Telstra Comments

On the

Productivity Commission

International Telecommunications Market Regulation

Position Paper

(June 1999)

30 July 1999

Introduction

Telstra offers the following comments on the Productivity Commission's Position Paper for its inquiry into International Telecommunications Market Regulation. These include and supplement comments made by Telstra at the Public Hearing on Wednesday 21 July 1999.

Telstra is disappointed that the main focus of the Position Paper has been on domestic regulatory issues which, as is recognised within the Position Paper, is already the subject of extensive debate within the ACCC. Telstra is further disappointed that in terms of the domestic regulatory issues considered, the Position Paper has been lead to some incorrect and inappropriate conclusions based on the use of selected performance indicators which have not been integrated into some justified analytical framework, and through reliance on some incorrect information.

Turning to the International issues which were to have been the main subject of the Inquiry we also have concerns about some of the analysis and data employed.

There are some issues however on which Telstra agrees with the Commission, most visibly with respect to the need for more equitable arrangements on Internet links to the US and with respect to the desirability of continued pressure for the liberalisation of overseas markets. It is only with market liberalisation that sensible commercial outcomes can be achieved with respect to international arrangements.

Significantly, Telstra also agrees with the Position Paper's conclusion that the current strategies adopted within Australia in pursuit of international telecommunications market reform in general, and towards reform of the international telecommunications payment arrangements in particular are appropriate and have been broadly effective.

Telstra's comments in this response address the following:

1. approach adopted in the Position Paper and some consequential issues
2. further issues raised in the Position Paper
3. the Position Paper's policy recommendations, or "Possible Options"
4. Conclusions

1. Approach adopted in the Position Paper and some consequential issues

Telstra's primary concern with the Position Paper is with the Commission's broader characterisation of the international telecommunications market and how it is working. In addressing this, Telstra would like to emphasise the fact that, in its view, this should be at the centre of the Commission's analysis. *That fact is that* the average i*nternational call cost has fallen by about 60% in real terms over the last five years. Furthermore, in the twelve months from 1 May 1998 to 1 May 1999, Telstra's average traffic-weighted price per IDD minute decreased by fully 72 per cent.* Prices today, in other words, are barely a third of what they were only a year ago.

This is a dramatic rate of price decline. Looking at it a clear inference can be drawn, that this is a market in which competition is working, and working well.

But that is not the picture a reader would obtain from the Commission's Position Paper, far from it. Rather, the Commission paints a picture of competition distorted and hindered. The Commission cites very little hard evidence in support of its assessment; what it does is point to indicators, in numerous cases reported at third hand. On that basis, it then advances a range of policy recommendations. It is Telstra's view that many of the indicators the Commission points to have little merit. As for the policy recommendations, some of these are plainly inconsistent with other statements the Commission has made only recently. Each of these will be dealt with in turn.

The Commission's Indicators of performance

The Commission's discussion of the indicators it has used to measure performance is cursory. No analytical justification is given for the indicators selected, and no framework is set out within which they can be integrated. Rather, they are cited as if they spoke for themselves. Two of these are addressed below.

(1). PSTN Access Charge

The first is the level of Telstra's access charges for the PSTN, that is the amount Telstra charges competitors for using its network. The Commission cites the ACCC's assessment of these charges; and it also cites the views expressed by C&W Optus. What the Commission has chosen not to cite is Telstra's view that the charges it has proposed are strictly in line with costs. But even more importantly, what the Commission ought to have noted is that, if the modelling approach used in its 1997 Staff Information Paper on International Telecommunications Reform is to be believed, the level of domestic PSTN access charges can have virtually no impact on IDD rates.

Attachment 1 provides a Telstra analysis which uses C&W Optus numbers to highlight the negligible impact of interconnect charges on IDD rates (the analysis also considers some of their other claims, as referred to later).

C&W Optus claims in its submission to this inquiry that in 1998, it was charging on average somewhere between $0.72 and $1.07 per minute for international calls. C&W Optus also claims that the interconnect charge is currently 4.7 cents per minute and that this could be slashed to a fictional world's best practice figure of 1 cent per minute.

In reality, Telstra's proposed interconnect rate, as detailed in our undertaking to ACCC, is 3.67 cents per minute.

But even putting this factual issue aside, the important point revealed in the C&W Optus data is the minuscule impact that a reduction in the interconnect rate would have on average IDD prices of between $0.72 and $1.07 per minute. Based on the price information presented by C&W Optus, a reduction in the interconnect charge from 4.7 cents per minute to 1 cent per minute would at most – assuming that the full benefit was passed on to customers – reduce international call prices by 3 to 5 per cent.

As the Commission rightly identified in its 1997 Information Paper issues of interconnection are of negligible significance in the market for international call services. The prominence they are given in the Position Paper is consequently surprising.

(2). Availability and Pricing of Non-switched Capacity

The second indicator used by the Commission is the availability and pricing of various forms of non-switched capacity, ranging from the purchase of ownership rights in undersea cables through to international leases. The paper claims these are over-priced and/or subject to 'practical access restrictions'.

