TELSTRA COMMENTS TO THE PRODUCTIVITY COMMISSION PUBLIC HEARING ON INTERNATIONAL TELECOMMUNICATIONS MARKET REGULATION
21 July, 1999

Thank you for the opportunity to provide Telstra's comments on the Productivity Commission's Position Paper on *International Telecommunications Market Regulation.*

I'm Deena Shiff, Director Regulatory for Telstra Corporation and 1 am joined by Robert Webster from our Wholesale and International area.

Before responding to questions, I would like to make some short opening remarks on Telstra's global strategy, and then briefly offer our views on:

(a) the approach adopted in the Position Paper and some issues arising from the Paper, and

(b) the Papers policy recommendations, or "Possible Options".

Telstra's global strategy

Firstly, Telstra's global strategy

Telstra views its international and wholesale businesses as two of the key areas for Telstra's growth into the future.

Telstra's strategic goal is to be a globally significant, full service communications company for the 21 st century. Our aim is to link all its international businesses into a network - a communication web encircling the globe - allowing seamless delivery of products and services to both corporate and wholesale customers.

To help achieve this global service web, Telstra plans to multiply the number of its switching "points of presence" (PoPs) around the globe to increase our capability in offering services to companies operating around the world.

Telstra already has extensive international network capability, through cable and satellite agreements and equity arrangements with global communications consortiums.

To help support burgeoning electronic commerce via the Internet, Telstra has greatly increased its broadband cable capacity in recent years - and will expand that capacity further in the near future.

Planning is underway to boost the company's connectivity with a bold new cable construction project which, if approved, will link Australia directly with Japan and connect with existing trans-Pacific links into North America. The capacity of this cable will be far greater than any currently available.

The Asia Pacific region will continue to play an integral role in Telstra's new global strategy. We've had business relationships in the region for more than 50 years, including a network build and operate relationship in Vietnam since the late 1980s.

In Europe, Telstra has a switch in the United Kingdom and will announce facilities in other European centres in the near future. New "PoPs" are also scheduled for the US, geared towards handling the exponential growth in internet traffic, much of which flows into North America.

Position Paper's approach and issues raised

With that background I would now like to address the approach adopted in the Position Paper and then discuss some of the issues arising from the Paper. Let me note at the outset that I do not intend to cover all the issues canvassed in the Commission's paper. We will be providing the Commission with fuller comments on these issues shortly.

There are numerous issues on which Telstra agrees with the Commission, most visibly with respect to the need for more equitable arrangements on Intemet links to the US and with respect to the desirability of continued pressure for the liberalisation of overseas markets. It is only with market liberalisation that sensible commercial outcomes can be achieved with respect to international settlements.

Significantly, Telstra also agrees with the Position Paper's conclusion that the current strategies adopted within Australia in pursuit of international telecommunications market reform in general, and towards reform of the international telecommunications payment arrangements in particular are appropriate and have been broadly effective. We have already indicated we believe that in terms of the international environment, Australia has one of the most open and liberal markets for competition in international telecommunication services.

My primary concern today is with the Commission's broader characterisation of the international telecommunications market and how it is working. In addressing this, I want to start by emphasizing the fact that, in Telstra's view, this should be at the centre of the Commission's analysis. **That fact is that in the twelve months from 1 May 1998 to 1 May 1999, Telstra's average traffic-weighted price per IDD minute decreased by fully 72 per cent.** Prices today, in other words, are barely a third of what they were only a year ago.

This is a dramatic rate of price decline. Looking at it, a clear inference can be drawn - that this is a market in which competition is working, and working well.

But that is not the picture a reader would obtain from the Commission's Position Paper -- far from it. Rather, the Commission paints a picture of competition distorted and hindered. The Commission cites very little hard evidence in support of its assessment; what it does is point to indicators, in numerous cases reported at third hand. On that basis, it then advances a range of policy recommendations. It is Telstra's view that many of the indicators the Commission points to have little merit. As for the policy recommendations, some of these are plainly inconsistent with other statements the Commission has made only recently. I will deal with each of these in turn.

The Commission's indicators of performance

The Commission's discussion of the indicators it has used to measure performance is cursory. No analytical justification is given for the indicators selected, and no framework is set out within which they can be integrated. Rather, they are cited as if they spoke for themselves. Let me address two of these.

The first is the level of Telstra's access charges for the PSTN - that is, the amount Telstra charges competitors for using its network. The Commission cites the ACCC's assessment of these charges; and it also cites the views expressed by C&W Optus. What the Commission has chosen not to cite is Telstra's view that the charges it has proposed are strictly in line with costs. But even more importantly, what the Commission ought to have noted is that, if the modelling approach used in its 1997 Staff Information Paper on International Telecommunications Reform is to be believed, the level of domestic PSTN access charges can have virtually no impact on IDD rates.

Some time ago, Telstra provided the Commission with an analysis that used C&W Optus numbers to highlight the negligible impact of interconnect charges on IDD rates.

C&W Optus claims in its submission to this inquiry that in 1998, it was charging on average somewhere between $0.72 and $1.07 per minute for international calls. C&W Optus also claims that the interconnect charge is currently 4.7 cents per minute and that this could be slashed to a fictional world's best practice figure of 1 cent per minute.

In reality, Telstra's proposed interconnect rate, as detailed in our undertaking to ACCC, is 3.67 cents per minute.

