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ATUG Submission

Productivity Commission
Review of National Competition Policy
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Introduction

For end users of telecommunications services, the Productivity Commission's review of National Competition Policy and in particular progress and problems in the telecommunications market, is very important at a time when new technologies such as wireless (for voice and data), 3G mobile, IP platforms and fibre networks bring the promise of innovation and effective competition. The issue for end users is how to ensure the rhetoric becomes reality.

Over the last seven years of open competition the telecommunications industry has developed from monopoly to duopoly to regulated competition, but has not yet achieved fully effective competition in any market due to the continued bottleneck nature of last mile access.

The access regime of the Trade Practices Act should have provided the first rung of a "ladder of investment". The idea is that companies will use mandated access to build customer bases that will support the subsequent rollout of independent infrastructure, which is the basis of effective competition.

Unhappily over the last 7 years of supposedly open competition, a number of companies who thought they were on this ladder of opportunity found themselves on a ladder of legal process, having to rely on the access and anti-competitive behaviour powers of the ACCC to go to the next rung.

Equity markets have been part of this painful learning experience and for them lessons from investment in telecommunications infrastructure linger longer.

A number of companies have spent significant amounts of capital building independent infrastructure (even ahead of a customer base eg AAPT, Next Gen Networks, IP 1, Comindico, TransAct, PowerTel/Request, UeComm, Hutchison, Macquarie Corporate, Flowcom among others) but have had to rely on arbitration and litigation over many years to achieve real access ie on workable price and non-price terms and conditions. A number have finished up being bought at fire sale prices by larger players.

Even with broadband, a market which was seemingly "born competitive" with an expectation at the outset that market shares would be more widely spread than the usual fixed network services, the ACCC has had to issue competition notices to Telstra to get action, the most recent one of which is still in force.

This short history of telecommunications competition becomes more relevant as debate heats up about how and when Australia will get the wireless, 3G, IP and fibre networks users need to deliver real, not bonsai, broadband and stronger competition in voice services, where margins are still very high.

Australia lost an opportunity in the early nineties to deliver effective competition in last mile access and the benefits this brings to end users, by allowing Telstra to duplicate the Optus HFC rollout. The negative impact of this on Australia’s broadband uptake is the subject of continuing comment by the OECD and the ACCC.

As we saw with the HFC cable network – effective infrastructure competition doesn’t emerge when different types of infrastructure are commercially converged.

Some commentators are focusing their questions on how to adjust the Trade Practices Act to ensure Telstra has the incentive it needs to build out these new networks. For ATUG, the real question is whether our regulatory framework will encouraging the new entry and innovation users need for an effectively competitive market.

Experience suggests that “tweaking” access regime alone is not enough - effective anti-competitive behaviour provisions are an important part of the story.

Innovation

The end game for telecommunications users is strong and effective competition. New technologies are part of the answer and must be encouraged, not least through the telecommunications regulatory regime. Users are looking for pro-competitive outcomes, not more of the same on a different playing field.

Professor William G Shepherd spoke to the ACCC Annual Conference in 2004 on the effectiveness of regulation. This address is attached. Professor Shepherd reviews US experience on regulating natural monopolies and anti-trust policies since 1900 before coming to the following conclusions:

"..recognise that much more is at stake than mere efficiency. The public interest involves many important goals. Innovation is probably the biggest one.

For over two centuries, innovation has been the great source of rising productivity, progress and welfare. X-efficiency has also been important, and so is the healthy competitive process itself. Also significant are freedom of choice, and fairness in the results, and the sound economic basis for democracy. The regulators' choices need to promote all of these, not just allocative efficiency."

"Fully effective competition.

To be genuinely effective, competition needs to have intense, sustained mutual pressure among competitors, with no monopoly or collusion. For a high probability of good results, the practical basis is:

1. At least 5 'reasonably comparable" rivals. (That number may vary slightly with the situation, but the need for "enough" strong rivals is fully affirmed by literature)
2. None of those firms must hold a dominant position, with 40% of the market or more (ATUG NOTE: the EU uses 25% as an indicator of significant market power)
3. Entry by new competitors must be easy to do."

If our aim is innovation and shared markets, then infrastructure competition is essential. ATUG's support for the Commission's draft recommendation goes to our concern for genuine infrastructure competition – not just between technology platforms but between commercial entities.

OECD Findings on Competing Infrastructure.

The OECD report on Broadband and Telephony over cable television networks (DSTI/ICCP/TISP(2003)1 (attached) outlines the importance of infrastructure competition at page 4,

"…One conclusion that can be drawn from this work is that the broadband markets in one-third of OECD countries are being held back where the cable networks are not providing independent competition with the PSTN. This is evident in the differences in the level of service, pricing and take-up of services. In these cases, all options need to be considered including separating cable networks from incumbent PSTN operators. There may be cases where this is not necessary if these cable networks were developed in an open market (i.e., not under a monopoly or duopoly applying to the telecommunications market."

