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Access Pricing – Time to Shift Gear

The last Economuse suggested that current access pricing is past its use-by date. In this edition, we explore why that is so and what might be done about it.

Australians will not be able to enjoy true broadband (10Mbps, according to some like the Australian Computer Society) for a long time. To get true broadband, you need something better than copper for data to travel on. But, who is going to build, say, optical fibre access networks when current access pricing regulation is likely to force its availability at marginal cost (or, rather, TSLRIC) ?

Deja Vu

Of course, the same quandary faced Optus and Telstra when they considered rolling-out their PayTV networks. Contrary to popular belief, Telstra was first to market with tariffed access to its network. But, when Optus said its network would be closed Telstra followed. And, both were granted an access holiday for this purpose.

There is a lot to be said for an access holiday. It grants investors the opportunity to recoup their investment within the period of exemption free from the uncertainties of access regulation. But, the ACCC's discretion in such matters may be limited as the recent over-turning of its exemption on set-top units (STUs) by the Competition Tribunal has shown.

If access holidays are not an option, the issue of access pricing cannot be avoided.

Competitive Benchmarks

Current access pricing is based on the ideal of perfect competition. In this environment, prices tend to marginal cost. Sensibly, regulation recognizes that in network industries marginal costs are below average costs so there has to be a mark-up to ensure total costs are covered. Less sensibly, costs are based on hypothetical efficient operators such that new entrants' costs are likely to be higher and competitive infrastructure will not develop.

But, this is not the right model. Perfect competition cannot exist in a market with few players and significant economies of scale and scope. The more correct starting point is the contestable market in which potential competition precludes monopolistic behaviour. Even if the market is not perfectly contestable (eg barriers to entry), the economic principles, which regulators can use to ensure that the network provider acts as if were a contestable market, are known.

Contestability Knows Two Bounds

The limits of pricing suggested by contestability theory actually accord with intuition and observation. Within these limits, the theory suggests regulators should exercise regulatory forbearance.

The upper limit is stand-alone cost. That is, only a statutory monopoly could get away with pricing above the cost of building an alternative. In practice, close substitutes often exist and new or replacement build may be in prospect (as with optical fibre, wireless loop etc). Market operators know where this ceiling is and are constantly evaluating build versus buy options.

The floor is some variant of marginal cost. A network operator is interested commercially in any new services or applications that exceed marginal cost and contribute toward fixed costs. Note that if the extra service displaces revenues from an existing service, this effect has to be netted-out to see the overall impact of the extra service. It does not seem unreasonable for a network operator to reject a service that would make it worse-off. This could be remedied if the access price were sufficiently higher than marginal cost; but this is not provided for under the current access pricing principles.

In fact, in some cases (eg local call resale) another access pricing is applied. This is retail price less costs avoided by reselling rather than retailing the service. But, this can only be applied where the network operator has an equivalent retail service. In the emerging NGN world where new services will be spawned this is unlikely to be the case.

What We Need

The new infrastructure that we need for true broadband will not be attractive to build under current access pricing arrangements. As with all resource allocation issues, the pricing signals have to be set correctly; not stuck in bottom gear. It is time to shift gears.

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