

CALCULATION OF ACCESS DEFICIT

– GUIDING PRINCIPLES & KEY CONCERNS

INTRODUCTION

- It is only right that TRAI attempts to create an environment in which the benefits of growth and cheaper prices are not limited to the affluent consumer segment, but filter down to all consumers. . COAI , would, however, like to express its concern on whether the approach to Access Deficit adopted by the Authority is based on sound regulatory principles or international best practices. As will come clear later in this document, TRAI may have inadvertently overlooked several extremely pertinent questions in its review of the IUC regime and its computation of Access Deficit

To put our point in perspective, we quote at the outset from an ITU briefing paper¹ that says,

“in principle a surcharge on interconnection pricing is by no means the only way to make good the incumbent PTO’s “social” deficit, and in principle by no means the best way. However, for practical institutional reasons, it is the way used in most countries where competition in the provision of basic telephone service has been introduced. Notwithstanding this, however, there are many choices to be made in devising a regulatory policy that not only provides the incumbent PTO with the right amount of “deficit” funding (it is far from obvious that the incumbent’s own methodology for estimating the deficit should always be credited), but also causes this revenue to be collected in the best way, which means (inter alia) the way that least distorts market signals and incentives away from those that will motivate economically efficient behavior by both the entrant and incumbent.”

- COAI strongly believes that the Authority’s approach to ADC is simplistic and overlooks many aspects that would make it a sound framework to ensure universal and affordable access for the low revenue generating subscribers to the network.
- **COAI appeals to TRAI to undertake a more thorough consultation and analysis to establish the scope and magnitude of Access Deficit in India.** This will enable the Authority to set the telecom sector on to a path in economic regulation that is, sound,

¹ ITU Regulatory Colloquium No. 4, Geneva, Switzerland – 19-21 April 1995

The Changing Role of Government in an Era of Telecom Deregulation

Interconnection: Regulatory Issues, Briefing Report No. 4, June 1995

practical, fair to all concerned, and avoids the several anomalies that are evident in the current interconnection framework. This is critical for growth of fair competition in India and for such competition to deliver quality service and lower prices. Failing to do so will encourage anti competitive practices, especially by dominant and vertically integrated operators.

NEED FOR ADC

- It is widely believed that many subscribers' monthly bills are less than it costs operators to serve them. This shortfall is often called the Access Deficit. A regulated incumbent, prevented from charging cost based tariffs, could justifiably ask for some compensation for meeting this social obligation. However there are various views on how this compensation can be provided, who should pay it and how much should the payment be.

It is worth quoting, again from the previously quoted ITU briefing report on interconnection:

“Typically but not necessarily², an incumbent incurs an access deficit because the government or regulatory authority prevents it from raising the prices that it charges end-users for access service and /or local call service to the level which would enable it to cover the full economic cost of providing those services. Governments or regulatory authorities in some countries insist on keeping access and/or local-call prices below costs (or, in the common term of art, prevent full “rebalancing” of the incumbent’s tariffs) in order to make access service and local service available to people who would not take it at any higher price. This widening of the corps of end-users is held to be desirable chiefly on two grounds. It obviously benefits the subscribers who would otherwise deny themselves telephone service, and in addition it benefits many existing subscribers by increasing the number of subscribers whom they can call or be called by”

- The problem of Access Deficit in India has also been exacerbated due to competition in national long distance (NLD), which has more than halved the rates for most STD calls. The revenues from NLD have historically been used to make up the shortfall in the access business. This has also been the model that has, till recently been followed by India. However, with the sharp fall in STD revenues, there is a need to address issue in a more transparent fashion – through tariff rebalancing (increase in charges for local access) and the balance, if necessary, through an Access Deficit Charge. (ADC) .
- ADC is essentially a subsidy for carrying out for a socially important service of universal access. To some extent, therefore, the ADC replicates the responsibilities that are assigned to the USO fund towards which all service providers contribute 5% of their

² Although the access deficits of incumbents, if intentional rather than accidental, arise always, as far as we know, from the intentions of governments or regulators, an incumbent might quite deliberately incur an access deficit as a way of enhancing the profitability of its business as a whole. It might set an access price lower than the fully distributed cost, in the expectation that the resulting increase in call traffic would raise its overall profitability. This expectation could be realised if the incumbent earned supra-normal profit on call services and/or enjoyed unexhausted economies of scale on call services.

