Telstra to wear new price caps

The government has resisted the pressure to eliminate telecommunications price controls, but Telstra will enjoy some new flexibility, says Gerard Goggin

Minister Alston has finally announced his long-awaited decision on Telstra price controls. Mindful of the need to gain the best possible price for the further 16.6 percent sell-off, Alston has taken the opportunity to ease pressure on Telstra's prices - while still demonstrating his custodianship of competition.

Telstra has been handed some flexibility in rebalancing its prices - allowing it scope to realise its long-cherished goal of raising its connection and access prices. Not surprisingly, Telstra's response has been largely favourable, as has that of other carriers.
But the response of consumer groups has been more muted, with concerns raised over potential rises in line rental charges, and whether benefits of the new controls will flow evenly to low-use, low-income consumers.

The government has presented its new regime of price controls on Telstra as a steady-as-it-goes approach. The Minister's June 15 press release noted that price caps had played an important role in delivering affordable services to telecommunications consumers but that changes were warranted in the light of increased competition. Particular mention was made of the considerable scope for further reduction in local call and mobile prices.

The basic form of the price controls will remain the same as those currently in place. There will be a cap of the Consumer Price Index (CPI) - 5.5% on a "basket" of services: connections, line rentals, local, trunk and international calls, leased line and digital mobile services.

Interestingly, the government has chosen to keep trunk and international calls in the broad basket, despite arguments from Optus, AAPT, and others that these were sufficiently competitive to be excluded. (Indeed Optus flew in UK telecommunications expert, Professor Martin Cave, for some unsuccessful last-minute lobbying in April on precisely this point.) The government consultant's report had noted the unevenness of competition in long distance and international call markets, and recommended their continued inclusion under a general price cap - advice which the Minister appears to have heeded.

But the innovative part of the new controls lies in the creation of three additional sub-caps, which allow a trade-off between consumer and competition protection on the one hand, and Telstra's ability to price its service closer to what it regards as cost, on the other. Firstly, there will be a basic access cap consisting of a basket of line rentals and local services. The government has stipulated that the annual increase in the average price of this basket may not exceed the CPI (in effect, the rate of inflation). Secondly, there will also be a cap on connection price, under which the annual increase in the average price of a basket of connection services may not exceed CPI.

The basic access cap means that Telstra will be able to increase the price of line rentals providing it lowers the cost of local call services. The industry regards line rentals and connection ("access" charges) as presently under-priced compared to what it feels they cost. All around the world, incumbent former monopoly telcos have been lobbying to raise access charges relative to call costs. So the government's loosening of controls in this area is welcome news for Telstra.

Consumers will be comforted by the handbrake on Telstra's potential to raise line rental in the form of the need to balance hikes with dips in local call prices. But there is enough room in this decision for some discriminatory pricing. The key may well be in the word "average". For instance, it will be interesting to see whether Telstra could potentially charge higher line rentals in some areas of Australia (the bush, for instance), while delivering discounted lower local call prices to those living in the cities. Hypothetically, Telstra would comply with the price cap by ensuring that the combined average of the basket of line rentals and local call services did not exceed CPI - but the actual benefit of this could be quite different for different classes of customers.

Telstra has rejected any suggestion of charging different access or connection charges in this way. There is also the pricing parity scheme which means that Telstra needs to pass on the average of any discounting in local calls in a given year to all residential customers in Australia in the following year. So if in 1999, it discounts local calls in Adelaide but not Mt. Gambier, in 2000 it needs to pass on the average of this and other discounts elsewhere to the Mt. Gambier customer.

There is also a welcome new initiative in these controls, a "safety net" for low-income, low-spending customers. This is the third of the new sub-caps, a special "low-bill" price cap, which will ensure that the average prices for a basket of fixed-line residential services must fall by one per cent per year in real terms (CPI - 1%). The basket includes connections, line rentals, local, trunk and international calls. The weightings for this basket will be calculated on the basis of the spending of the bottom 50 per cent of Telstra's pre-selected customers by telephone bill size.

Another initiative in the package is the directive that Telstra will also be required to satisfy the Australian Competition and Consumer Commission (ACCC) that it has made arrangements to ensure the bottom 10 per cent of its residential consumers will not face real increases in their bills, before it can increase the telephone line rental charge by more than CPI. This stricture will really get the regulator, Telstra and government poring over the fine-print of pricing impacts - for virtually the first time ever. If it did wish to hike up the price of rental by more than the CPI, then Telstra would need to ensure that it also gave discounts in services that the bottom 10 per cent of its pre-selected customers used - predominantly local calls.

The targeting of the lower volume consumers with the "low-bill" price cap and rental line charge protection is an important and genuinely interesting move in policy terms, no doubt taking its impulse from similar initiatives by UK regulator, OFTEL. The aim of these measures is to counter the criticism that competition in telecommunications has only led to reductions in prices for "high-spend" customers who can take advantage of volume or spot discounts, or the plummeting price of long distance and international calls. One of the problems with price controls in Australia and other countries has been that regulation has neither been sufficiently sophisticated nor adequately targeted to pass on anything like a fair share of discounting to all customers.

