

**NON-COMMERCIAL SERVICE OBLIGATIONS AND LIBERALIZATION**  
***HUNGARY***  
**8-Oct-2003**

**TABLE OF CONTENTS**

UNIVERSAL SERVICE OBLIGATIONS .....	2
1. The definition of USO.....	2
1.1. Telecommunications.....	2
1.2. Energy sector .....	3
1.3. Postal services .....	3
2. Making a service a USO .....	3
3. Financing USOs .....	3
3.1. Telecommunications.....	3
3.2. Energy .....	4
3.3. Postal services .....	4
4. Entry and exit barriers.....	5
4.1. Telecommunications.....	5
4.2. Energy .....	5
4.3. Postal services .....	5
5. Problems of USOs and planned solutions in the field of telecommunications .....	5

## UNIVERSAL SERVICE OBLIGATIONS

### 1. The definition of USO

1. Although no general definition on USOs exists in the legal texts, based on the Constitution establishing that *citizens of the Republic of Hungary have the right to social security* and based on other, sector specific legal provisions it can be established that under USO the Hungarian law means services necessary for the maintenance of a certain level of lifestyle, social welfare and competitiveness for the society.

2. Beside the designation of these services the nature of their provision also forms part of the definition. In general USOs could not be provided on a sufficient level without setting up a monopolistic service provider for both potentially competitive and non-competitive parts of the given service. As measuring profitability in the case of such services is a complex issue, some activities might be unjustifiably established as USOs. This fact however does not disprove the definition itself, simply leaves grounds for further liberalisation.

#### 1.1. Telecommunications

3. USO is a relatively new concept in the Hungarian telecommunications sector. After the change of the political and economic regime, 4 local telecom operators (LTOs) and the former monopolist Matáv were entrusted with providing telecommunications services. The obligations and rights of the operators were laid down in the concession agreements concluded with the Minister. The enterprises had exclusive rights for 8 years in their territories to provide fixed line telecommunications in order to ensure the development of the core networks and to supply services at an affordable price. The exclusive rights of the incumbent companies expired in 2002.

4. The universal service obligations were at first defined in the Communications Act of 2001. The universal service obligation embodies the provision of (i) access to the public telephone network at a fixed location capable of supporting voice and data communication (appropriate for sending fax messages and providing modem-based data transmission offering a transmission rate of at least 9600 bps), (ii) public pay telephone services, (iii) directory enquiry services and directories and (iv) emergency calls free of charge.

5. The Hungarian system distinguishes between two types of universal services, which means that there are two tariff packages called the 'normal' and the 'preferential' universal service package. The technical content of the two packages is more or less the same; main differences can be found in the pricing structures. The 'normal' package is thought to be cost covering (aside from the local access deficit as a consequence of the lag of the tariff rebalancing) thus should not be financed but the 'preferential' universal service package has a lowered subscription fee and higher calling tariffs. This latter is a targeted tariff package dedicated to specific consumer groups and for social purposes the regulator has determined the minimum difference applicable in the monthly subscription fees between the two universal service packages. As this package thought to be money losing service it can be financed from the so called Universal Telecommunications Service Fund.

## **1.2. Energy sector**

6. The right for a certain level of social welfare appears in the field of energy supply as a right to get access to a justifiable minimum level to electricity and to the supply of gas in areas where its provision can be carried out economically. The State determines prices on a way to enable the consumption of electricity and gas also for those who are on the lowest level of living. It also establishes special price for those who are in need.

## **1.3. Postal services**

7. According to the Act on Communications, the following postal services are established as USO:

- a) postal services relating to the delivery of domestic and international postal consignments up to two kilograms in weight;
- b) postal services relating to the delivery of parcels within Hungary and from Hungary to abroad up to ten kilograms in weight and from abroad to Hungary up to twenty kilograms in weight;
- c) postal services relating to the domestic and international delivery of consignments containing materials written in Braille for the blind, up to seven kilograms in weight;
- d) postal money order service within Hungary;
- e) extra services: acknowledgement of receipt and insurance of value available along with the services specified in points a) to c), registered service in connection with the services specified in points a) to c) and acknowledgement of receipt in connection with the service specified in point d).

Compared to the USO defined in Directive 97/67/EC, an additional element can be identified in the provision of postal money orders which is not only a universal service but also reserved for the designated universal postal service provider. Besides, the obligation on the provision of deliveries with written material to the blind is also additional to those defined in the Directive.

