SUBMISSION TO THE PRODUCTIVITY COMMISSION

REVIEW OF

TELECOMMUNICATIONS SPECIFIC COMPETITION REGULATION

BY R.S. GILBERT

INTRODUCTION

1. I make this submission as a private individual, although one who

- has experience of competition law (as the first Deputy Chairman of the Trade Practices Commission, from 1977 to 1983);
- who is concerned that the telecommunications specific access regime provided for in Part XIC of the Trade Practices Act, unlike the general access regime that Part 111A provides, does not have the backing of the Hilmer Report, and departs from the philosophy underlying Part 111A; that it is legislation that also departs from the philosophy underlying the rest of the Trade Practices Act, which is to regulate industry conduct in the interests on competition, and not try to influence industry structure (as Part XIC tries to do); that it is trying to inject competition into an industry which has significant natural monopoly traits, and which therefore might not provide much scope for real competition and the benefits that competition can bring; and that it is legislation that tends to favour and support individual suppliers and create a kind of 'pretend' competition, rather than enhance and protect genuine competition and the competitive process itself - and, by doing so, can be regarded as itself anti-competitive;
- who is also concerned that the so-called 'competition rule' in Part XIB of the Act, which is specific to the telecommunications industry, is illogical, draconian, and indefensibly more restrictive than equivalent provisions in the Act that apply to other industries; could discourage competition rather than enhance it; and poses the danger of penalising success in the competitive process and thereby discouraging competition, and outlawing quite normal and competitive commercial negotiation and behaviour; and
- who is also concerned that the vast regulatory framework within which the telecommunications industry now has to operate is so intrusive, and involves govt. regulatory authorities (the ACCC and the ACA) so much in the operation of the industry and in making commercial judgements that are normally made by suppliers and buyers in the commercial world, that it poses the risk of the industry being seen as operated by the Govt, with Telstra and other carriers as merely its 'agents'.

PART 111A (THE GENERAL ACCESS REGIME)

2. Although it is the Part XIC access regime governing the telecommunications industry that is under review, it might be helpful to compare some of its features - and its rationale - with those of the general access regime, Part 111A.

3. Part 111A was introduced as a direct result of the Hilmer Report and the resultant Competition Policy Agreements between the Commonwealth and the States, the philosophy underlying it being that anyone supplying a service using a facility which cannot be economically duplicated (a natural monopoly) should be required to provide access to that facility, on reasonable terms, to suppliers or buyers *in markets that are 'downstream' or 'upstream' of the market in which the facility operates*, if that would permit effective competition in the 'downstream' or 'upstream' market.

4. Part 111A was intended to act as an 'umbrella' regime to cover other specific regimes (largely State regimes) relating to (e.g.) electricity, or natural gas, where the transmission facilities almost certainly constitute 'natural monopolies', but there is scope for competition in the production and sale of the product - provided the entity that owns the transmission facilities isn't allowed to control or dictate, through that ownership, production and sale as well as distribution.

5. There can be debate as to whether this regime is really necessary, given that anti-competitive conduct by monopolies (including unreasonable refusal of access by others to their facilities) is already covered by the existing monopolisation provisions of the Act; debate as to whether this kind of regulation helps particular competitors rather than the competitive process itself; and debate as to whether intrusive regulation like this, aimed at bringing suppliers together as compared with most competition regulation (which aims to keep competitors apart, and make them compete at arms length), is more likely to lessen or discourage competition in the long term than enhance it. However, as it is Part XIC that is under review, not Part IIIA, that debate can be left aside - other than to comment that whatever arguments there are against the general regime, they are magnified when it comes to the telecommunication specific regime, given the more intrusive and different nature of that regime (as discussed below).