The figure of the bottom 50 per cent of customers in the "low-bill" cap is fairly crude and unambitious so Telstra should not have its regulatory nose put too far out of joint by this. But at least the government has taken a step in the right direction. How this will be monitored by the ACCC will be interesting - and hopefully data relating to this will be made available publicly, to allow any citizen to evaluate the efficacy of the price controls. (The 50 per cent and 10 per cent figures are based on Telstra modelling using historical price data from its records, combined with hypothetical price movements. This study remains commercial-in-confidence so it is difficult for citizens to properly evaluate whether or not these are the appropriate percentiles for the new price controls).

The government's recognition that many consumers have not received benefits of either nascent price competition or via the proxy of price controls is useful - but unfortunately may only be of symbolic value. This is because the government has chosen not to enact a far more fundamental reform needed. To date, Telstra has been able to count discounting through Flexiplans and other non-standard tariffs towards its compliance with the general price cap. For instance, in its May 1999 Performance Safeguards 1997-98 report, the ACCC noted that more than half of Telstra's compliance with the price controls in 1997 was contributed through non-standard pricing.

This was the case for previous years, and so much of the price reductions gained through price controls have therefore related to non-standard, discounted prices, rather than real reductions in standard prices. This has meant that the benefits of the price controls have been concentrated in geographical areas and market niches where Telstra has faced at least some competition - rather than reductions being more widely spread.

For this reason, the report by Access Economics, commissioned by the government in 1998, recommended that future price controls no longer give credit for discounts offered through Flexiplans and other non-standard tariffs - and that Telstra should be required to file a set of benchmark tariffs for capped services. So not only has the government set a much less ambitious "x"-factor of 5.5 per cent (citing improvements in total factor productivity and competition - though really there is little evidence to justify this specific "x" factor), but it has allowed Telstra to reap the windfall of keeping its standard prices high on insufficiently competitive services.

The new arrangements will come into effect from July 1, 1999, operating until June 30, 2001, with a further review prior to the end of 2000. As this issue was going to press, the draft regulation on the price controls had just been released but much of the detail of compliance and methodology was still be developed by the ACCC with Telstra's assistance. It is not clear how the public will be involved in these discussions, if at all - though Telstra is committed to consulting with consumers through its Consumer Consultative Councils. There is still a question mark over whether the ACCC will have sufficient detailed information and adequate resources to properly monitor Telstra's compliance - an issue which goes to the heart of the effectiveness of the price controls.

So despite some flaws in these new price controls, it does appear that the government has substantially resisted the clamour of the top end of town -

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Telstra price controls

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	1996 - July 1999	July 1999 - June 2001
General price cap on main services	CPI - 7.5% Connections; line rentals; local, trunk and international calls; leased line, analogue and mobile services	CPI - 5.5% Connections; line rentals; local, trunk and international calls; domestic and international leased lines; digital mobiles
Sub-caps	CPI - 1% On standard prices on the following fixed-line residential services: connections; line rentals; trunk calls and international calls	CPI cap on basic access services Line rentals and local call services (the charge for these services as a group must not raise in real terms each year)
		CPI cap on basket of connection services
		CPI - 1% on basket of fixed-line services consumed by residential consumers: connections; line rentals; local, trunk and international call services Revenue weights set at the average for bottom 50% of Telstra's pre-selected residential consumers by bill size
Other protections	Telstra required to obtain the prior consent of the ACCC where it wished to increase a charge subject to price control by more than the change in CPI in a given year	Line rental charge safeguard: If Telstra wishes to increase a line rental charge for residential consumers by more than change in the CPI, and that service is used by one or more of bottom 10% of Telstra's pre-selected customers, the ACCC must give consent; To give consent, the ACCC must be satisfied that Telstra will make available products or arrangements to ensure that the average telephone bill for the bottom 10% of customers does not increase in real terms
	Local call parity provision: revenue-weighted average untimed local call from residential and business lines in non-metropolitan Australia is not to exceed the same applying in metropolitan Australia in the previous year	No change
	Prohibition on local call charges rising above 25 cents (residential/business phones) and 40 cents (public payphones)	Prohibition on local call charges rising above 25 cents (residential/business phones) and 40 cents (public payphones), except in the case of voluntary discount plans
	Directory assistance charges subject to Ministerial notification and disallowance	No change

big business users, dominant and aspirant telcos alike - to take a leap in the dark on Telstra's pricing, in the hope that lifting or substantially loosening price controls would accelerate competition (whatever the interim effect on consumers).

Instead, the government, nervously nudging its privatisation legislation through the upper house, appears to have managed to keep at least one beady eye steadfastly on the voting consumer - and gone some way to ensuring that Telstra's pricing policy fits the bill.

Gerard Goggin teaches in the School of Humanities, Media and Cultural Studies at Southern Cross University. He does not own any Telstra, Optus, AAPT, ecorp or other digitally hyped shares. He has assisted the Australian Consumers Association with its work on price controls on Telstra.

Comment

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Indeed it would make good economic sense if it's as good an investment as the government is claiming.

There's some genuinely valuable new interventions in the telecommunications market made possible with this new legislation and some extraordinarily useful activity is likely to be funded by government under the range of new and expanded programs.

But it seems an oddly interventionist supplement to be taking with the medicine of faith in the necessity of full privatisation to maximise the quality, affordability and competitiveness of telecommunications services in Australia.

Intelligent Island? There must be one out there somewhere.

Jock Given