

FINANCIAL RISK OF PROVIDING THE UNIVERSAL TELECOMMUNICATIONS SERVICE IN LATVIA

Irina Klevecka¹, Janis Lelis²

*¹Riga Technical University, Institute of Telecommunications
12 Azenes Str., Riga, LV-1048, Latvia
Ph.: (+371) 6006970, e-mail: klevecka@iseco.lv*

*²Telecommunication Association of Latvia
1 Akademijas Laukums, office 702, Riga, LV-1050, Latvia
Ph.: (+371) 9556340, e-mail: jlelis@com.latnet.lv*

1. INTRODUCTION

In accordance with the requirements of the European Union, the Latvian government is obliged to establish the Universal telecommunications service – a minimum set of services of a definite quality which will be available to all users at an affordable price, irrespectively to their geographical location.

Under the conditions of a liberalized market an operator would not offer its services in the territory of economically risky regions or to unprofitable customers, if it did not have the corresponding obligations to do so, because provision of these services would produce incommensurably large costs. In this case, the task of the Latvian government is to find ways how to compensate the additional expenses of the Universal service provider.

International experience shows that there are several sources of compensation of the costs of Universal service obligations, one of them being the state budget. In Latvia the net costs¹ of the operator, which provides the Universal service under the corresponding obligations, are expected to be rather high. It means that if a Universal service provider covered all its expenses by itself, its competitive ability would decrease dramatically. On the other hand, implementation of a financial scheme in line with the Universal service obligations is hindered by the inability to evaluate the operator's costs that are caused by the provision of telecommunication services to everyone who demands it for a reasonable price.

2. MINIMUM SET OF THE UNIVERSAL SERVICE OBLIGATIONS

The main aim of the EU Universal service policy and legislation in telecommunications sector is to ensure that a defined set of services is available to all residents of a country, independently of their location and at an affordable price, especially considering the interests of disabled users and users with special needs.

The Universal Service Directive [1] contains rules and principles designed to protect the interests of consumers under the conditions of a liberalized market of telecommunications services. The main obligation of the Universal service remains the provision on request of a connection to the public telephone network at a fixed location and access to publicly available telephone services, in the whole territory of the European Union.

In accordance with the requirements of the EU, a minimum set of services, which must be ensured to every resident of a country independently of his/her geographical location, includes the following:

- ◆ Provision of connection at a fixed location to the public telephone network and access to publicly available services of local, national and international voice telephony;

¹ Net costs are defined approximately as the difference between the operational results of the Universal service provider (revenues and costs) that would be obtained with and without the Universal service obligations.

- ◆ Data transfer services at a speed that is sufficient to permit functional Internet access, taking into account prevailing technologies used by the majority of subscribers and technological feasibility;
- ◆ Directory enquiry services and directories;
- ◆ Access to the public pay phones;
- ◆ Special measures for disabled users;
- ◆ Specific facilities and services, which allow subscribers to monitor and control expenditure and avoid unwarranted disconnection of service [1].

The obligations, which are put on the Latvian incumbent operator *SIA Lattelekom* in 2004 [2], do not contain the requirement to support an access to Internet and specific services, which enable subscribers to control their expenses. Besides, the operator does not have to decrease the deficit of access to the services of public voice telephony. It means that if the establishment of a new telephone line leads to high operator’s costs, it has a right to refuse service provision to a potential customer.

Although, in general terms, the Universal service seems to be provided in all highly developed Member States of the EU, there are still some areas of concern. Mainly it refers to the implementation of specific measures for disabled users and users with special social needs, and the provision of directory services and directory enquiry services covering all subscribers. In one Member State, the draft law does not contain the principle to make the universal service available in the whole of the national territory. In another Member State the draft legislation does not require explicitly that the connection to the public telephone network must permit functional Internet access. But the main problem still arises regarding the evaluation of the net costs of the Universal service and the provision of a relevant financial mechanism [3].

3. FINANCING OF THE UNIVERSAL TELECOMMUNICATIONS SERVICE

The net costs of the Universal service provider are associated with the level of tariffs, which might be considered as “affordable” to the residents of a country. In its turn, the level of affordable prices is influenced by income of the customers, their purchasing power, as well as what part of their income they agree to spend for telecommunication services.