Adjusted Gross Revenues In telecom, as in utilities like power or gas, it is important today to target subsidies carefully so that consumers who can afford to pay do not abuse the subsidy.

- ADC charges cannot be separated from the overall approach to Universal Service since both these mechanism are intended to help the provision of basic telecom services to those who can not afford to pay fully for the service.

COAI'S VIEW ON ADC

- a. There is agreement amongst most regulators that the Access Deficit payments must reflect the actual or **“net cost”** of serving low revenue or high cost, customers. We believe that determination of Access Deficit cannot be based on simple calculations of below cost phone rentals or mandatory free calls alone as TRAI has done. There are several other sources of revenue available especially to incumbents that can and do reduce this burden considerably. The Authority must therefore follow a holistic approach and follow a “net cost” approach as has been done in the case of the USO Fund.
- b. In our view, ADC charges computed by the Authority vastly exaggerate the losses incurred by BSNL in providing access. Our calculations, shown in the table enclosed as Annexure-1) demonstrate that.
- c. COAI believes that the IUC consultation documents issued by the Authority on 15th May has adopted an over-simplistic and somewhat inconsistent approach to calculate the Access Deficit. Such an approach seemingly designed to help BSNL recover some of its losses from low revenue subscribers will not help the said subscribers and will instead hurt BSNL's competitors by asking the latter to pay additional amounts for perfectly profitable and often hugely lucrative services
- d. The Access Deficit approach of TRAI treats all 40 million lines as similar and goes on to treat phone rental charges as the only indicator, besides the minimal free calls, of whether the costs of any service provided to subscribers are recovered by the operator. This is clearly flawed. The Authority must consider the age of the BSNL lines / assets and accordingly determine the extent of deficit.
- e. To calculate any deficit created for BSNL due to price controls, it is necessary to consider all costs and revenues from its services that involve access to the phone. This would include access part of long distance as well as call termination. Only if BSNL incurs losses after these have been taken into account, that one can justify an “access deficit” payment. The fact that a particular component i.e. monthly rentals, is provided below cost does not entitle an operator to seek an Access Deficit payment, in any form including through IUC charges.
- f. Further, it is not obvious that all losses incurred by an incumbent should be reimbursed to the full. To assume that only price controls are responsible for its losses in access is unrealistic. The incumbent enjoys considerable market power, has flexibility in other pricing and would be expected by regulators to recover at least some of these costs by other means.