Little point would be served by going through the Commission's statements in this respect line-by-line. In numerous instances they involve gross technical errors -- as when a leased 2 Mbit/s/s circuit (which is an end-to-end managed transmission service) is compared with an ownership claim on capacity in a cable (which is merely a claim on the physical transport layer, and not the provision of a transmission service). But there are some simple economics that need to be set out.

The facts of the matter are these. International transmission is provided in a market that is undergoing explosive growth. In the short term, strong demand has tended to push prices higher than they might otherwise have been. However, in this area as in others, the price mechanism works, and strong supply expansion is now under-way.

The Australian situation is by no means unique in this respect. The last major trans-Atlantic cables to go into service, TAT 12/13, sold out almost immediately, and since then demand has more than doubled. As for the trans-Pacific routes, the last major increase in capacity occurred with the opening of TPC-5 in 1996; since then, demand has risen from some 50 STM-1s (each STM-1 provides 155 Mbit/s) to close to 200.

It is precisely for this reason that carriers are investing in developing new facilities. For example, the Southern Cross cable, in which Telecom NZ and Cable & Wireless C&W Optus hold major stakes, is scheduled to be in place by January 2000. This cable will add some 40 (inner ring) to 80 (outer ring) Gbit/s of capacity – that is, it will have 4 to 8 times the capacity of the current TPC-5 cable, and will be further expandable to an estimated 480 Gbit/s. Further substantial capacity additions will come from the SE-ME-WE-3 cable, from Australia to Europe, in which Telstra is playing a leading part.

Now, the Commission claims that these investments are examples of inefficiencies and distortions. This is an argument that Telstra finds difficult to understand, much less support. Surely, what we are seeing here is not inefficiency but rather the market at work – that is, the response of supply to strong and sustained growth in demand. These trends ought therefore to be commended rather than condemned.

2. Further issues raised in the Position Paper

2.1 Retail prices for international calls (section 2 Box 2.4, p.20).

This was discussed in the preceding section and is included here for referencing. To support the earlier comments, Table 1 below provides further details of Telstra IDD prices since 01 August 1991.

↓end of pricing constraints on Telstra and end of duopoly.

	01-Aug-91	01-Nov-92		01-May-98	01-May-99	Change 5/92 to 5/98	Change 5/98 to 5/99	Change 5/92 to 5/99
CANADA	$1.49	$1.49		$1.39	$0.40	-6.71%	-71.22%	-73.15%
CHINA	$2.09	$3.09		$2.50	$0.88	19.62%	-64.80%	-57.89%
DENMARK	$1.59	$1.59		$1.59	$0.59	0.00%	-62.89%	-62.89%
FIJI	$1.79	$1.79		$1.70	$0.85	-5.03%	-50.00%	-52.51%
FRANCE	$1.59	$1.59		$1.50	$0.49	-5.66%	-67.33%	-69.18%
GERMANY	$1.79	$1.79		$1.50	$0.49	-16.20%	-67.33%	-72.63%
GREECE	$1.99	$1.99		$1.99	$0.49	0.00%	-75.38%	-75.38%
HAWAII	$1.49	$1.49		$1.20	$0.28	-19.46%	-76.67%	-81.21%
HONG KONG	$1.49	$1.49		$1.25	$0.41	-16.11%	-67.20%	-72.48%
INDIA	$1.99	$1.99		$1.99	$1.14	0.00%	-42.71%	-42.71%
INDONESIA	$1.99	$1.99		$1.85	$0.88	-7.04%	-52.43%	-55.78%
IRELAND	$1.49	$1.49		$1.35	$0.41	-9.40%	-69.63%	-72.48%
ISRAEL	$2.39	$2.39		$2.39	$0.79	0.00%	-66.95%	-66.95%
ITALY	$1.59	$1.59		$1.45	$0.45	-8.81%	-68.97%	-71.70%
JAPAN	$1.99	$1.99		$1.60	$0.49	-19.60%	-69.38%	-75.38%
KOREA SOUTH	$1.99	$1.99		$1.80	$0.79	-9.55%	-56.11%	-60.30%
MALAYSIA	$1.59	$1.59		$1.47	$0.62	-7.55%	-57.82%	-61.01%
NETHERLANDS	$1.79	$1.79		$1.59	$0.59	-11.17%	-62.89%	-67.04%
NEW ZEALAND	$1.29	$1.21		$1.00	$0.28	-22.48%	-72.00%	-78.29%
PNG	$1.49	$1.49		$1.41	$0.76	-5.37%	-46.10%	-48.99%
PHILIPPINES	$1.59	$1.59		$1.47	$0.70	-7.55%	-52.38%	-55.97%
SINGAPORE	$1.49	$1.49		$1.25	$0.45	-16.11%	-64.00%	-69.80%
SOUTH AFRICA	$1.79	$1.79		$1.79	$0.69	0.00%	-61.45%	-61.45%
SPAIN	$2.19	$2.19		$1.99	$0.71	-9.13%	-64.32%	-67.58%
SWEDEN	$1.59	$1.59		$1.59	$0.49	0.00%	-69.18%	-69.18%
SWITZERLAND	$1.79	$1.79		$1.70	$0.49	-5.03%	-71.18%	-72.63%
TAIWAN	$2.19	$2.19		$2.00	$0.88	-8.68%	-56.00%	-59.82%
THAILAND	$1.99	$1.99		$1.85	$0.88	-7.04%	-52.43%	-55.78%
TURKEY	$1.99	$1.99		$1.99	$0.89	0.00%	-55.28%	-55.28%
UK	$1.49	$1.49		$1.19	$0.34	-20.13%	-71.43%	-77.18%
USA	$1.49	$1.49		$1.20	$0.28	-19.46%	-76.67%	-81.21%
VIETNAM	$1.99	$1.99		$1.99	$1.27	0.00%	-36.18%	-36.18%