PART XIC - THE TELECOMMUNICATIONS SPECIFIC ACCESS REGIME

6. Probably the most important difference between Part 111A and Part XIC is that Part 111A can be invoked only if access to the service provided by the natural monopoly facilities is required to enhance competition ***in another market***, in a market "other than the market for the service" - whereas, under Part XIC, there is no such requirement. The only requirement for applying Part XIC is that access to the facilities concerned (obviously, access by so-called competitors of Telstra to Telstra's network and other facilities) would, in the ACCC's opinion, promote the long-term interest of end-users of telecommunication services (a very broad concept indeed); and would promote competition ***in telecommunication services*** (not competition in another market), 'any-to-any connectivity', and economic efficiency (again, a very broad term).

7. In other words, Part 111A is intended to overcome the adverse impact that a 'natural monopoly bottleneck' could have on competition in other markets - whereas Part XIC aims to break up a monopoly in the telecommunications market itself. This raises two significant points about competition policy. First, should the Govt. be attempting to manipulate or alter the *structure* of an industry, when up to now competition policy and law has been essentially directed at regulating industry *conduct* in the interests of competition (the exception being merger provisions, which, for a number of reasons, should probably be repealed - or at least revert to applying only to the creation of monopolies - anyway). Second, the question arises whether there is really much scope for creating *genuine* competiiton in a market that is constituted largely by a natural monopoly, as distinct from 'pretend' competition of the kind that prevailed under the old, and now discredited, two-airline policy - or as distinct from a kind of "Govt.-arranged market sharing' of telecommunications services, or a sharing among a number of suppliers of the spoils of a natural monopoly. (This question of the scope for competition in the telecommunications industry is discussed further later).

8. Moreover, as far as I know, the Hilmer Report, the 'bible' on competition policy, did not recommend that Govt. legislate to try to break up monopolies - so that Part XIC cannot be said to have the backing of Hilmer.

9. In my view, Part XIV should never have been introduced - and if a need was seen to guarantee access to telecommunications facilities for the transmission of the products of other markets such as radio or TV programmes (although I doubt that there was, or is, such a need), then Part 111A would cover that. However, how to now 'unscramble the egg' is something for the Commission to consider.

PART XIB - THE COMPETITION RULE

10. One of the worst features of the telecommunications specific competition regulation is the provision in Part XIB (obviously aimed at Telstra) that a supplier with a substantial degree of power is acting unlawfully if he takes advantage of that power with the **effect or likely effect** of lessening competition. That is quite discriminatory, in that it could prevent Telstra from competing with other carriers in ways that are regarded as quite legitimate in other industries. The equivalent general provision in the Act (s.46, concerning monopolistic conduct) enables a strong supplier to do things, things it is able to do only because of the strong position it has attained, to compete with its less successful competitors. It outlaws such conduct only if its intention, its **purpose**, is to eliminate or damage a competitor. On the other hand, similar conduct by Telstra, normal competitive conduct quite legal under s.46, would be illegal under Part XIB if it has the **effect** of lessening competition.

11. This distinction between a test of 'purpose' and a test of 'effect' is very important indeed. For example, if a strong firm in an industry other than telecommunications took advantage of its size and power to negotiate a lower price for its inputs than its competitors (a common and perfectly acceptable business practice), and that gave it a considerable competitive advantage over its competitors, that would not be regarded as unlawful under s.46 - unless it was done with the *purpose* of damaging or eliminating its competitors. However, in Telstra's case, there is a serious risk that it would be breaching Part XIB if, regardless of its intention or 'purpose' in negotiating lower prices (e.g. to keep costs down), that enabled it to reduce its prices - and that had the *effect* of taking business away from its competitors to an extent where their competitive ability was weakened or they went out of business, and the ACCC or the Federal Court thought that substantially weakened the competitive process.

12. A further example is if Telstra is able to "take advantage" of its size to set lower prices than its competitors (e.g. because its size gave it better economies of scale), that might be regarded as unlawful if it had the *effect* of taking a lot of business away from its competitors and as a consequence substantially lessened competition - even if the prices it set were not lower than its costs.

13. This clearly must have an inhibiting effect on Telstra's ability to compete with Optus and other new entrants to the industry. And competition law shouldn't favour some competitors over others, or keep some participants 'down' in an attempt to bring others 'up'.