## **2. Making a service a USO**

8. While deciding whether a service should be covered by a universal service obligation or not, the government considers the social and political importance of the particular service and if it were underprovided without the universal service obligation. Only those services can come under the scope of USOs that are already generally provided to the society. Non-commercial service obligations are not appropriate to resperse new or rare, immature services such as Internet access.

9. Due to changes in the relevant EU provisions and the obligation to harmonize national legislation the system of USOs were revised in the telecommunications sector. In the field of energy due to gradual liberalisation the scope of USOs is also subject to revision to some extent.

## **3. Financing USOs**

### **3.1. Telecommunications**

10. The most acute problem is the financing of USOs. Activities thought to be non-profitable are financed by the Universal Telecommunications Service Fund. The contributions to the Fund's revenues must be paid by every telecommunications service provider, e.g. fixed line telephone operators, mobile

operators, cable TV operators, Internet service providers and so on. The payments shall be made each year in the amount of a certain percentage – determined according to the actual funding requirement – of the net revenues generated from telecommunications services less expenditures on interconnection, revenues generated from universal services provided on the basis of targeted tariff packages and payments from the Fund. However the subsidies in fact are not based on the operators' reasonable and recognised additional costs incurred in connection with the provision of the universal services. The payments from the Fund are granted in the amount of the revenue lost due to the difference in the subscription fees between the 'normal' and the 'preferential' tariff packages and the system ignores the universal service providers' potential benefits accruing from the enhanced network usage and the higher calling tariffs applied in the 'preferential' package. The total financial demand is expected to increase collaterally with the widening of the gap between the subscription fees for social purposes.

11. Similarly, the principles of the contributions to the Fund are also criticised. On the one hand, the total amount is presumably higher than it should be, and on the other hand, the services, on which the financial burden of USOs is settled, benefit from the advantages of USOs far less. Charging modern, recent and immature services with the costs of universal services can have undesirable effects on the development of these new services and can cause losses in the social welfare by distorting market conditions. These services typically have high demand elasticity so higher prices result in much lower demand.

12. As there are five different universal service providers facing with different cost structures, density ratios and demographical and material characteristics of the population, operators offer disparate universal service packages. Only the price of building a new connection is regulated uniformly for all operators with the proviso that they can claim 50% of their additional costs from the subscriber when the line must be established in a suburban/rural area and the regulated price does not cover the corresponding costs.

13. The universal service providers must keep separate books and accounts for their revenues, costs and expenditures occurring due to the provision of the targeted universal service package. In order to determine the need for financial maintenance, the universal service provider has to calculate the costs of providing universal services at a discount using the long-run incremental costs method.

### **3.2. Energy**

14. In the case of electricity or gas provided for individual consumers the smallest cost and a suitable margin for efficient suppliers serve as a basis for the calculation of the price cap. In the sector of electricity and gas suppliers costs are analysed on a benchmark basis. Justifiable cost elements are included in the calculation of the price cap. Cross-financing is prohibited between the competitive and the utility markets.

### **3.3. Postal services**

15. The Communications Act established a Postal Fund for financing the USO. The payment obligation to the Fund is also imposed on the service providers outside the USO, which obligation is not considered justified by these providers and in fact not compatible with Directive 97/67/EC. The planned new act, which would take effect next year does not foresee a Postal Fund taking into account the European experience, which showed that the reserved services are sufficient to cover potential losses stemming from the provision of USOs. The planned changes would result in a more competitive market in relation with a great part of universal postal services while cross financing between reserved and competitive services by the designated provider would secure the constant provision of all universal services. The abolishment of the Postal Fund would eliminate the burden imposed on competitors, which did not provide services subsidised by the Fund. It is considered that cross financing even if it would reduce transparency is a better solution in this special field.

#### **4. Entry and exit barriers**

##### **4.1. Telecommunications**

16. The Minister shall invite proposals for the provision of universal services if (i) provision of the universal service is not fully guaranteed under the concession agreements or the universal service contracts, (ii) the scope of universal services is broadened and the procedure aiming at the modification of the existing contracts fails or (iii) a universal service provider intends to terminate provision of the universal services. The Minister shall make the decision on the bidder considering the tariffs and the quality of the universal service to be supplied. As a consequence, a new operator can only be designated as a universal service provider if a new service is to be provided or a former universal service provider exits. In spite of this, entry in the markets covering or embodying universal services is possible but new entrants could not reckon on compensation in respect of the provided services.