YUGOSLAVIA	$1.99	$1.99		$1.99	$1.06	0.00%	-46.73%	-46.73%

↑end of pricing constraints on Telstra and end of duopoly.

<u>Table 1, Telstra IDD prices from 1 August 1991 to May 1999</u>

2.2 Selected accounting rates with the United States: Australia, Singapore and China, 1993 to 1999 ($US) (Table 3.1, p.24)

The rate quoted in the table is an old rate which existed under the US International Settlement Policy, and we have since moved to different commercial arrangements with the US carriers which do not require reporting within the US or Australia. The current arrangements are commercial in confidence to Telstra & the US carriers.

2.3. Payment for Internet traffic, (Section 3.5 p.33).

As peering is actually an exchange of traffic without settlement, the statement that "peering has traditionally been one of the main forms of settlement for Internet interconnection, originating when Internet access was managed principally by a limited number of subsidised regional entities" is misleading as written.

2.4 Interconnection (p.53)

This issue was mostly discussed in the preceding section and is listed here for referencing. There are some further details however, which are briefly included below.

The final determination from the ACCC in May 1998 came down with a range for 1997/1998 (the same year to which our undertaking refers) of 1.87-2.77 c/min, with the range largely reflective of trench lengths that support the upper end of the range. As the only provider currently owning and running a ubiquitous network in Australia Telstra is well placed to know what these lengths actually are.

Furthermore, Telstra claims and will continue to argue, that 2.77 c/min is not reflective of actual or efficient costs due to the ACCC assumptions that are inconsistent with international practice in Customer Access Network (CAN) dimensioning (pairs/SIO), capital cost annualisation and WACC.

In preparing the Position Paper comments on Interconnection, the Commission considered a number of submissions on this issue, including one from C&W Optus which Telstra believe contains errors and is therefore likely to be misleading. In order to balance this material Telstra has attached to this response its analysis of that particular submission (Attachment 1).

2.5. *Respective roles of Government and Operators in Reducing Trade Barriers*

The Position Paper refers throughout to "Australia" in the context of being just the Government, apparently exclusive of the industry itself. Telstra would like to clarify the relative roles of the Australian Government and the Australian Operators in relation to International negotiations[1].

Telstra looks to the Government to set an environment which allows the participants to operate in an open competitive market and, wherever possible, influence relevant international forums, and governments in other countries to liberalise their markets to the same degree as the Australian market.

The role of Australian Operators is to conduct business within the regulatory environment set by the Governments here and overseas. Therefore, commercial issues such as lowering accounting rates, the implementation of asymmetric and differential settlement rates, implementation or use of alternative calling procedures and the separation of mobile from fixed accounting rates are all negotiations which would be undertaken by the Australian Operators with overseas operators.

The removal of parallel accounting and proportionate return requirements, and greater freedom for Australian providers to negotiate with foreign providers on commercial terms and conditions, would become part of the Australian Government negotiations in multilateral forums such as the WTO.

2.6. Internet connections

Telstra believes that the Position Paper profoundly understates the significance of the Internet. There is only one reference to the "excess cost" borne by Australian users. More importantly, in terms of future traffic growth and multimedia applications (including e-commerce), the Internet will be vastly more significant in the longer term future of Australia's international telecommunications growth than telephony accounting rates, in this or other countries. The summary is almost entirely concerned with the various structural features of the past or current telephony market. Whilst at this time more historical material exists in relation to international telephony structures than to the Internet, we believe that the summary would be enhanced by recognising that the Internet has almost none of these structures and is and needs to be characterised by a more commercial approach.

2.7. Internet - Indirect Evidence of Inefficient Pricing - Congestion (section 4.5)

There are many causes of congestion in the Internet but operators, users and regulators need to be aware that the absence of an international payment mechanism for traffic carriage is a major factor. The international telephony system however distorted and inefficient it may have been, provided good rewards for successful calls and none for failed calls, encouraging operators to dimension for peak usage. The Internet, operating under a 'best efforts' service paradigm , provides far less rewards for units of

[1] as referred to in the 3 bullet points in the Position Paper's section on International negotiations, pp xiii-xiv of the summary (and as repeated in Section 6.8 of the report).

traffic carried, no direct penalties for dropped packets, hence less direct incentive to invest in increased network capacity . A range of technological solutions has been developed for the problem of quality of service but it is difficult to see how these can be deployed across multiple networks in different geographies without an inter-provider payment system.