But even putting this factual issue aside, the important point revealed in the C&W Optus data is the minuscule impact that a reduction in the interconnect rate would have on average IDD prices of between $0.72 and $1.07 per minute. Based on the price information presented by C&W Optus, a reduction in the interconnect charge from 4.7 cents per minute to 1 cent per minute would at most -assuming that the full benefit was passed on to customers - reduce international call prices by 3 to 5 per cent.

As the Commission rightly identified in its 1997 Information Paper issues of interconnection are of negligible significance in the market for international call services. The prominence they are given in the Position Paper is consequently surprising.

Let me turn now to a second of the indicators the Commission uses. This the availability and pricing of various forms of non-switched capacity - ranging from the purchase of ownership rights in undersea cables through to international leases. The paper claims these are over-priced and/or subject to 'practical access restrictions'.

Little point would be served by going through the Commission's statements in this respect line-by-line. In numerous instances they involve gross technical errors -- as when they compare a leased 2 Mbit/s/s circuit (which is an end-to-end managed transmission service) with an ownership claim on capacity in a cable (which is merely a claim on the physical transport layer, and not the provision of a transmission service). But there are some simple economics that need to be set out.

The facts of the matter are these. International transmission is provided in a market that is undergoing explosive growth. In the short term, strong demand has tended to push prices higher than they would otherwise have been. However, in this area as in others, the price mechanism works, and strong supply expansion is now underway.

The Australian situation is by no means unique in this respect. The last major trans-Atlantic cables to go into service, TAT 12/13, sold out almost immediately, and since then demand has more than doubled. As for the trans-Pacific routes, the last major increase in capacity occurred with the opening of TPC-5 in 1996; since then, demand has risen from some 50 STM- 1's (each STM-1 provides 155 Mbit/s) to close to 200.

It is precisely for this reason that carriers are investing in developing new facilities. For example, the Southern Cross cable, in which Telecom NZ and Cable & Wireless C&W Optus hold major stakes, is scheduled to be in place by January 2000. This cable will add some 40 (inner ring) to 80 (outer ring) Gbit/s of capacity - that is, it will have 4 to 8 times the capacity of the current TPC-5 cable, and will be further expandable to an estimated 480 Gbit/s. Further substantial capacity additions will come from the SE-ME-WE-3 cable, from Australia to Europe, in which Telstra is playing a leading part.

Now, the Commission claims that these investments are examples of inefficiencies and distortions. This is an argument that Telstra finds difficult to understand, much less support. Surely, what we are seeing here is not inefficiency but rather the market at work - that is, the response of supply to strong and sustained growth in demand. These trends ought therefore to be commended rather than condemned.

Position Paper's policy recommendations or "Possible Options"

Let me now turn to the policy recommendations or "Possible Options" proposed in the Paper. These are divided between Australian telecommunications regulation, and International negotiations.

In firstly considering Australian telecommunications regulation, I want to repeat the fact I set out a few moments ago - that in just 12 months, IDD prices have declined by over 70 per cent. This decline was not brought about by increased regulation - rather, it was the result of reducing the extent of regulatory constraint. With the end of the duopoly period, in July 1997, two changes occurred: scope was created for new players to enter the industry; and many of the constraints until then imposed on Telstra's pricing, for example in terms of non-discrimination provisions, were relaxed. Combined, these changes have generated enormous benefits for consumers.

Set against this background, some of the Commission's recommendations are puzzling and disappointing. For example, the Commission urges the ACCC to consider requiring carriers to report and then disclose charges for services such as dedicated lines. Yet consider what the Commission itself said in its 1997 Report:

> "[G]iven the increasing incentive for tacit collusion as switched service providers' market share increases, it may not be desirable for the ACCC to publish tariffs supplied upon its request. **Standard competition policy safeguards alone may be more effective means of preventing anti-competitive pricing"'** (At page 43).

Telstra believes there is a deal of good sense in the 1997 report's assessment, and that the Commission, in reviewing its Position Paper, would do well to give it serious weight.

Even abstracting from the specific recommendations, there is a more general opportunity that has been missed. This is the opportunity to consider whether we actually need as much regulation as currently weighs upon this area of activity.

Thus, the Paper cites the international benchmarking work released by the Commission earlier this year. In that work, the Commission compared telecommunications prices across a range of countries. There is a vigorous and continuing debate about how such comparisons should be conducted. But one result on which there is agreement is that the countries in which consumers get the best deal are not those which are usually held up as models for Australian regulatory choices -that is, the UK and the US. Rather, it is the countries with truly light-handed regulatory regimes, such as Sweden and Finland. Subsequent analysis, using a fuller data set than that exploited by the Commission, has also found that New Zealand, that has no industry-specific regulation, has low consumer prices.

What these results suggest is that there could well be gains from moving further and sooner from a reliance on an ind policy. Such a move would surely be consistent with an overall commitment to minimising the burden regulation imposes on the Australian economy.

In terms of the options proposed by the Commission in relation to International negotiations, we agree with the Commission that fundamental reform of these arrangements is neither necessary nor desirable.

It is also important to take into account the fact that whilst international telephony traffic is growing rapidly, it is being very rapidly outpaced by Internet and data traffic, driven internationally by e-commerce, multimedia, and other manifestations of the so-called Global Information Infrastructure.

We would like to see Australia's limited resources concentrated on issues where Australian consumers stand to gain the most - internet arrangements to the US are a prime example of this. The Government and industry are playing a productive role in addressing this issue and this effort needs to continue.