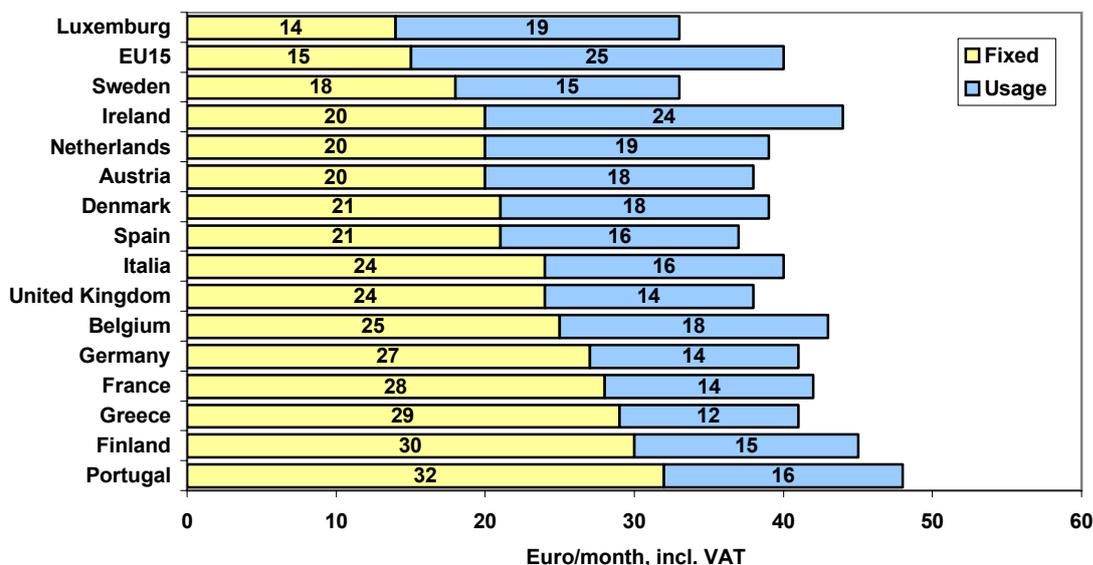


Figure 1. Average monthly expenditure of residential users (composite basket) [3]

Figure 1 provides the average monthly expenditures of a “standard” European residential customer (household) in August 2003, expressed in €. The user is assumed to have a contract for the

provision of voice telephony services with the incumbent operator, and to use only this operator for all types of calls (local, long-distance, international, calls to mobile).

The chart shows that the average monthly expenditure of a household for telecommunications services in EU countries is about € 40. In Latvia, the income and the purchasing power of its inhabitants is much lower. According to the data of the Central Statistical Bureau of Latvia, in 2003 the disposable monthly income per household member was about 86.88 Ls. At the same time, the average expenditure of a Latvian household for telecommunications was 15.63 Ls per month, which comes to 7% of the whole income of a household [4]. Thus the customers' protection and the acceptance of the financial mechanism of the Universal service are extremely important questions for Latvia.

Besides, the net costs, which are involved in provision of the Universal service, are directly connected to the tariffs, which an operator can offer to its present and potential customers. Therefore one of the most important preconditions for the introduction of the Universal telecommunications service is tariff rebalancing, i.e. approaching to the real costs.

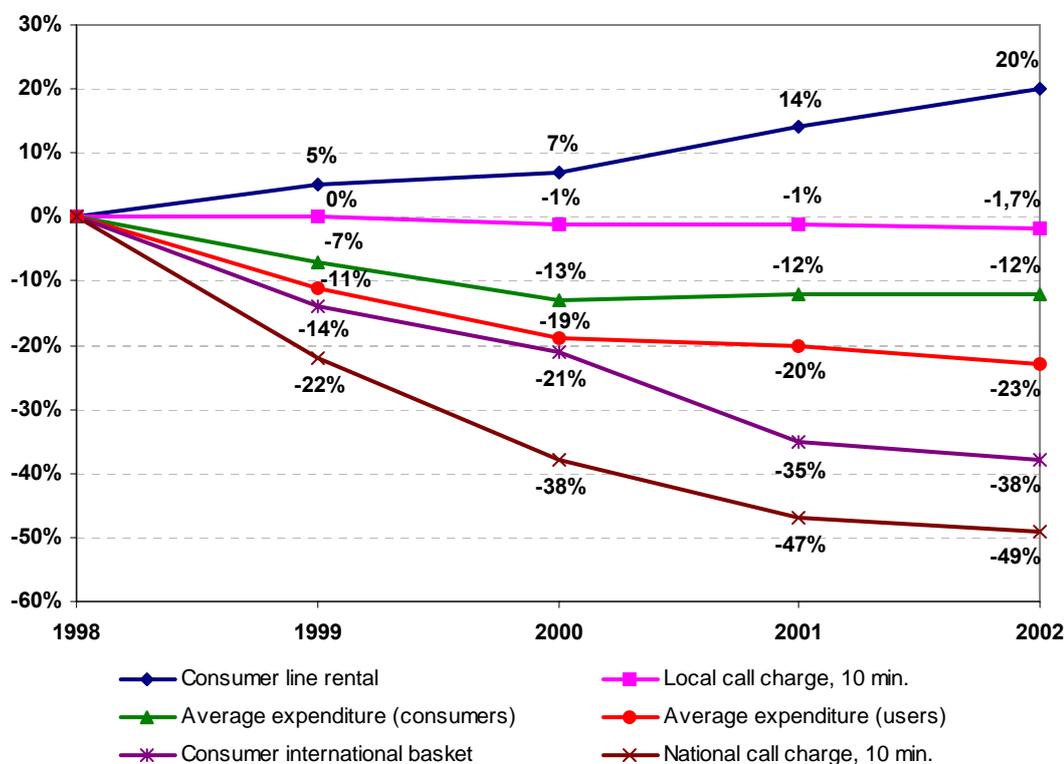


Figure 2. Tariff rebalancing and consumer / user expenditure for fixed telephony services², 1998-2002 [5]

Under the conditions of a monopoly the cross-subsidies were possible – tariffs for local calls and line rental charges were significantly lower than its prime cost that was compensated at the expense of overpriced tariffs for the services of international voice telephony. But a liberalized market does not accept this policy, because first of all the competition appears in the sector of international services.