This issue is particularly poignant in the context of the future growth of e-commerce, which will depend upon the Internet. A recent study by the International Data Corporation (IDC) estimated in 1998 that, although 56% of www users resided outside the USA, they accounted for only 26% of total global electronic purchases. By 2003, IDC estimates that 65% of www users will be outside the USA and that they will account for more than half of total electronic purchases.

2.8 Payments for Internet traffic - Possible future benefits (Section 5.4)

The interaction between transmission costs and port charges requires some further clarification. The statement " excess transmission costs could be reduced as Australian providers link directly into US Internet exchange points" represents only one part of the costs to end-users. Australian providers can still bear the full *transmission* costs (leased or fully-owned international capacity) by establishing a router/Point of Presence at US Internet exchange points but, by so doing, they can by-pass and reduce *port* costs otherwise paid to US transit operators.

3. Position Paper's policy recommendations or "Possible Options"

We now consider the policy recommendations or "Possible Options" proposed in the Paper. These are divided between Australian telecommunications regulation, and International negotiations.

In firstly considering Australian telecommunications regulation, as already indicated the average international call cost has fallen by about 60% in real terms over the last five years, and that in just the last 12 months, IDD prices have declined by over 70 per cent. This decline was not brought about by increased regulation – rather, it was the result of reducing the extent of regulatory constraint. With the end of the duopoly period, in July 1997, two changes occurred: scope was created for new players to enter the industry; and many of the constraints until then imposed on Telstra's pricing, for example in terms of non-discrimination provisions, were relaxed. Combined, these changes have generated enormous benefits for consumers.

Set against this background, some of the Commission's recommendations are puzzling and disappointing. For example, the Commission urges the ACCC to consider requiring carriers to report and then disclose charges for services such as dedicated lines. Yet consider what the Commission itself said in its 1997 Report:

> "[G]iven the increasing incentive for tacit collusion as switched service providers' market share increases, it may not be desirable for the ACCC to

> publish tariffs supplied upon its request. ***Standard competition policy safeguards alone may be more effective means of preventing anti-competitive pricing***" (At page 43).

Telstra believes there is a deal of good sense in the 1997 report's assessment, and that the Commission, in reviewing its Position Paper, would do well to give it serious weight.

Even abstracting from the specific recommendations, there is a more general opportunity that has been missed. This is the opportunity to consider whether we actually need as much regulation as currently weighs upon this area of activity.

Thus, the Paper cites the international benchmarking work released by the Commission earlier this year. In that work, the Commission compared telecommunications prices across a range of countries. There is a vigorous and continuing debate about how such comparisons should be conducted. But one result on which there is agreement is that the countries in which consumers get the best deal are *not* those which are usually held up as models for Australian regulatory choices – that is, the UK and the US. Rather, it is the countries with truly light-handed regulatory regimes, such as Sweden and Finland. Subsequent analysis, using a fuller data set than that exploited by the Commission, has also found that New Zealand, that has no industry-specific regulation, has low consumer prices.

What these results suggest is that there could well be gains from moving further and sooner from a reliance on an industry-specific regulatory regime to one based on the economy-wide competition policy. Such a move would surely be consistent with an overall commitment to minimising the burden regulation imposes on the Australian economy.

As is suggested (p.86) we do not consider it appropriate or practicable to suggest making the Rules of Conduct for international telecommunications more explicit. There is a fine balance between what Australia can and cannot achieve internationally via these rules and we consider that the existing rules generally achieve an appropriate balance.

In terms of the options proposed by the Commission in relation to International negotiations (p.86), we agree with the Commission that fundamental reform of these arrangements is neither necessary nor desirable.

Rather than suggesting (p.87) that "Australia" should negotiate bilaterally with particular countries , or make other commercial arrangements (p.87), we believe it is more appropriate to suggest that the Government should continue to work towards creating an international environment in which operators are able to competitively make such arrangements and negotiate the most favourable settlement arrangements for the benefit of consumers. Whilst the traditional international accounting rate system served a useful purpose in a monopoly environment, it needs to be recognised that in today's more liberalised and competitive international telecommunications environment this is already being replaced by commercial arrangements between operators. Given that further effective reforms internationally are most likely to be achieved when Government and industry work together to achieve them, we consider it would be useful to recommend such an approach.

Telstra would like to see Australia's limited resources concentrated on issues where Australian consumers stand to gain the most, Internet arrangements to the US are an example of this, as is continuing the effort aimed at further liberalisation of domestic markets outside Australia. DoCITA, DFAT and industry are playing a productive role in addressing these issues, and this effort needs to continue.

4. Conclusion

Telstra believes that whilst worthwhile reforms have already been achieved, remaining impediments and regulatory barriers to further reducing international telecommunications costs and expanding services in particular overseas markets continue to need to be addressed by the Government, in such fora as the WTO. What is required is further liberalisation of international markets and creation of an environment in which operators can negotiate internationally competitive commercial arrangements.

