Understanding Price Cap 2012

Printed in Business Monday Newspaper on April 16, 2012

The telecommunications market in Barbados, especially the residential and business services market, is one where limited competition presently exists. In this market there are two active providers: Cable & Wireless (Barbados) Limited (C&W) and TeleBarbados. Under the Telecommunications Act, C&W is named the dominant provider of telecommunications services and therefore is subject to regulation. The list of services to be regulated is determined by the government ministry responsible for telecommunications. The other service providers do not require FTC approval of their rates. To address circumstances such as these, regulators have designed various forms of incentive-based regulation like Price Cap, in order to regulate those markets which are moving towards effective competition though not entirely there yet. The price cap regime is designed to ensure that customers continue to have access to telecommunications services at just and reasonable rates while at the same time providing C&W with incentives to operate efficiently and to be innovative in the provision of services.

On March 29 the Commission issued its Price Cap Plan 2012 (PCP2012) Decision which will govern the manner in which C&W can adjust its prices over the period April 2012 through March 2015. This article will look a bit closer at how it will work and how it was developed.

The PCP2012 has, for price control purposes, separated the regulated services into two baskets, Basket 1 for ‘competitive’ services and a second basket for ‘non-competitive’ services. The Decision placed a freeze on increases of all regulated telecommunications services until March 2013. In Basket 1, the Commission has applied a light level of price control which has international overseas calls and international private leased services. Cable & Wireless is only required to provide the Commission with notification of price changes for these services.

The other basket which has domestic regulated services such as residential landline, business landline, residential and business line installation, voice mail and call-waiting will be controlled by a price cap index. The Commission however determined that in addition to this general constraint for these services, there should be a specific constraint or sub cap applied to residential landline services. The Commission set the sub cap at 5% to ensure that the price of residential landline services is not increased more than this amount by C&W.

The price control for the non-competitive basket requires that the average change in prices for the services within this basket must be less than or equal to the predetermined price cap index. The price cap index for a given year is calculated as inflation minus a productivity factor which is derived from an estimate of C&W’s productivity increases over the relevant period. The Commission used modelling to estimate that the productivity factor is 5.25% and the Barbadian retail price index will be used as the measure of inflation. So if at April 2013 inflation is 7.25% then the price cap index will be 2%. This does not mean that all prices in the basket will increase by 2%. C&W could decide to increase the prices of some services and decrease the prices of other services.

However the sub cap on the residential landline service limits any price increase for this particular service to 5% in any year. This prevents C&W from, for example, raising the price of residential landline service by 10% and balancing this by decreasing the prices of some other services in order to achieve the average increase of 2% for the overall basket. Without this additional constraint C&W would have full flexibility to increase or decrease prices to any level within the service basket as long as the weighted average of all of the prices is below the price cap index. This therefore ensures that consumers would not be subject to excessive increases in the price of residential landline service.

The PCP2012 was developed through the application of a Price Cap Model which forecasted the costs and revenues resulting from the regulated services under a range of assumptions. This required forecasting the expected volume of demand for the regulated services and the expected costs to C&W to deliver these services. The level of costs for the regulated services is determined taking into account the demand forecasts, expected inflation and expected efficiency. The productivity factor is set at a level which, in conjunction with the price freeze, will result in reasonable prices for the consumers and gives C&W the opportunity to earn a reasonable return on these services.

Given the structure of the market and the nature of the existing competition there is the probability that competition-related issues could occur. These can be addressed by the Fair Competition legislation. Price caps are a regulatory mechanism that can mimic the competitive market model in offering to consumers the price protection that can be provided to them by effective competition. The price cap provisions constitute a powerful and effective instrument for protecting consumer interests in telecommunications and in conjunction with the competition legislation, they can also effectively address competition concerns. The Price Cap Plan 2012 Decision can be downloaded from the Commission’s website at www.ftc.gov.bb.