Box 3.1: Accounting rates and how they work

One reason why 20 European countries came together in 1865 to form the predecessor to the International Telecommunication Union (ITU) was the need to agree upon a common method of dividing the revenues for international telegraph service between the originating and destination countries. The methodology they developed was later carried over to telephone services, albeit with some modifications. It is based on a dual price system for each call with independent prices for each route

For each international call, the originating carrier charges users one price, known as the collection charge or tariff, but the cost to the originating carrier of terminating the call is governed by a second price, known as the accounting rate. This rate is negotiated between the originating and terminating carrier and is related, although sometimes very loosely, to the carriers' end-to-end facilities costs. Accounting rates are commonly stated in US dollars or Special Drawing Rights (SDRs)—a monetary unit based on a "basket" of major currencies—per minute of traffic.

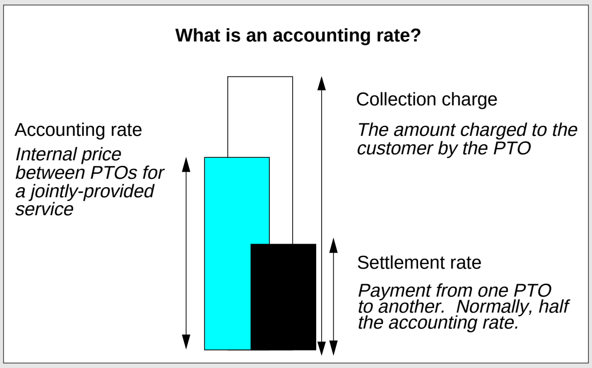
The originating and terminating carrier usually divide the accounting rate 50/50 to determine the amount paid by the originating carrier to land its traffic; that rate is known as the settlement rate. On any given route, one carrier pays settlements to another carrier only to the extent that there is a traffic imbalance — that is, one carrier has terminated a greater volume of telephone minutes than the other carrier.

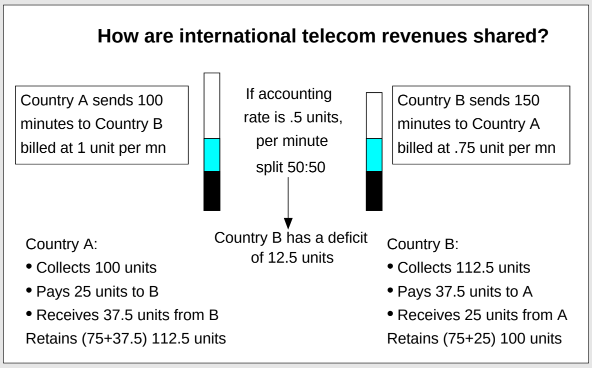
The dual price system for international telephony makes carriers' net revenue for international service a function of their accounting rates as well as their collection charges (see Box Figure 3.1). If traffic is balanced on a particular route, the value of the accounting rate is essentially irrelevant since no settlement is necessary and each carriers' revenue will depend directly on its collection charge. However, where traffic is imbalanced, the accounting rate may have a significant effect on the commercial options of the two carriers. If a carrier has a significant incoming traffic deficit, the settlement payments which it must make to its foreign correspondent limit its ability to reduce its collection charges.

Conversely, a carrier with a net traffic surplus has little incentive to operate more efficiently or to reduce the accounting rate because of the net settlement benefits it receives under the *status quo*. This is a major reason why the carriers which have relatively lower collection charges, often due to the competition from other carriers, and a net traffic deficit are dissatisfied with the current accounting rate regime: it tends to subsidize high cost monopoly carriers at the expense of lower cost carriers and end-users from competitive regimes (see Box Table 3.1 below).

Box Figure 3.1: How does the accounting rate system work?

Simple example showing application of accounting rates to international telecommunication services





Box Table 3.1: Who wins, who loses?

US settlement payments to rest of world for international telecommunication services, 1995

Region	*Revenue (US$ million)*	*Payout to Foreign Carrier (US$ million)*	*Receipts from foreign carriers (US$ million)*	*Net deficit (US$ million)*
Africa	517	302	68	-234
Middle East	692	524	157	-367
Americas	5'732	3'227	925	-2'302
Asia-Pacific	3'715	2'124	682	-1'442
Western Europe	2'945	1'048	543	-505
Central and Eastern Europe	489	309	95	-214
Total	14'130	7'571	2'472	-5'099

Source: FCC.