14. And given the comparative size of Telstra and other carriers, it is no answer to say that Part XIB applies to all parties, not only Telstra. Nor is it an answer to say that Part XIB wouldn't in fact be applied in the way I've suggested. If there is law that *could* be applied to prevent quite normal and sensible commercial conduct in an industry, it is intimidating law, and should not be on the statute books.

15. Part XIB should be repealed forthwith, leaving the general monopolisation provision in the Act (s.46) to apply in this industry as well as in all other industries.

THE SCOPE FOR COMPETITION IN TELECOMMUNICATIONS

14. There are two questions to be considered here -

- whether the very extensive and intrusive Govt. regulation of this industry is conducive to the achievement of genuine competition; and
- whether the nature of the industry, which would appear to rely very heavily indeed on facilities that constitute a 'natural monopoly', really lends itself to a competitive structure.

GOVT. REGULATION

15. Before discussing either of those questions in detail, however, it might be said, as a broad comment, that the present scenario of Telstra, Optus and others squabbling over such things as the terms of access to Telstra's facilities, the 'churning' of some services, Optus and others providing precisely the same services that Telstra provides but relying very heavily on Telstra's own facilities to do so, and the heavy involvement of regulatory authorities like the ACCC and the ACA in the industry, isn't exactly evidence of real competition. Nor is the fact that prices of many telecommunication services have come down considerably, or not increased, in recent years. Some people might see that as due to, or evidence of, competition in the industry. However, the reality is that such price reductions have been very largely the result, not of competition, but of dramatic technological advances in the industry in recent years, which have reduced costs and created additional demand for telecommunication services (the latter having the 'doubling-up' effect of also reducing unit costs and enabling price reductions). And such reductions would probably have occurred even if Telstra were still the sole supplier of telecommunication services.

16. On the matter of Govt. regulation of the industry, it is almost axiomatic that Govt. regulation, if overdone, is the very antithesis of competition - and even though the extremely detailed and intrusive regulation of this industry might have the effect of bringing a number of suppliers into the industry whereas in the past there was only one, its very existence might well mitigate against achieving *real* competition in the industry - real competition, as distinct from the industry's business being shared among a number of suppliers by Govt. edict.

17. This is perhaps illustrated by the fact that, whereas competition legislation is normally aimed at keeping competitors apart, requiring them to compete at arms length, Part XIC (and, for that matter, Part 111A) doesn't do that. On the contrary, it is legislation that requires 'competitors' to come together in relation to a large part of their input (i.e. Telstra's network), *and* authorises a Govt. regulatory body to determine the terms of access to that network. And in doing this, Govt. is making commercial judgements that are normally made by suppliers and buyers in the commercial world - for example, judgements as to whether or not it would be economic to duplicate particular facilities (which involves judgements about future supply and demand, consumer habits and preferences, etc), or about the most economic use of facilities; judgements about the costs of operating and providing particular services, the most efficient way of providing and maintaining a network, etc..

18. Also, of course, there is the industry specific Part XIB mentioned earlier, which could inhibit quite legitimate competitive conduct, and favour some 'competitors' over others - something that competition legislation should not do.

19. And Govt.regulation of the industry doesn't stop there. There is also the Telecommunications Act and the ACA, which also exercises very extensive and detailed control, and gives the Govt. considerable powers over the industry - including some pricing powers, and including a right to require Telstra or other carriers to carry out what are called Universal Service Obligations at a loss, with the loss to be borne by the industry rather than Govt. (a quite questionable arrangement), and with the Govt. even having the power to calculate what that loss is and how much of it will be borne by each carrier. Again, an example of how a Govt. agency can affect the competitive position of each supplier vis-a-vis the others.