- g. There is no shortage of literature on pricing which shows how entry price of a service may be designed to be low with an eye on future profits. For example if the call charges of BSNL are in fact are *much* higher than costs then it would make eminent sense to charge less for entry. Similarly it would make perfect sense to have low rentals to provide incentives to come on to the network since even if the low rental subscriber pays little to the operator, calls made to the subscriber from elsewhere generate significant revenues from the originator of calls. Therefore, it is patently simplistic to use the shortfall in rentals as the only measure of Access Deficit.
- h. There is an implicit assumption that the lost revenues from the 30 or so free calls represents a loss just because call charges amounting to about Rs 36 are not recovered. Firstly, losses on this score are misleading since there is virtually no marginal cost incurred when an existing network is used to make calls. Secondly, there is enough evidence that for various reasons including poor maintenance and service interruptions the rural users hardly ever get to use the phone or use up the free calls. So to use the notional price of the 30 calls as an obvious measure of losses incurred is misleading.
- i. The Authority has not taken into account the fact that even though BSNL is still dominant in the market place it has received major concessions from the government, which have been justified frequently on grounds of social obligation. Even if the recovery of its losses from these sources is incomplete, it cannot be argued that these explicit financial concessions should be excluded from Access Deficit calculation.
- j. Regulators carry out rate re-balancing to enable incumbents to reduce or eliminate losses in provision of local access. As a part of this exercise in India, BSNL too has been allowed by TRAI to raise its rentals to bring them closer to costs. In spite of this, it has consistently failed to implement the high tariffs allowed to it so as to bridge the gap between its costs and revenues . This is true even for its commercial subscribers. A substantial part of Access Deficit would vanish if BSNL charged its commercial subscribers appropriately. We respectfully submit that BSNL's need to follow political compulsions tariff setting cannot be an excuse to punish the competitors of BSNL and ask them to fund BSNL's low tariff regime.
- k. It is significant that unlike other incumbents elsewhere it is not BSNL that has approached TRAI for permission to raise local access prices. In fact, unlike its counterparts virtually everywhere else, it is resisting raising the price of local access. This would be extremely laudable were this not accompanied with pleas for reimbursement of access deficit from competitors.
- l. In view of BSNL's unwillingness to price its services appropriately, it can only be assumed that the pricing approach of BSNL is more a commercially and politically convenient approach and less one that is designed to protect rural, remote or similar users from high prices. It enables BSNL to demand huge licence fee waivers. It also allows it to recover the some possible losses not from its more profitable customers as it should and, in turn, fund these costs from competing operators. In the process TRAI 's IUC rates allow BSNL to remain competitive by keeping its prices down and raising the cost of its competitors by imposing an Access Deficit Charge on them. This is the precisely the kind of market distortion most economic regulators would seek to prevent in their treatment of Access Deficit.

- m. The Authority has also omitted to take account of another reason for the its high figure of Access Deficit in the country. A significant part of BSNL's revenues have been used to provide expensive rural and other similar loss making phones which private basic operators in India were mandated to do and have not done. BSNL's costs on this account can only fairly be passed on to private BSOs who were legally obliged to provide the services in question. These cannot be recovered from Access Deficit payments implicit in interconnection pricing.
- n. Unlike in other countries, eg UK, Australia etc, there is no single operator with an obligation to provide universal access in India. Universal Service Obligation has not been passed on to BSNL or private BSOs. In fact the new licences for BSOS have removed even earlier obligations in respect of DELs and VPTs. In this context the obligation for other operators such as CMSOs to pay ADCs is difficult to understand since they do not receive any subsidies from any source.
- o. It is worth mentioning that the licensor/government has also failed to enforce the BSO licences in spite of serious defaults. The decision to introduce competition in NLD that resulted in reduced surpluses for local access was also taken by the licensor. Consequently, the Access Deficit should not be passed on to CMSOs who have met with all obligations of their licences can not be expected to take the brunt of those decisions.
- p. There is also an important point to be made about costs used by the Authority in the Consultation Paper. TRAI has chosen to work with incumbent's own data. Elsewhere, regulators frequently treat such data with justified scepticism. With widespread concern about the quality of BSNL's accounts, as it was till recently a government department, the need to carry out a more careful and transparent costing exercise cannot be underestimated.
- q. There is no structural separation of BSNL and MTNL into legal companies on circle and service basis as is the case with their competitors. In the absence of this, accounts of these two companies are of limited value to the Regulator trying to establish a fair competitive regime.
- r. All the factors raised above would significantly reduce the magnitude of Access Deficit that is sought to be funded by competing service providers.. These are essentially cellular mobile operators, who are already facing massive anti-competitive practices from the incumbent. Its free entry into cellularservices gives it an advantage estimated to be worth a billion dollars. Its national licence, its monopolistic control over vital bottleneck facilities, its existing infrastructure and large work force, still receiving government perks, confer major advantages in the market place. This is well borne out by the fact that BSNL has already grown to be the second largest mobile operator in the country, against all trends.