The Position Paper and its conclusions are focused mostly towards traditional telephony arrangements, probably because these arrangements have been around for a considerable length of time and because there is relatively less information available on Internet directions. It is important to take into account the fact that whilst international telephony traffic is growing rapidly, it is being very rapidly outpaced by Internet and data traffic, driven internationally by e-commerce, multimedia, and other manifestations of the so-called Global Information Infrastructure.

Whilst Telstra is not seeking regulation of the Internet by Governments, we are seeking a fair, equitable and sustainable set of commercial arrangements for international Internet connections, specifically now with US networks. Industry and DoCITA need to continue to work together towards achieving this end.

Telstra has already indicated it believes that in terms of the international environment, Australia has one of the most open and liberal markets for competition in international telecommunication services. It is Telstra's view that a primary focus for future effort in this regard should similarly include continued effort by Industry and DoCITA towards achieving further liberalisation, in those domestic markets offshore which have not yet been reformed.

Finally, and as already indicated, we believe that a general opportunity has been missed in the Position Paper, that is the opportunity to consider whether we actually need as much regulation as currently weighs upon the domestic regulatory environment. This will be even more the case as Internet (Internet Protocol) replaces traditional telephony and its networks, allowing low cost IP technology to further lower cost-barriers to market entry.

(ATTACHMENT 1)

Telstra comments on information provided by C&W Optus to the Productivity Commission's Inquiry into International Telecommunications Market Regulation

These comments addresses a number of incorrect and misleading statements made by Cable & Wireless Optus in its submission to the PC's inquiry into International Telecommunications Market Regulation. Telstra considers it necessary to make these comments to ensure that the focus of the PC's inquiry is not diverted to the commercial interests of individual carriers, but instead addresses the main issues that impact on the reform of the international telecommunications market.

Telstra's main concerns are with Section 4 of the Optus submission "The Impact of Domestic Regulation on the International Market". In this section Optus provides a seriously misleading characterisation of the domestic telecommunications market and a flawed analysis of the impact of domestic interconnect arrangements on international telecommunications services. In particular, Optus makes a number of factually incorrect and misleading statements regarding:

- interconnect arrangements in Australia;
- international interconnect rate comparisons;
- the impact of interconnect charges on international call costs; and
- resale and facilities-based competition.

Each of these issues is addressed separately below.

1 Interconnect arrangements in Australia

At paragraph 4.3 of its submission Optus claims:

> *In delivering an international call, Cable & Wireless Optus is dependent on Telstra's network for originating the call. ……… Cable and Wireless Optus is also dependent on Telstra for terminating incoming international calls, again paying rates well above international best practice for termination.*

This statement is incorrect. As the PC would be well aware, the Australian telecommunications market has been open to facilities-based competition since 1 July 1997. There is no requirement on Optus or any other carrier to use Telstra's network for originating and terminating international calls (or any other call type). Optus is free to establish its own local network wherever it chooses and has in fact done so in many areas. For example, according to Cable & Wireless Optus: Australia's Leading New Entrant, 8 January 1999, p. 38 Optus' HFC network now passes 2.2 million dwelling units and to date Optus has 60,000 local telephony customers and has been increasing this at a rate of 1,000 per week.

Optus' claim is not only incorrect but also inconsistent with later sections of its own submission. For example, at paragraph 4.18 Optus states:

> *If competition is to establish itself with any longevity, facilities based competition is crucial. In a structural sense, ongoing regulation is a pre-condition for resale based competition, whereas facilities based competition promises a properly functioning free market in the medium term.*

In this part of its submission Optus argues that facilities-based, rather than access-based, competition should be encouraged. Optus suggests this should be achieved by charging resellers a higher interconnect rate than network-based competitors such as itself.

Effectively, Optus is suggesting that where it has not established its own network, interconnect charges should be lower and where it does have its own network it should not have to compete with resale competition. While these arguments are consistent with advantaging Optus' commercial position, they are in no way consistent with international telecommunications reform. The duopoly period, which was designed to protect Optus from intense competition, has come to an end. As a result, both Telstra and Optus must now compete with resellers and facilities-based operators for a share of the international calls market. Market share information indicates that since the end of the duopoly, the majority of Telstra's long-distance market share losses have been to new entrants rather than to Optus (see Table 1 below). While Optus would obviously prefer to be the only recipient of Telstra's market share losses, an ongoing duopoly would hardly be consistent with telecommunications reform.