20. In fact, this industry is probably the most heavily regulated industry in Australia - so much so that it has the appearance of being an industry that is operated by the Govt., with Telstra and others being its 'agents'. That doesn't make the industry a good candidate for a truly competitive structure. Perhaps it is time the Govt. stopped trying to create more competition in this industry, and left it to market forces and the characteristics of the industry itself to determine the industry's structure and the degree of competition within that structure, and simply regulate its conduct to outlaw conduct considered anti-competitive - in the same way that it does other industries. It's an appropriate role for Govt. to regulate to try to *protect* competition; but it's highly questionable that Govt. should be regulating to try to *create* it (particularly as the market, if regulated to guard against anti-competitive conduct by participants, will ensure it occurs anyway *where there's room for it*. The question whether there is in fact much room for it in the telecommuniocations industry is discussed next).

THE NATURE OF THE INDUSTRY

21. If the Govt. does insist on trying to create competition in an industry, it should be careful to do so only in industries whose characteristics are such that it's clear there is sufficient scope for it, and a prospect of gaining the benefits that competition can bring. As the Hilmer Report made clear, competition isn't something to be revered for its own sake. It's only worthwhile if it forces suppliers and buyers to use resources more efficiently as they struggle to survive and beat their competitors - ***and*** *to do so to an extent that more than offsets the additional resources that competition often involves* (e.g advertising, higher unused production capacity at any time, diseconomies of small scale, etc.). And whether that balance can be achieved depends very much on the characteristics of the industry - in particular whether the nature of its inputs to provide its services provide scope for competitive forces to achieve reductions in costs, to a greater extent than the additional resource costs that the competition brings with it.

22. For example, almost by definition, there's little scope for meaningful competition in an industry whose production facilities have 'natural monopoly' characteristics (e.g. a highly capital-intensive industry whose production facilities, because of the level of demand - present or potential - and other factors, cannot be economically duplicated by would-be competitors). It may be that, being in a monopoly situation and therefore not under competitive pressures, the production facilities are not being used as efficiently as they might be. But competition is not going to cure that - because, if production facilities cannot be economically duplicated, either a would-be competitor isn't going to stay in business long (so that the industry reverts to a monopoly situation), or the former monopolist is forced out (with the same result).

23. And if there isn't the scope, as in the case of a natural monopoly, for competition and the greater efficiencies and reductions in costs and prices that competition (in a proper setting) can achieve, then the community is left to bear the additional costs that competition entails (and perhaps also the cost of Govt. regulation desperately trying to maintain competition where there's really no room for it), with little or no offsetting benefits.

24. That leads to the question whether telecommunications fits into the category of an industry which to a large extent has natural monopoly characteristics, and therefore does not provide much scope for *real* competition (as distinct from a spreading of supply among a number of suppliers by Govt. edicts of various kinds, such as declarations under Part XIC and determination by a Govt. body of the terms of access by others to Telstra's network). In my view, the answer is that it probably does - that the telecommunications industry has a greater element of natural monopoly than most others, with all suppliers depending heavily on the same facilities to provide their services, thus severely limiting the scope for real competition between them. Certainly one supplier taking over from another to supply a telephone service, using the same facilities to do it, doesn't necessarily constitute meaningful competition .

25. In this regard, telecommunications is different from other major utilities such as electricity and gas -which, with the impetus of Hilmer and the Competition Agreements, seem to be regarded (and perhaps rightly) as ripe for the introduction of competition. In those industries, supplying the product to end-users involves two (perhaps three) fairly discrete activities - one being production of the product itself, and the other being transporting it from the point of production to end-users (and perhaps the third activity being that of 'middlemen' buying and selling the product). And there's probably scope for competition in the production or selling activities (the generation and sale of electricity - or the extraction and sale of natural gas), but not much scope for it in the transmission and distribution networks to get the products to end-users.

26. Telecommunications also involves the transmission and distribution of 'products' - the transmission of voices and data from point A to point B. But in this case there's no 'product' to produce and sell. There's no concept of 'producing' what's to be transmitted, or scope for 'competition' in the production of what's to be transmitted; what has to be transmitted is simply the voices of people and data from point A to point B. (I leave aside here broadcasting of such 'products' as TV and radio programmes, which are products of markets where there clearly *is* scope for competition, seperate from the telecommunications market itself. If a need is seen for an access regime to protect competition in those markets, that is precisely what Part 111A is for. There's no need for a Part XIC as well).