WHAT ADC CAN FUND AND WHAT IT CANNOT

- ADC can be used to fund the net costs of only those services that an operator is constrained to provide at a loss because of price controls imposed by regulators.
- ADC can not be used to fund

- Inefficiencies of BSOs
 - Below cost pricing on competing services (long distance / Cellular)
 - High return on investments for fixed investments (safeguard their ROI)
- ADC cannot be used as a commercial option but only a means of last resort. If the incumbent refuses to carry out existing regulatory options, it has little justification in seeking inputs to Access Deficit from competitors.
 - As mentioned above, it is patently illogical that an operator making significant revenues from large users, claims an Access Deficit because its rentals are supposedly below 'cost'. This is even more untenable if the choice to raise these rentals is available to the incumbent. In such a case, not only is this Access Deficit payment not justified but the practice of the incumbent to under-price its rentals to some users, a veritable anti-competitive practice.

QUESTIONS THAT NEED TO BE INCLUDED IN VIEW OF THE ABOVE FOR A COMPREHENSIVE CONSULTATION ON THE SUBJECT OF ADC.

- (a) To what extent is it justified to concentrate only on monthly rentals and free calls to determine the Access Deficit?
- (b) What is the estimate of revenues on calls made to low revenue subscribers?
- (c) Should other services, for which access to telephones is a part, be included in the calculation of "Access Deficit"?
- (d) Should Access Deficit payments be linked to incumbent willingness to undertake rate rebalancing?
- (e) Have options to recover losses in rentals from prices charged from profitable subscribers been exhausted?
- (f) To what extent do the net losses from rural or remote subscribers reflect inefficiencies?
- (g) How can ADCs be integrated into a unified USO framework?
- (h) Some of the subsidies and remedies available to BSNL include
 - BSNL's entry fees were completely waived
 - Licence and spectrum fees were being waived or refunded till very recently.
 - Loans in perpetuity from government
 - BSNL revenues are significantly augmented by its having a national licence which enables it to do under 1 licence what a competitor needs about 45 licences to do.
 - Payments likely to come to BSNL from Universal Service Fund.

- (i) What is the contribution of subsidies and remedies available to BSNL in reducing the Access Deficit?
- (j) How is the computation of access deficit impacted by BSNL accounting system which does not separate service wise accounts?
- (k) Is structural separation of BSNL into a circle wise, service wise set of companies important for effective implementation of Access Deficit regime?
- (l) What is the contribution to the Access Deficit of unmet obligations of basic service providers that have been taken up by incumbent?
- (m) If the main cause, apart from the supposedly low cost rental, is the massive decline in NLD revenue, then does the regulator need to respond in the area of NLD tariffs, rather than imposing ADCs on customers of a completely different service, which in no way has caused or increased the need for ADCs?

Table I

BSNL's financial status & Analysis of Access Deficit during financial year 2001-02

(All figures in Crores)

i)	Total income from Services	24,000
ii)	Income from rental & local call charges @ 50% of (i)	12,000 (assumption)
iii)	Income from NLD & ILD Services @ 50% (i)	12,000 (assumption)
iv)	Operating cost of NLD/ILD Services @ 15% of (iii)	1,800
v)	Profit before Tax	6,852
vi)	Access Deficit due to local access (iii)-(iv)-(v)	3,348
vii)	Average No. of DELs during the year	3.5
viii)	Access Deficit/DEL	Rs. 957 per year Rs. 80 per month
ix)	Increase in rentals per month allowed in TTO-99 (24 th amendment)	Rs. 30 per month
x)	Increase due to reduced free calls	Rs. 40 per month
xi)	Increase due to local calls duration being reduced from 3 min. to 2 min.	Rs. 20 per month (assumption)
xii)	Net Access Deficit after TTO 24th amendment	(-) 10