Table 1: Retail national and international long-distance market shares (excl. mobile telephony): 1994– 1998 (per cent)

Company	*1998 (est.)*	*1996*	*1994*
Telstra	55	64	74
Optus	25	24	22
Other service providers	20	12	4

Source: *Paul Budde Communications,* Telecommunications Strategies Report 1998/1999, *www.budde.com.au*

2 International interconnect rate comparisons

While international comparisons of any type are problematic and must be treated with due caution, Optus' international comparison of interconnect rates is entirely misleading. Optus fails to identify a number of key differences in the interconnect rates it presents which make direct comparisons meaningless. For example, Optus chooses comparison countries which have no access deficit contribution included in their interconnect charge, while a substantial proportion of Telstra's interconnect charge is an access deficit contribution[2]. In addition, Optus includes Telstra's inter-CCA charges but fails to identify whether or not such charges are included in the interconnect rates of the comparison countries. Had Optus compared the net interconnect charges (net of the access deficit) as set out in the Ovum report (and as used in the ACCC's draft determination) it would have come to the same conclusion as the ACCC.

The Productivity Commission should also note that the Ovum methodology and its application contain a number of serious problems. Telstra has raised these with the ACCC and has provided a revised international comparison which attempts to account for these errors[3]. The resulting interconnect charges (gross and net), for both terminating and originating services are presented below in Figures 1 and 2.

[2] The access deficit is a direct result of the regulatory price-cap on rental and connection charges.

[3] If this issue is to be considered in detail, Telstra can provide a copy of this analysis to the PC on a confidential basis.

Figure 1: Gross and Net Call Termination Charges (4.5 minute call)

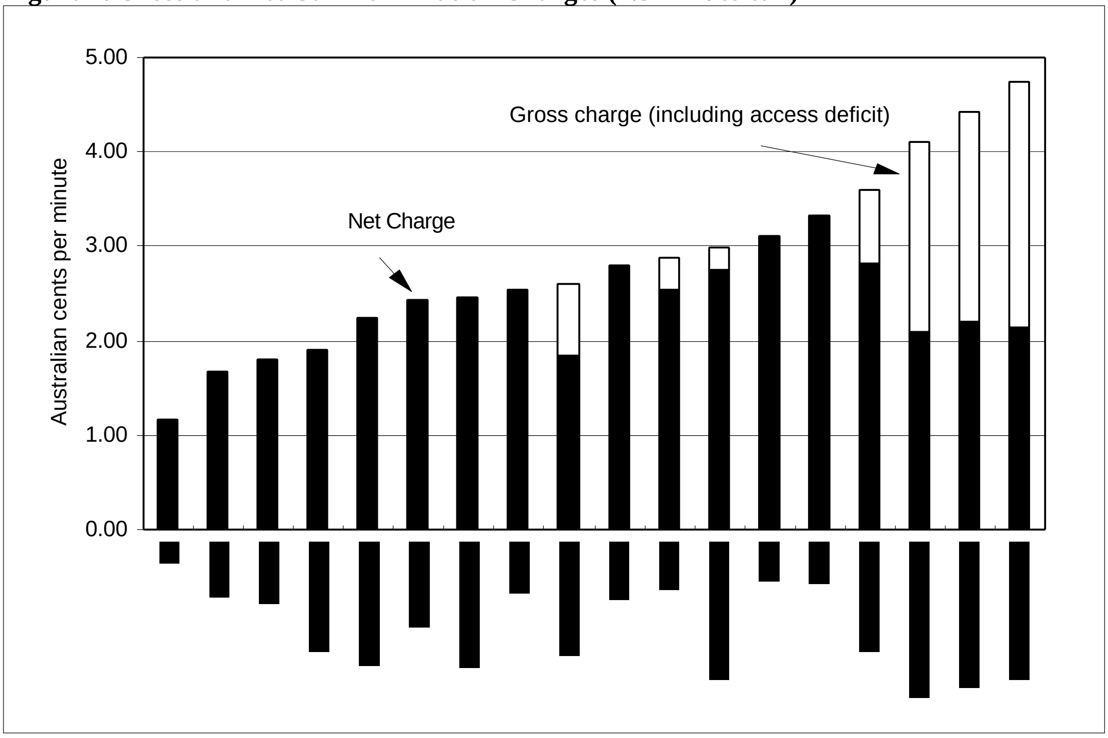
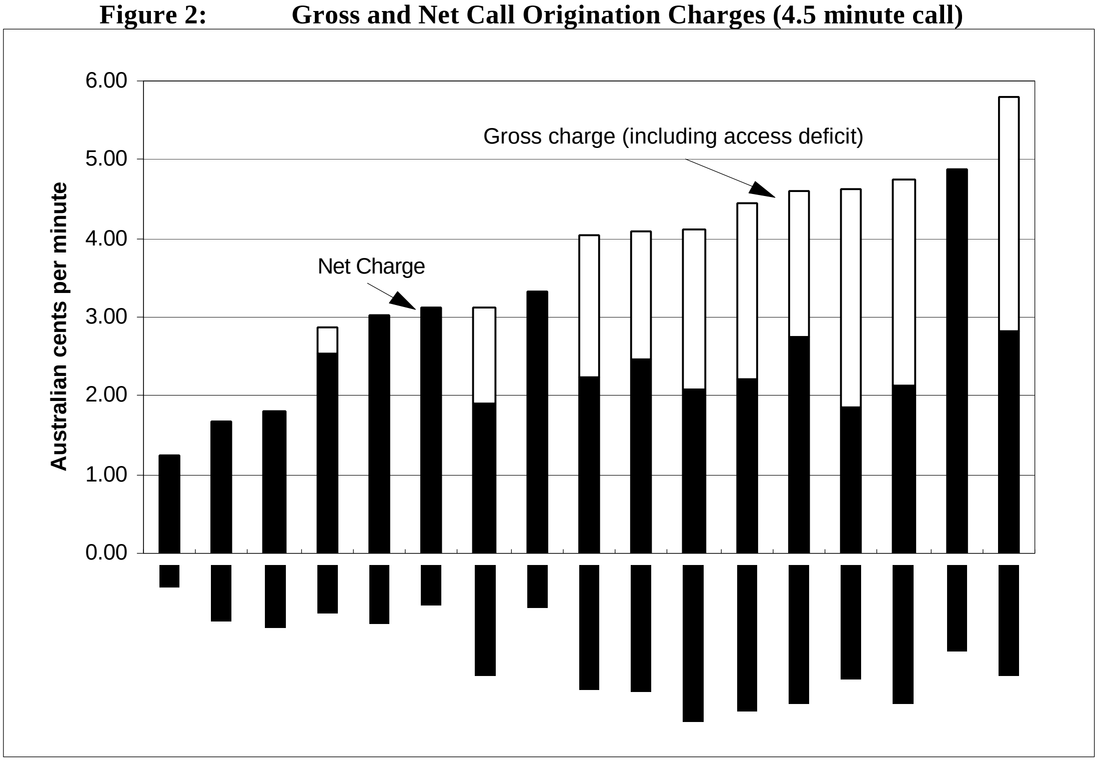