27. For the above reasons, there's probably less scope for meaningful competiition in telecommunications than in other utilities like electricity and natural gas. And as a large part of Telstra's telecommunications network (its 'mesh' connecting points A, B and all other letters of the alphabet) is almost certainly a natural monopoly, and as suppliers other than Telstra have to rely so heavily on Telstra's network to supply their services, the question has to be asked whether that factor also mitigates against the achievement of genuine competition in this industry in the long term.

28. It might be argued that telecommunications involves a number of separate markets, some of which provide scope for competition, and some (those with a large 'natural monopoly element') not - but with those 'natural monopoly markets' having the ability to stifle competition in others. On the other hand, it can be argued - as I do - that telecommunication services constitute one overall market, the transmission of voice and data from one point in

Australia to another -or others. Certainly I find it difficult to regard, for example, local calls and STD calls as two separate market - or a call from person A in Sydney and person B in Perth as involving two separate markets, one the 'market' for services from house to local exchange, and the other the 'market' for trunk line services from Sydney to Perth. And as indicated earlier in the comparison with electricity, there is no concept of a 'market' that produces the 'product' that is transmitted over the telecommunications network, or a market that 'sells or markets' the product; the only 'products' are the voices and data of people, which are not 'produced' in the economic sense, and do not need 'selling and marketing' in the normal economic sense.

29. It might also be argued that selling and marketing of a transmission service itself, the facilities through which the voices and data pass, constitutes a separate market from the provision of the transmission service itself. In my view, that is highly debatable. It is a strange kind of 'market' if the service all participants are offering involves to very large extent use of the same assets - so that to a large extent all suppliers are offering very literally the same service, with the only noticeable difference being that the client sees one supplier's name on his bill instead of another's. And if this *is* treated as a 'market', as discussed later it's a 'market' where there is very little scope indeed for meaningful competition.

30. However, even if one regarded the telecommunications industry as consisting of a number of separate markets instead of constituting one overall telecommunications market (or even as part of a larger 'communications market', including postal services, and even perhaps passenger transport services), it still does not justify the existence of Part XIC. On the contrary, it demonstrates more clearly the lack of a need for it, bearing in mind the existence of the access regime in Part 111A - which was designed precisely to cover the situation of a monopoly in one market hindering competition in other markets. And if the latter view prevails (that telecommunications constitutes one overall market), then it is inescapable that Part XIC amounts to an attempt to break up a monopoly, or create competition in a monopoly market (as distinct from preventing a monopoly from hindering competition in other markets) - and the reservations raised in this submission about that warrant serious consideration. In other words, either there is no need for Part XIC; or the concerns about it should be addressed.

31. Expanding the discussion in para. 29 as to whether there is scope for competition in the selling and marketing of telecommunication services, as I indicated there, in my view, while other carriers have to rely heavily on Telstra's network (or key parts of that network) to provide "their" services, there is very limited scope indeed - at least scope for genuine competition which can yield a net saving in resource use and cost from this activity. The question is whether the 'quantum' of competition that's possible, and hence the scope for individual competitors to achieve greater efficiency and reduce their costs, in that segment of the industry is sufficient to yield efficiencies in resource use which outweigh the additional resource cost that the competition itself involves. And if a high proportion of the inputs for suppliers other than Telstra are Telstra's resources (over which other suppliers have no control as to operation, maintenance, etc., and which they use for a uniform price determined ultimately by the ACCC anyway), it's doubtful that it is.

32. Of course, the more that suppliers other than Telstra provide their own resources rather than rely on Telstra's, the more this situation will change - so that, ultimately, there could well be real competition, with a number of suppliers , each with ownership and control of their own facilities, and operating at arms length from each other. But to the extent that happens, it will not be due to PartXIC, and there is no need for Part XIC. There is no monopoly to break

up. So the more the carriers other than Telstra look to see when investment in their own facilities becomes economically feasible, the better it will be. But the 'comfort and security blanket' that Part XIC gives them is a disincentive for them to do that - so that Part XIC, in effect, delays the day when there might be *genuine* competition in the industry.