Figure 2 shows that since the liberalization of voice telephony (January 1, 1998) [6], line rental charges have increased across the EU (around 20% for both residential and business users), while local

² These variations are calculated on a PSTN basket, users/consumers are assumed to be using a PSTN service from the incumbent operator. Average expenditure refers to local and national calls only.

call tariffs have remained practically stable. On the contrary, national and international call prices have decreased sharply (around 50% and 40% for business and residential users respectively) [5].

The Universal Service Directive [1] and the new Electronic Communications Law of Latvia [7] determines to drive the tariffs for national and international voice telephony services towards their real costs. However, the process of tariff rebalancing has not been started yet, because the evaluation of the real costs of these services is not accomplished.

It is necessary to mention that for the time being only two Member States have required the funding of the net costs of the provision of universal service (France and Italy), while two other Member States (Spain and the United Kingdom) have come to a conclusion that the provision of the universal service had not implied an unfair burden for the designated operator. These data are displayed in the Table 1.

Table 1. Financing of the Universal Service Obligations (USO) [3]

EU Member State	Year	Have the organization(s) in charge of USO requested funding?	The net costs of the USO	Have the funding scheme been activated?
Spain	2000	Yes	€ 298 million	No, it was found that the net cost did not represent an unfair burden
	2001	Yes	€ 185.95 million	No, it was found that the net cost did not represent an unfair burden
France	2001	Yes	€ 142.1 million (final evaluation integrating intangible benefits and social tariffs)	Yes
	2002	Yes	€ 296.6 million (provisional evaluation, integrating intangible benefits and estimating the impact of social tariffs)	Yes
Italy	2000	Yes	€ 58.90 million	Yes
	2001	Yes	€ 40.52 million	Yes
The United Kingdom	2001	Yes	Between net cost of £12 million and net benefit of £8 million.	No., an unfair burden does not exist
	2002	Yes	Between net cost of £12 million and net benefit of £8 million.	No., an unfair burden does not exist

4. CONCLUSION

Many unsolved financial questions, imperfection of the Universal service policy and its partial discord with the demands of the European Union complicate the establishment of the Universal telecommunications service in the territory of Latvia. The main financial and political issues, the solving of which is necessary for the implementation of the Universal service policy and its successful functioning in Latvia, are shown in the Table 2.

Table 2. Recommendations regarding the implementation of the Universal telecommunications service in the territory of Latvia

Recommendations	Motivation	The consequences of the accomplishment of recommendation
Evaluate the so called "uneconomic" customers and regions	Since the Universal service policy refers only to economically disadvantageous customers and regions, it is very important to evaluate such categories in advance	Possibility to calculate the net costs, which are involved in the provision of the Universal service and to establish the mechanism of its financing
Carry out the rebalancing of tariffs for the services of fixed voice telephony	The completion of tariff rebalancing is necessary for successful implementation of the Universal service	Tariffs, which are based on real costs, will ensure the honest competition under the conditions of a liberalized market and allow to evaluate the net costs of the USO
Determine the level of tariffs, which might be acceptable to all concerned	There is no decision on the level of affordable tariffs in Latvia, which leads to the impossibility to evaluate the net costs of the Universal service and select the appropriate financial scheme	Possibility to calculate the net costs, which are involved in the provision of the Universal service and to establish the mechanism of its financing
Compensate the deficit of access to the network of voice telephony services	The Universal service must be available to all the inhabitants of a country independently of their place of residence	Increase in a level of social protection of Latvian residential customers
Establish the Universal Service Fund or any other financing mechanism in order to compensate the net costs, which are involved in provision of the Universal service	The US provider's net costs, which will be involved in the provision of services in the whole territory of Latvia and to everyone who demands it, are expected to be rather high. In this case an operator would essentially decrease its ability to compete on the market, if it had the obligations to compensate all the expenditures of the Universal service by itself.	Establishment of the Universal service fund or any other financing mechanism will allow the operator to work without distortion of its ability to compete on the market of fixed voice telephony.

Although in the "old" EU Member States the assessed net USO costs vary from about 0.3% (The United Kingdom and Italy) to 3% (France) of the turnover of the relevant operator, in Latvia this value is expected to be much higher – to 10% of a turnover of the Universal service provider [8]. It is also necessary to mention that the huge financial investments will be required by undertakings, which have to be accomplished before the implementation of the Universal telecommunications service in the territory of Latvia – tariff rebalancing, determination of a level of affordable prices, as well as evaluation of the proportion of residential users who would require the compensation in compliance with the Universal service obligations.

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