Figure 2: Gross and Net Call Origination Charges (4.5 minute call)



Based on the correctly adjusted interconnect rates, international comparisons suggest that the charges in Telstra's Undertaking are comparable to charges in other countries. The average charges across other countries with cost-based regimes are around 12% higher than those in the Undertaking, whilst the charges across the top five countries are about 5% below those in the Undertaking.

3 The impact of interconnect charges on international calls

Optus' analysis of the impact of interconnection charges on international call prices is incorrect. In paragraph 4.7 Optus claims that interconnection charges make up between 20 and 30 per cent of the costs of providing international calls to the more popular destinations. Optus also claims that a reduction in the interconnection charge to 1 cent per minute would reduce the price of international calls by around 16 per cent. These claims are incorrect and not supported by the information that Optus presents on prices and interconnect charges in its own submission.

In Section 2 of its submission Optus presents Figure 1 showing the price reductions that it has achieved for international calls between 1992 and 1998 on its 10 most popular call destinations (see paragraph 2.3). This figure indicates that in 1998 Optus charged on average $3.20 for a 3 minute duration international call or $1.07 per minute. With the volume discounts it claims are excluded from Figure 1 the price of an Optus originated 3 minute international call in 1998 to its 10 most popular call destinations was on average $2.16 or $0.72 per minute[4].

Even using the interconnect charge of 4.7 cents per minute reported by Optus implies that domestic interconnect charges accounted for between 4.4 and 6.5 per cent of Optus' international call charges in 1998[5]. Unless Optus is charging customers substantially above cost for international calls then it is difficult to see how domestic interconnect charges could account for 20 to 30 per cent of international call costs. For example, for domestic interconnect charges to account for 30 per cent of Optus' international call costs Optus' total international call costs would have to be 15.7 cents per minute – one-fifth of the price Optus claims it was charging for international calls in 1998.

Moreover, as Optus points out in its submission, it has 66 POIs and hence does not need to purchase inter-CCA services from Telstra. In Telstra's Undertaking, the interconnect rate without inter-CCA charges is 3.67 cents per minute, further decreasing the share of Optus' costs accounted for by domestic interconnect charges. In addition, Optus claims to have some 60,000 directly connected customers and hence would not pay for origination or termination interconnect services for these customers. Finally, the PC should note that nearly 80 per cent of all IDD traffic originates in metropolitan areas and consequently the applicable interconnect rate for international calls is well below the headline national average.