##### **4.2. Energy**

17. As the provision of universal services is obligatory market entry and exit is restricted. The regulator supervises the financial and technical suitability of the entering undertakings. All changes in the structure are controlled and the regulator may intervene in case of changes endangering supply. Although no exit without succession happened on the market it is clear that such an abandonment of the provision of the services is not possible.

##### **4.3. Postal services**

18. Universal postal services may be provided by the designated universal postal service provider. In parallel with the preparation of the new Electronic Communications Act, the Government is preparing a new act on postal service with a purpose to liberalise the market segment of USO services. According to the draft of the new act, the universal service provider will be designated by the Act, and it can maintain the exclusive right to provide the reserved services. Other universal postal services not reserved for the designated undertaking may be provided by other service providers in a chosen territory subject to the authorisation of the regulator. Since these providers cannot benefit from the possibility of cross-subsidization between reserved and the selected universal services, these latter services will not be subject of legal obligations relating to supply, quality and prices. The provision of postal money order services will not be a part of USO, nevertheless, the designated universal service provider will still be obliged to provide them.

#### **5. Problems of USOs and planned solutions in the field of telecommunications**

19. The adopted system does not ensure the aims of the universal service concept, as it does not serve for the expansion of access and usage. The supplied universal service tariff packages do not reflect the actual market situation and the income features of the Hungarian society. The so-called targeted (preferential) tariff packages are not in fact targeted, the self-selection mechanism poses problems of equitableness among consumers and the financing method burdens particular operators unduly.

20. One of the problems revealed is that regulation meets the requirement of technological neutrality only at the level of principles but in practice it prefers fixed line telephone services. As it has already been mentioned the penetration rate had been very low before the privatisation process. The incumbent companies undertook in their concession agreements to develop the networks and the provision of services so they commenced to invest huge amounts in this field. Accordingly, penetration rate stepped up measurably but in 1994 – far before the saturation of the fixed networks – mobile services appeared and gradually gained ever larger importance. In the meantime fixed penetration growth slowed down and from 2000 it is even declining. The intention of the regulation in connection with universal service obligation

was presumably to further improve the fixed penetration but this attempt failed. Not only the efforts to enhance fixed penetration were unsuccessful but the system was not even able to stop churning.

21. The purpose described above was also not answered by the 'preferential' tariff packages. Any the less that these packages are not in fact targeted packages as it is conceptualised in the law. They are aimed at establishing a real alternative, a choice for low income consumers but they are used not only by socially disabled, indigent people but for other purposes (e.g. as a second subscription in weekend-cottages) as well. This situation both enhances the financing requirements and poses problems of fairness.

22. The current regulation does not promote competition in the field of universal services. As a consequence of the nomination process there is only one designated operator in each particular area for all items of the universal service obligation determined in the Act. Moreover, without any detailed procedural guarantee the rules of the operators' assignment are not appropriate for securing the efficiency, objectivity, transparency and non-discrimination of the process.

23. As a result of the review of the effective legal framework and as a consequence of the new regulatory regime in the European Union the Minister has decided to codify a totally new law. This new regulation, called the Act on Electronic Communications, has not yet been adopted, as the Parliament discusses the draft this fall. Whereas the final version of the text is not known we can only describe here the main points and alternatives the Ministry considered when preparing the new rules concerning universal service obligations.

24. The set of services to be provided as universal services will presumably not change but the system of providing those services would be modified. The proposed measures are all aiming at reducing the financing weight on telecommunications operators:

- The selection of universal service providers would be based on a less arbitrary scheme – the most cost-effective company (companies) would be assigned, being either fixed line or mobile operators;
- The financing demand of an operator would not be granted automatically and would be calculated as Net Evitable Costs using LRIC method;
- The universal service concept would be separated from social considerations, the affordability of services would be secured in the form of vouchers awarded to low-income subscribers and would be financed from the budget;
- Only those service providers would be obliged to contribute to the Fund's operation who can benefit from the provision of universal services.

25. The current regulatory framework was not able to reach its aims of creating competitive circumstances in the telecommunications sector and so enhancing social welfare: incumbent operators and service providers of the same ownership still have significant market power on the relevant markets. From the new regulation and within this from the rules concerning universal service obligations both the regulator and the Competition Office await the intensification of competition, increase in the competitiveness of the economy and growth of the consumers' welfare.