33. A comment on the ACCC's power to decide the terms (including price) on which Telstra must provide its competitors with access to its network is also worthwhile.. It might be argued that this is where the scope exists for pressures to be put on Telstra to achieve greater efficiency in the operation and maintenance of its network - that the ACCC can determine prices that are less than Telstra's costs, and thus put pressure on Telstra to become more efficient and reduce its costs to that level. That is a highly questionable approach, and one that poses considerable dangers - not only for the unwarranted damage it can do to Telstra (and its work force, incidently) if the ACCC doesn't 'get the price right' (which is quite likely if ,as a Govt. regulatory agency standing apart from the industry, it doesn't have real knowledge or experience of the 'ins and outs' of operating and maintaining the network); but also because it could discourage other suppliers from investing to set up their own facilities to the maximum extent possible (the only chance there is of getting real competition in the industry in the long term); and because 'not getting it right' must result in some competitors being favoured over others (something that competition law should avoid). Also, of course, while it might be thought appropriate for governments to *encourage* industry to become more efficient, it's debatable that it's appropriate for governments to try to *force* it.

34. But apart from all that, if the Govt. is intent on forcing Telstra to become more efficient through a price control mechanism, it doesn't need to set up an access regime, and try to create some form of 'pretend competition' in the industry (with the additional resource costs that involves), to do that. It's not uncommon for Govt. to maintain some control over monopoly pricing - and, indeed, in the case of a natural monopoly, that's a less costly way to try to improve efficiency than the alternative of attempting to provide a natural monopoly with 'competition' (although, even then, the main objective should be to prevent monopoly profits, not set cost objectives).

A FINAL COMMENT

35. I do not feel it necessary to summarise the objections I have raised to the existence of Parts XIB and XIC in this submission. One final broad comment, however. I have suggested that the existence of these provisions tends to create a costly and artificial Govt.- managed kind of 'competition' which, in the circumstances of this industry, is unlikely to yield the efficiencies that real competition can, and that this is an inferior option to letting market forces determine the structure of the industry and the degree of real competition within it (but with some degree of monopoly price control if there is a large natural monopoly element in the industry, and the degree of competition isn't sufficient to keep costs and prices down). Unfortunately, not only are such provisions the inferior option; while they are on the statute books, they will prevent or hinder achievement of the preferred option.

36. The structure of any industry, and the scope for competition within it, will change as time passes. With increasing populations, with increases in demand and changes in the nature of the demand, and with developing technology throwing up new and more efficient ways of doing things, it becomes economically feasible in time for 'natural monopoly' facilities to be duplicated by would-be competitors of the monopoly supplier, or for them to provide the same service via some other kind of facility - so that, in due course, market forces (if left to operate as they should) will ensure that a former monopoly market becomes a market in

which competition can thrive. And that is a desirable kind of development. However, it won't occur in the telecommunications industry while Govt. has legislation in place which enables would-be competitors to use Telstra's facilities to compete with it for supply of the services those facilities provide, rather than the preferred alternative of them developing their own facilities to do that. And they will certainly take the 'easy and cheap' option if the ACCC uses its pricing powers to dictate an 'efficiency' price for that access which is lower than the actual cost of operating and maintaining the network, thus giving those seeking access the benefits of efficiency without them having to work for it - and at the same time putting Telstra at a competitive disadvantage vis-a-vis the others.

37. Perhaps the time has come to take these provisions, Parts XIB and XIC, off the statute books, have the normal competition laws (including the monopolisation provisions of the Act, s.46) apply to this industry as it does to all others, and allow market forces to determine the structure of this industry and the scope for genuine competition within it - part of that process being that would-be competitors of Telstra would be forced to make their own investment decisions about new (and perhaps more efficient) facilities of their own.

38. It is, of course, for the Commission - and, ultimately, the Govt. - to judge whether there should be a phasing out period to give Telstra's competitors time to wean themselves away from Telstra, and to stand on their own two feet as participants in other industries do.

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