In regard to broadband the OECD is clear, (pg 19)

"39. The ownership of cable television networks by incumbent telecommunications carriers has had quantifiable impacts on the development of broadband access. The average take-up rate for cable modems on networks owned by telecommunications carriers is just 2.6%. By way of contract the average for independently owned cable networks is 10.7%. In other words, if their home is passed by an independently owned cable company, users are four times more likely to take the cable modem service."

ATUG Research

ATUG's 2002 study into Top 100 buyers of telecommunications services and more recently ATUG's 2004 Regional Broadband Roadshow which visited 22 centres in regional Australia confirm that end users understand the significance of infrastructure competition to the effectiveness of telecommunications markets and to innovation, quality and prices.

ATUG has been supporting competition in telecommunications since 1981, on the basis that a competitive industry would deliver better benefits to end users in terms of prices, service levels and innovation than monopoly providers.

The driver for ATUG's interest has been to ensure that Australian business, government and consumer users are not disadvantaged in comparison to their overseas counterparts in terms of cost structures, productivity and service capability, and innovation.

ATUG thinks it is worth taking a stocktake on where we are up to with competition in telecommunications before deciding next steps and for this reason supports the Productivity Commission's draft recommendation. ATUG believes there are important areas where current arrangements should be strengthened before proceeding with the further privatisation of Telstra.

In the 7 years since open competition, while there has been good progress towards competition, user experience has revealed two major problems in relying on competition alone to deliver public interest outcomes in telecommunications:

1) market power – which has remained an issue even in potentially more competitive geographic markets such as urban areas and still requires significant regulatory attention for certain services and in certain markets eg wholesale broadband offers

2) market failure – which has been an particular issue in non-competitive geographic markets such as regional, rural and remote areas, and will continue to require significant regulatory attention and government funding eg mobile and broadband services in regional Australia

User concerns about market power and market failure need responses in the following areas:

1) The role of Parliament in monitoring the effectiveness of competition in telecommunications and securing public benefit outcomes from this industry
2) The need for continued Government focus and funding in areas that are non-competitive and underserved
3) An ongoing commitment to the role of the ACCC, its telecommunications sector specific powers and its focus on the long-term interests of end users
4) Strengthening the role of the ACCC to include increased powers in regard to wholesale access prices and anti-competitive behaviour,
5) Enhancing the role of the ACA to one of ensuring pro-competitive outcomes and effective consumer protection

Assessment of competition

Both the ACCC and the ACA provide reports to Government every year in which they assess progress towards effective competition in telecommunications and the reactions of consumers and small business.

The ACCC’s Market Indicator Report 2002-2003 reports a picture of continuing dominance across the range of basic services - Telstra has 87% of access revenues; 77% of local call revenues; 71% of domestic long distance revenues; 62% of international long distance revenues; 74% of fixed to mobile revenues.

The ACCC's Annual Reports into Price Changes for Telecommunications Services, 2002-2003, show an unwelcome trend of price increases for some services and some customer groups, during the period of a more relaxed Price Control Regime from 2002. Mobile prices should ring alarm bells given the consistent claim that this is one of the most competitive parts of the industry. The value of the ACCC report is that it goes to past the marketing hype to what end users are actually paying for services.

The ACA's 7th Annual Consumer Satisfaction Survey also makes an important annual assessment of progress in telecommunications competition from the consumer's perspective,

> "As in all previous years, fixed phone line rental was the areas in which respondents were most likely to say the price they paid was too high. Although the proportion of respondents who thought fixed lines prices were too high was slightly lower than in 2003, it still represented the majority of both household respondents and small business customers – 67% and 65%, respectively. This finding was made before the April 2004 announcement that Telstra would be increasing fixed line rental costs."

On satisfaction with competition, the report says at page 29,

> "While 69% of household respondents were satisfied with the current level of competition for fixed line services, only 50% were satisfied with the level of price competition for these services. Among small business respondents, 64% indicated satisfaction with the current level of competition for fixed line services, whereas only 54% were satisfied with the level of **price competition** for these services."

Other matters

ATUG also wishes to make a few remarks on matters raised in other submissions.

One is the prospect of integrated firms leveraging market power into potentially competitive markets. From an end users perspective this is exactly what Telstra is doing with its bundled retail offerings – where fixed, mobile and Internet services are bundled at the retail end. The ACCC has this matter under review and its continued concern is highlighted by the increased regulation recently applied to the Corporate Customer market for telecommunications services.

The argument about economies of scale and scope applies where common infrastructure is used to deliver multiple services. The over-build of competitive infrastructure (Optus cable) by Telstra is not an example of economies of scale or scope but anti-competitive conduct, in ATUG’s view. The fact that Government policy permitted this inefficient investment in infrastructure does not support continuation of a situation which continues to have the effect of stifling competition. Optus’ recent divestiture of its “content” interests is a pertinent local example of why it is not always necessary for carriers to have a position in content businesses.

