For discussion
on 7 November 2002

Legislative Council
Panel on Information Technology and Broadcasting

Increase of Access Charge for Calls to Mainland China

Background

Based on a notice issued by the Ministry of Information Industry (MII) of China, China Telecom on 28 October 2002 notified the external carriers in Hong Kong that the termination rate (or sometimes referred to as the "access charge") for incoming telephone traffic from all countries and regions into Mainland China will be increased to not less than US$0.17 per minute, effective from 1 November 2002.

2. Upon receipt of this notification, external carriers in Hong Kong have sought clarifications from China Telecom on the terms and conditions under their interconnection agreements for traffic between Hong Kong and Mainland and announced a series of consumer price increases to be effective from 1 November 2002 to cover the increase in costs for terminating traffic in Mainland. However, on 4 November 2002, upon further clarifications with China Telecom, the external carriers announced that the impact of the increase of the termination rate should not be as significant as originally expected and therefore they announced cancellation or impending revision to the price increases they announced earlier.

3. This paper explains to Members the arrangement of access charge and the possible impact on Hong Kong.

Termination Rate (Access Charge)

4. Telephone services between two different countries or regions are provided through the collaboration of the international or external carriers of both countries or regions. When a call is made from one country/region to the

other, the originating carrier in the country/region where the call is made has to pay a termination (or access) charge to the carrier in the country/region receiving the call for terminating the traffic. The termination charge is calculated on a per minute basis (termination rate). This arrangement applies on a reciprocal basis, but the termination rates in both directions are not necessarily the same. Different termination rates may also apply to traffic below or above certain threshold of traffic volume.

5. The arrangement described in the preceding paragraph applies also to the external telephone service between Hong Kong and Mainland. As an external carrier pays termination charges to its counterpart for termination of outgoing traffic from Hong Kong to the Mainland and receives termination charges from its Mainland counterpart for the termination of incoming traffic in Hong Kong, the net cost for delivering outgoing traffic to the Mainland is not necessarily equal to the termination rate in the Mainland. The net payment depends on the balance of outgoing and incoming traffic, and the difference, if any, between termination rates for traffic into Mainland and into Hong Kong. In other words, if the traffic volume and termination rates are equal in both directions, there is no payment between the carriers in Hong Kong and Mainland. If the Hong Kong external carrier generates more outgoing traffic than the carrier in Mainland, the operator in Hong Kong will be liable to a payment which equals to the difference of incoming and outgoing traffic multiplied by the termination rate. Accordingly, the termination rate (access charge) affects the costs of the Hong Kong external carrier in providing external telecommunications services from Hong Kong to Mainland.

6. However it should be noted that agreements between carriers for cross-border communications also contain many other terms that would complicate the payment arrangement described in the preceding paragraph. Firstly, the agreement may contain committed volume of traffic which either party has committed to send to the other party and for which the sending party has committed to paying the termination charge. Secondly, the agreement may contain arrangement for the handling of traffic to and from third country or region and the revenue and cost for such handling would be taken into account in the net payment between the parties under the agreement. Thirdly, the agreement may include arrangement for provision of dedicated circuits between the two countries or regions. Fourthly, the agreement could cover the charges for the handling of different types of calls (e.g. toll-free calls, Home

direct calls, etc.). All these other terms in the agreement will affect the cost base of an operator. The termination rate for telephone traffic is only one of the factors affecting the overall cost.

7. The termination rates and other related terms are part of the commercial interconnection agreements between the external or international carriers in the two countries/regions. In Hong Kong, the external carriers negotiate interconnection agreements with their counterparts in other countries and regions and do not have to seek approval from, or notify, the Telecommunications Authority (TA) of the negotiated terms. The TA is normally not involved in the terms of these interconnection agreements for external or international telecommunications services unless the terms are inconsistent with the local regulatory framework or international treaties or agreements.

Volume of Traffic from Hong Kong to Mainland China

8. From January 2002 to September 2002, outgoing external traffic from Hong Kong to Mainland amounted to 1.61 billion minutes, representing 52% of the total outgoing external traffic. Incoming external traffic from Mainland to Hong Kong amounted to 700 million minutes, representing 51% of the total incoming external traffic. It can be noted that over the nine months, the net IDD traffic in the direction of Hong Kong to Mainland was 910 million minutes.

9. As there is an imbalance of traffic volume in the two directions, any increase in the termination rate in Mainland would be expected to increase the cost of providing external telephone services in Hong Kong. However, the impact of the increase would be dependent on a number of factors including the traffic balance of individual operators, the committed traffic levels, etc. (see factors listed in paragraph 6 above). *The increase in cost is therefore not directly equal to the increase in the termination rate in Mainland.* In most cases, the increase in cost to the operator is likely to be less than the increase in the termination rate. Each operator should take its own independent commercial decision on whether it is prepared to absorb the additional cost, if any, or to increase the prices of its services, based on the market conditions and its own costs. It should be noted that the traffic flow pattern is dependent on the charges of the IDD service on the two ends of the circuit. If the IDD

charges to the consumers increase at one end it is likely to reduce the use of IDD services and traffic outflow from that end. Market forces may also drive demand to other forms of communications, e.g., IP phones and leased circuits. This will to some extent reduce the traffic imbalance thereby reducing the net cost of settlement.

Regulation of IDD Tariffs in Hong Kong

10. The external facilities and services markets in Hong Kong have been fully liberalized and are very competitive. The TA does not regulate the prices for external services, both at the wholesale or retail levels. He believes that the prices should be determined by market forces and effective competition in the market would adequately protect consumer interests. However, the TA keeps a watchful eye to ensure that the market is working satisfactorily. In this regard, the TA will closely monitor market developments to ensure that there is fair competition in the wholesale and retail markets, that operators do not mislead consumers into believing that the increase in terminating charges necessarily brings about the same magnitude of increase in retail prices, and that all charges should be set out in a clear and transparent manner for consumers to make their best choices.

Follow up

11. Given the possible impact on consumers of the increase in termination rate, OFTA has approached the MII and expressed its concern on the matter. OFTA expects operators in Hong Kong will continue to negotiate with their counterparts in Mainland China and lower their prices when their costs are lowered. In any case, OFTA expects that effective competition will prevent excessive prices in the market. OFTA will monitor the progress of these business negotiations. OFTA will consider intervention only if it can be established that the terms in the interconnection agreements for the delivery of external traffic are inconsistent with the local regulatory framework or international treaties and agreements.

Office of the Telecommunications Authority
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