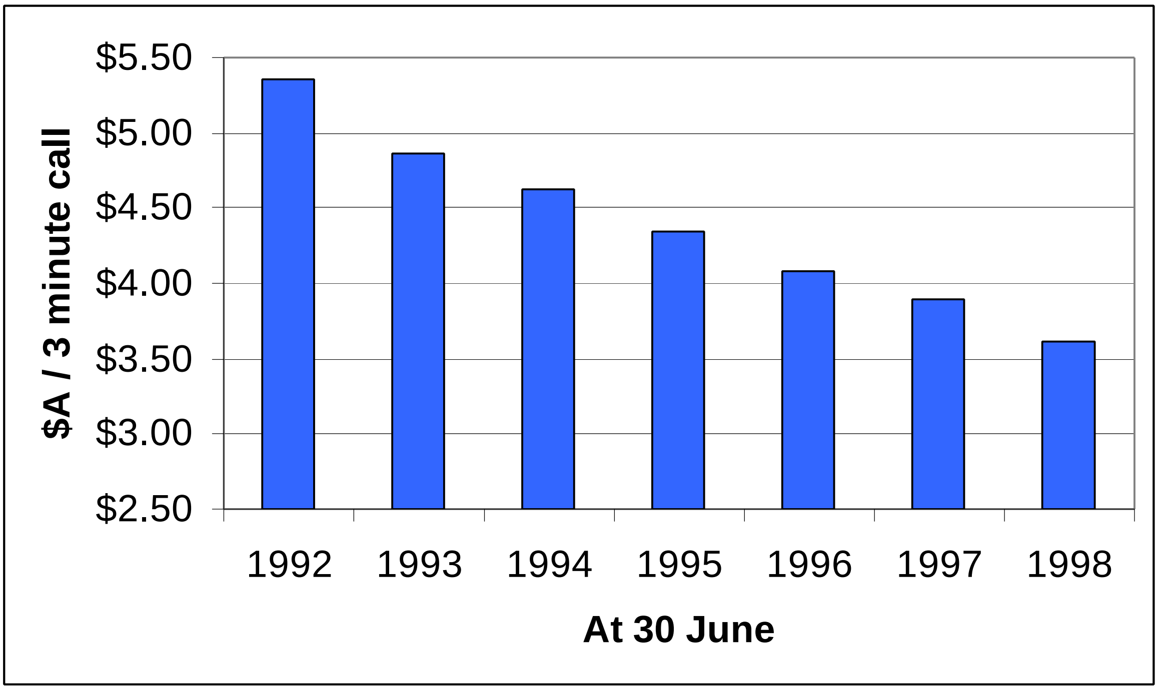
Optus' claim that interconnect rates are excessive is also inconsistent with the large price reductions that it reports have been achieved for IDD calls. Telstra agrees that international services are now intensely competitive, with the result that both Telstra and Optus have made steep reductions in charges. As can be seen from Figure 3 below, Telstra's price reductions for international calls to all destinations have fallen rapidly since 1992. Including discounts, even greater price reductions have been achieved. For example, Telstra's recently introduced IDD rate reductions have provided customers with a further 35 per cent saving on international call charges. On individual destinations the reductions are as much as 55 per cent less than previous rates. In addition, Telstra has reduced its Easy Half Hour rates by up to 40 per cent on individual routes. The strong competition and large price reductions experienced for international calls is hardly an outcome consistent with excessive interconnect charges.

---

4 Optus revenue and traffic information reported in Australasia's Telecom Review, 15 January 1999, p39 indicates that Optus' revenue per minute on all international calls in 1998 was $0.89.

5 When an international call originates on Telstra's network, an access seeker only pays originating interconnect charges.

Figure 3: Telstra's international call charges, 1992 to 1998
Source: ACCC 1998, Telecommunications Charges in Australia, ACCC, Melbourne



Optus' calculation of the price reduction possible from a reduced interconnect charge is also incorrect. Based on the price information presented by Optus, a reduction in the interconnect charge from 4.7 cents per minute to 1 cent per minute would at most – assuming that a reduction in the interconnect charge would be fully passed on to customers – reduce international call prices by 3 to 5 per cent. More importantly, Optus fails to examine the consequences on Australia's domestic telecommunications network of the interconnect charge reduction it proposes. Not only is Optus' suggestion inconsistent with competitive neutrality, but would discourage further investment in telecommunications infrastructure by both Telstra and new entrants.

4 The impact of resale and facilities-based competition

In the final part of its submission Optus claims that an entrant such as One.Tel, with only one POI, is charged about the same interconnect rate as Optus. This is incorrect. Optus has 66 POIs which means that it can carry its own traffic between CCAs, thereby avoiding an inter-CCA charge. In Telstra's Undertaking, the interconnect charge excluding inter-CCA transmission was 3.67 cents per minute. If an access seeker makes a commercial decision not to place a POI in every CCA then it will incur some inter-CCA charges to carry traffic between CCA's. In Telstra's Undertaking, the proposed interconnect charge including inter-CCA charges was 4.7 cents per minute. However, it is important to note that Telstra is not the only carrier that provides inter-CCA transmission services, Optus itself has the facilities in place to provide this service both to itself and access seekers.

Therefore, it should be clear that Telstra does not charge One.Tel the same interconnect charge as Optus, but a higher charge reflecting the costs of inter-CCA transmission (a service also provided by Optus).

Finally, Optus claims that its services should not be subject to regulation because it undermines the incentive to invest. Based on the arguments Optus puts forward earlier in its submission on the appropriate cost of interconnection, it is difficult to see why this would be the case. If, as Optus claims, Telstra's interconnection charge of 4.7 cents per minute was four times world's best practice, then this would encourage new investment not only to bypass Telstra's network for the provision of end-user services, but also to offer wholesale services at lower rates. If Optus believes that the ACCC's draft decision on Telstra's Undertaking is still substantially above cost, then surely it would be happy to have the same regulated charge applied to its own network. Regulation of Telstra and new entrants will only discourage efficient investment if the regulated access price is set too low.

▪