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NEW ZEALAND
BusinessROUNDTABLE
PROMOTING POLICIES FOR A BETTER NEW ZEALAND

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Dear Ralph

Public Consultation on the TCF TSO Report

Thank you for calling on me on 17 March to explain the Telecommunications Carriers' Forum initiative on the Telecommunications Service Obligation and for inviting comments on the report you subsequently sent me.

The Business Roundtable has had reservations about the TSO from the outset and agrees it is now outdated. It fails most, if not all, tests of good public policy. It is hugely distortionary and gives rise to unnecessary and wasteful disputation.

We have been keen to see telecommunications carriers examine in depth options for moving away from current arrangements. The TCF report is a very welcome initiative and we are impressed by the depth in which it has considered the issues.

We endorse the broad directions of the report and have no particular views to express on the options canvassed – save that the amended status quo option appears to simply perpetuate the current TSO model and its costs. We favour an end-point which is as far-reaching as possible.

With that end-point in mind, it might be useful to offer some more fundamental reflections on two key issues, namely universal service and free local calling.

It is not clear to us that there is a strong case for mandating any form of universal service. There are no comparable mandates for many other goods and services (eg electricity and transport) that are delivered to remote consumers. The cross-subsidies that arise result in a misallocation of resources at the margin and reduce the economy's growth potential. They may also be inequitable in many cases, with less well-off customers subsidising better-off ones. If the TSO were removed, we have little doubt that telecommunications carriers using a variety of technologies, such as copper, cellular, cable, wireless and satellite, would find ways of serving a large number of the beneficiaries of the TSO without subsidy. Telecom would not lightly shed customers, and would be under public pressure to maintain widespread services. We understand that already some 70 percent of so-called commercially non-viable customers are covered by cellular networks. Arguably those who might not be commercially viable should meet the full costs of the services they use.

If this argument is not favoured, the presumption must be that there is a case for maintaining cross-subsidies on social grounds. In this event logic suggests that the costs should be met by taxpayers on behalf of the community at large, not other carriers or users of telecommunications services. It is ironic that the government imposes a specific tax on what it deems to be an underperforming sector of the economy in order to meet social objectives.

The costs of such taxpayer subsidies would not be large. Currently we understand the estimated cost of the TSO is around $60-70 million. This is significant for some carriers but not in the context of the government's overall budget which is running at around $55 billion annually. Such a move would make what are currently hidden costs transparent and provide a basis for ongoing debate, in the context of parliamentary appropriations, as to whether such expenditures are justified on social grounds. This is as it should be. It would also remove the necessity of ongoing administration of the TSO which we understand involves a cost to the Commerce Commission and carriers in the region of $1-2 million annually. This is pure waste from an economic point of view.

We note that the TCF has not devoted the same level of attention in its report to the free local calling mandate (and the current price cap on monthly line rentals). We think it should do so. Free local calling has become increasingly archaic with the development of technologies that do not involve local calling areas (eg mobile and VoIP) and with the emergence of services other than voice, such as internet. Few other countries, including Australia, have our regime. It again involves cross-subsidies, as heavy users (for example of the internet) require carriers to install greater capacity than would otherwise be the case and spread the costs over other users. This too is inefficient and inequitable.

Free local calling also has an effect on other economic objectives such as broadband growth. An OECD study suggests that the impact of free local calling on internet dial-up pricing has resulted in a reduction in broadband uptake[1].

In addition we would draw attention to an important connection between the TSO and free local calling which suggests that the objectives of TSO reform cannot be fully met without addressing the latter issue. If wider access ("social inclusion at lowest cost") is the pre-eminent concern, then free local calling directly contravenes this objective. Under free local calling, those valuing calling most (ie those who make the most calls) are heavily subsidised by those valuing calling least (ie those who make the fewest calls). Free local calling encourages the high valuers to substantially over-consume, pushing up the total cost of service for all users, but predominantly at the expense of those valuing calling least (and hence the most likely not to purchase a connection if the price rises). This substantially undermines both the numbers of connections sold, the business case for serving a region, and the achievement of the social objective. Most regimes promote wider connectivity by using calls to subsidise connections, not vice-versa. To induce competitive entry, and to allow the operator to recover costs, it is logical to allow a regime where call revenue can be used to recover fixed costs. This is precisely the reason why prepaid mobile phones (zero monthly charge, higher-priced calls) have diffused widely and quickly – low call makers still have one, increasing network effects and connectivity, but make calls only when the benefit exceeds the cost. As over 60 percent of New Zealand mobiles are prepaid, it is reasonable to speculate that a regime requiring 'free mobile calling' and mandatory monthly fees would have virtually killed the New Zealand mobile market. Maintaining the free local calling regime for a fixed line operator suppresses the development of the fixed market and distorts competition between the two forms of connectivity.

1 OECD http://www.oecd.org/dataoecd/34/34/39360525.pdf, footnote 18 on page 30.

For these reasons we suggest that the TCF should do a comparable exercise of exploring options of moving away from universal free local calling. It may well be that some carriers would be willing to offer free local calling, perhaps subject to a limit on calls, as one package among a range of others. An assurance of this sort might ease political concerns. The analysis would also focus on different services (voice, fax, internet etc) and the case, if any, for a mandate on each of them separately. In any event we see no reason why a user pays approach, which would stimulate innovation to serve customers at least cost and level the playing field for other services such as mobile, should not apply in this area.

We also raise for consideration other aspects of the original 'Kiwi share' that gave rise to the TSO which are not covered in the report. An example is the foreign ownership restriction on Telecom. We are not clear that this is justified and it may be imposing economic costs.

The TCF may regard more fundamental reforms than are canvassed in its report as politically infeasible. We would caution against such an assumption. Few people would have regarded the general deregulation of the telecommunications market in the late 1980s as politically feasible only a few years before it occurred. Political attitudes can change as governments change, and they are influenced by sound public-interest arguments. We would like to think that, as a body which is exceptionally well-informed on these issues, the TCF would accept a responsibility to advise governments and the community on the first-best policies to adopt in this area. New Zealand won't achieve wider goals such as faster increases in living standards without high quality policies. Indentifying them is in no way inconsistent with canvassing other transitional and pragmatic options of the kind that are well analysed in the report and leaving policy makers to decide between them.

Yours sincerely

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