invite submissions; but no account would be given of how they or the government responded to any views expressed. Rather, the populace would be expected to patiently await the appearance of a new set of price controls in the manner that the world waits for the puffs of smoke that signal that the Cardinals have elected a new Pope in the Catholic Church.

This official reticence may be contrasted with the U.K. example where regulator OFTEL not only issued a discussion paper and reported on its findings, but also convened a consumer panel and an expert panel to advise it on price controls. In the U.S. and Canada, lawyers, consumer advocates and others pore over the detail of price regulation proposals. Even in Australia, the Australian Competition and Consumer Commission (ACCC) has issued detailed public discussion papers and views on issues to do with wholesale pricing of telecommunications.

Happily, after sustained criticism from a number of quarters, most prominent of which was the consumer movement, the government decided in December 1998 to release the consultant's report with a discussion paper of its own, and hold a consultation.

The consultant's report is a useful document which provides a good starting point for an informed decision on price controls. It provides evidence for a strong argument that it is too early to lift price controls as local calls, connection charges, long distance and mobile markets are simply too insufficiently competitive to set prices. (There are some promising signs: for instance, Optus announced in early April that it had 310,000 local call customers, roughly 100,000 of whom were directly connected to its network. But competition is still incipient in the local call markets, and not fully developed in long distance markets). The report contends that what is needed to simulate the pressures of competition where Telstra is currently still not facing the full force of it is for a broad price cap to be levied - with an "x" factor of CPI-9. All regulated services would come under this cap, and Telstra would have some freedom to rebalance its prices within these, as long as it met the overall requirement. The report also criticises the pre-

sent compliance regime, and calls for monitoring to be improved.

The interesting thing about the reception of the report and the present debate, as the government prepares to make its decision, is that no-one appears to want to accept the consultant's recommendations as an integral package, as was demonstrated at the government's helpful if limited consultation (viz., industry insiders in Optus' North Sydney Board Room for a morning in late February 1999).

In its discussion paper, the government did not declare its hand. Telstra cautioned against continuing to make it carry the CAN for social policy, and so declared that it does not want tight controls on local call and connection services. The emerging competitors (Optus, AAPT, and relatively new entrants represented by industry association SPAN) were adamant that the local loop is uncompetitive, and, while interconnection prices are finally being whipped into shape by the ACCC, that Telstra cannot be allowed to uncompetitively raise its local call and connection prices. But they dissented from the consultant's finding that competition is uneven still in the market for long distance services - varying across the country, for instance, with more choice in metropolitan areas. And so they did not agree that long distance should be kept in the basket of regulated services. Indeed, Optus and AAPT vociferously argued that further regulation of these services would "chill" emerging competition, and kill the goose that is laying the golden eggs (or at least, some cable here and there).

While agreeing that local call and connection services must have specific controls, the consumer movement appeared to be keeping an open mind on whether or not long distance services should be in the

... continued on page 8 >>

Telstra's prices

... continued from previous page

cap. And big business lobby group ATUG publicly called for a paradigm shift, and complete rethink - doubtless amounting to a preference for lifting regulation on services where there is at least some competition.

With a round of further submissions lodged by the end of March 1999, it is now up to the government to see whether or not how it accommodates the divergent views, and whether or not it actually delivers on its policy in this area.

One of the key things that the government will be struggling with, as well as with doctoring a more or less Solomonic political fix, is the place of equity. The dominant conceptual framework of the consultant's report as well as the positions of the various telecommunications companies is a conceptual framework in which neo-classical economics, selectively appropriated, reigns supreme, and at which narrow economic efficiency is valued most highly. (A fine example to hand is the Productivity Commission's February 1999 report *International Benchmarking of Australian Telecommunications Services*). Equity and social policy issues, it is believed, should be surgically removed from economic and competition policy, and handed over, rather disdainfully, to governments whose revenues are shrinking.

Yet price caps have been effective in delivering economic efficiency and equity outcomes for consumers, as Xavier notes quizzically in his useful 1995 report for the OECD, *Price Caps for Telecommunications: Policies and Experiences*. Despite this, Xavier makes a typical recommendation that government takes efficiency as its prime consideration when designing price controls, regarding it as more cost effective to pursue equity objectives through targeted subsidies, this frees up pricing policy from any distortions.

An alternative is the position that Professor John Quiggin has argued, that it can be economically optimal to design policy with both narrow efficiency and equity considerations in mind. Low telecommunications connection and line charges may well be a more *economically efficient* as well as a *fairer* way to price these services, rather than jacking up phone connection prices to address an alleged cross-subsidy on call charges (or as the only way to meet an access deficit).

Thus it can be both efficient and fair to consider questions of the distribution of the benefits of competition when designing price caps. We might consider this as a Tony Blair "third way" for proceeding in the telecommunications area. In this light, it is obvious there are different sectors of the economy and society with claims to the productivity and profitability benefits of micro-economic reform. Accordingly, pricing policy may be conceived as a dialogue, sometimes a heated argument, among consumers, shareholders, citizens, managers, corporations, users and small business, about who should get cheaper prices, and the benefits of competition.

One of the problems in this regard has been that price caps have only gone part of the way to delivering safeguards and benefits to residential consumers. An early problem, noted by Access Economics, and repeatedly the regulator, has been that downward price movement was coming from flexiplan and special discounts rather than decreases in standard prices. The effects of this have not been adequately documented in the Australian context but in the U.K., OFTEL estimated that where the official price controls averaged 6.6 per cent, all business customers raked in 9.3 per cent, the top 20 per cent of high spending residential customers gained 5.7 per cent, and the first 80 per cent of residential consumers consoled themselves with 2.7 per cent. Slim pickings for the low-billing customers!

We might guess that the Australian price controls show something of the same distribution of benefits, though not as pronounced (because of the early sub-caps on services heavily used by low-billing consumers such as local calls and connection charges). I say "guess" advisedly, because though there was a push by consumer and public interest advocacy groups for research and modeling on the effects of price control on different sorts of consumers and users, the suggestion was only briefly implemented and the results never released. Once again, we lack decent data in the public domain on policy issues, something the Access Economics report highlights. What this means is that the effectiveness of price caps in safeguarding low-billing residential consumers needs to be addressed: surely such regulation, and eventually price-based competition, must drive down prices overall, meaning *standard* prices as well.

The Coalition government's policy makes it clear that it does see price controls as being both about equity and efficiency. This being the case, it surely has a responsibility to keep price controls in place at this stage of telecommunications reform - to deliver consumer benefits in non-competitive markets such as local call and connection services, and, more contentiously, in long distance and mobile services. It should retain innovations such as the local call parity provisions, and move early if ISDN prices do not plummet. While finding the right balance between regulation and competition is a tricky affair, it is simply too early to lift or substantially wind back retail price controls.

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