The suggestion that market forces will drive structural separation depends on markets being effectively competitive, a core assumption ATUG would contest and a circular argument at best. From ATUG’s perspective, the market for telecommunications is not effectively competitive and it is hard to see how further regulation without structural change is going to change this situation.

In regard to examples of innovation in telecommunications prior to deregulation, ATUG would suggest that examples such as Computerphone (with its 64kbyte memory) and Viatel actually support the need to introduce competition. End users would argue that these products were an indication that Telecom did not understand the customer market, rather than being positive examples of innovation from an integrated, monopoly provider.

ATUG would use innovations in mobiles and broadband in markets outside Australia to make the case for measures to deliver stronger competition. More competition, not less will drive innovation.

ATUG watches developments in technology in Asia as a benchmark for what users should be offered in Australia.

CommunicAsia in Singapore in June each year provides a snapshot of developments in the world's most dynamic telecommunications market. APECTel meetings in March and September also provide a background view of developments in the production, promotion and use of telecommunications technologies for economic, social and government service delivery outcomes.

Asia's lead in the OECD broadband league table is driving the development of entertainment and business applications to make e-commerce and e-lifestyle faster and easier. The focus by Korea on high-speed and now wireless broadband, and by Japan on fibre to the home, lift the stakes higher again.

The value of competition to all stakeholders in the telecommunications industry is undisputed – the increased availability, use of and spend on telecommunications that accompanies liberalization and innovation is evident around the world. The benefits of this capability to productivity and growth have been well documented by the OECD, Australian government agencies and private sector research companies.

Mobile, wireless, broadband and IP technologies have the potential to take competition in telecommunications to the next stage by allowing cost effective infrastructure and new applications to be deployed in competition with legacy, fixed wire networks.

The ACCC has been highlighting its concerns with market structure in the telecommunications industry for over two years. OECD evidence is clear that infrastructure competition is critical to the development of broadband. Canadian experience tells us that competition between copper and cable has been key to the development of broadband. The time has come for a debate on the substance rather than the politics of these issues. The legacy of decisions taken with cable networks must not be carried forward into the fibre generation.

OFCOM Review

The suggestion that life has moved on since the Hilmer recommendations may be true but the progress envisaged by these reforms has not been achieved in telecommunications. Technology has changed rapidly but the response in other jurisdictions is not to suggest that the original aims are currently misguided but rather to face the fact that the current market and regulatory structure is unsustainable, per OFCOM’s review:

"Faced with the technology shift to digital, it is becoming clear that the current market and regulatory structure is unsustainable. It is that challenge that OFCOM’s Phase 2 proposals seek to address.

“Telecommunications is an important economic sector in its own right. It also has a growing impact on our lives as individuals, on businesses in terms of efficiency and customer service and on the United Kingdom's competitiveness as a knowledge-based economy….

On the final question posed - whether structural or operational separation of BT Group plc, or full functional equivalence, still remained relevant issues - the answer from the Phase 1 consultation was that, yes, they were still relevant; more so perhaps than we had anticipated. However, the large majority of industry respondents expressed caution about the prolonged uncertainty and disruption to the sector that would be involved in the process which would determinatively answer the structural separation question, namely an Enterprise Act market investigation and subsequent referral to the Competition Commission. If genuine equality of access could be made to work, the overwhelming majority of responses suggested that it would be a far preferable outcome. Equally, however, they shared Ofcom's view that the status quo was unsustainable.”

ATUG has included a full extract from the report as an attachment to this submission. The detailed review identified by OFCOM is needed in Australia before the further privatisation of Telstra.

ACA/ABA merger inquiry

ATUG notes that there is currently a separate Senate Reference looking at the proposed ACA/ABA merger.

The inquiry's terms of reference are:

(a) the provisions of the Australian Communications and Media Authority Bill 2004 and the Australian Communications and Media Authority (Consequential and Transitional Provisions) Bill 2004 and related bills;

(b) whether the powers of the proposed Australian Communications and Media Authority and the Australian Competition and Consumer Commission will be sufficient to deal with emerging market and technical issues in the telecommunications, media and broadcasting sectors; and

(c) whether the powers of Australia's competition and communications regulators meet world best practice, with particular reference to the United Kingdom regulator Ofcom and regulators in the United States of America and Europe.

The Committee is to report to the Senate on 10 March 2005, and submissions to the inquiry to be lodged by 31 January 2005.

House of Representatives Inquiry into the Structure of Telstra, 2002.

ATUG has also attached its submission to the House of Representatives Inquiry into the Structure of Telstra, December 2002 which canvasses ATUG views on competition, regulation and structural separation.

Conclusion

ATUG supports the recommendation that:

"The Australian Government should widen the scheduled 2007 review of the telecommunications-specific, anti-competitive conduct regime to include consideration of the appropriateness of the structural configuration of Telstra. Consistent with NCP requirements, if the Government proceeds with the full sale of Telstra prior to that date, this review should also be brought forward and its findings considered before the sale arrangements are put in place."