The Presiding Commissioner
Review of Telecommunications Specific
Competition Regulation
Productivity Commission

6 May 2001

Dear Sir

I attach our submission on your Draft report released on 29 March.

Yours sincerely

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TELECOMMUNICATIONS COMPETITION REGULATION

PRODUCTIVITY COMMISSION DRAFT REPORT

SUBMISSION BY THE INSTITUTE OF PUBLIC AFFAIRS

General Points

We commend the Commission on the production of a thorough and wide-ranging Draft Report. That it is the standard expected of the Commission should not be cause to omit mention. In a world where public information and misinformation is profuse, trusted and standard references are the more important.

The size, detail and complexity of the Draft reflects the Commission's traditional approach, magnified in this case by the nature of the sector under study but further amplified by the intricate web of regulation which determines or influences so many of the crucial commercial and economic parameters.

It would be instructive to step back and ask what regime of regulations would now be put in place if none existed. That is a threshold question. We suspect that such a regime would be different not only from the current one but also from that envisaged by the Commission. But, to paraphrase the Irish joke, "If you were going to Utopia, you wouldn't start from here."

Having said this, it would have been easy to fall into the intellectual trap whereby perception of monopoly power leads inexorably to competition regulation, then to price controls and on to detailed supervision of access to facilities, capital investment, product characteristics and quality and the "equitable" treatment of all consumers. We are already deep in the trap in practice and the Draft proposes an attempt at partial extrication.

The direction of the Draft towards lighter-handed regulation is then laudable. It is consistent with the original intent of the government and the fact that changes to the industry structure and rapid technology advances have overtaken the existing regime.

Even though the proposed changes are not revolutionary, those with established interests in the current regime will attack them. We urge the Commission not to concede the principal proposals for change, particularly given the unlikelihood of a similar review being conducted within the next few years.

One matter of concern that spans the Draft is the deficiency of some crucial data. There is no shortage of data generally but the opacity of crucial price data and the consequent difficulty in contriving appropriate shadow prices weakens the Draft. Paradoxically, this also points up the futility of a regulator trying to produce synthetic prices. The tension between consumption and investment, which is illustrated in the price disputes, is one of the central themes of the Draft. The approach taken by the Commission may be the best we can hope for and we support it (see below).

The Findings

We are in agreement generally with the findings of the Draft.

The conclusion that the telecommunications network in Australia is not a natural monopoly represents a maturing of our understanding of the industry reinforced by the structural and technological changes it has recently undergone. It deserves wide currency publicly. It should inform all policy decisions hereafter in the knowledge that the disappearing monopoly is not just a state of affairs but is progressive.

We must avoid thinking in static terms. It is increasingly clear that even the local access network is a decreasing and decreasingly significant monopoly. We have argued that it may well be sustained by the current regulations. There is a risk that the regulations will turn into new shelters for those "new" entrants who are comfortable with the regime they know. Such operators may not necessarily be inefficient. Indeed, some of the calls for continued protection may come from operators who have stretched their competitive efforts to the limit, possibly over-discounting, and are now reliant on continued access at unrealistic prices to sustain their marketing. It justifies a readiness on the part of government to liberalize rather than taking a conservative line.

The rejection of the option of returning to a statutory monopoly (like the old Telecom) is also welcome. There is still nostalgia in some quarters for the old days when it took a month for upwards of four technicians to arrive to correct a line fault. The malfunctioning of the current industry structure still owes something to the continuing government part-ownership of Telstra and interference in its operations by various government agencies.

The Draft's documentation of the potential for regulatory failure and its economic costs is salutary. Regulation is always a second best course of action. There has been something of a doctrine of infallibility built up around the ACCC, which is both unhealthy and unfounded (as its staff would no doubt admit). It is essential to maintain public confidence in agencies such as the ACCC but confidence is more likely

to be enduring if the limits on bureaucratic omniscience and omnipotence are well understood.

The Commission's counter-intuitive conclusion that, in some circumstances, access prices that are too low could be more adverse to the general welfare than prices that are too high needs to be more widely appreciated. The old mantra of "low price good, higher price bad" needs to be qualified.

We agree with the Commission that the telecommunications sector is unique but we do not believe that it follows that it requires a unique set of regulations. Every industry is unique in its own way. We continue to believe that telecommunications does not have, or no longer has, a sufficiently distinct set of characteristics that justify a separate regime. We do not know of an industry that does.

The Recommendations

We support most of the Commission's recommendations. It was always accepted that there would be a need for competition regulation of this sector. The debate is largely about how heavy-handed this needed to be. The Commission has been relatively bold. In some areas we think that it could still be bolder.

Part XIB

We strongly support the repeal of Part XIB of the Trade Practices Act. We believe that it is a redundant attempt at regulatory perfection. It is a clear case where the existing generic Part IV regulation would more than suffice. Furthermore, the potential reversal of the onus of proof in Part XIB is an objectionable extension of state powers and ought not to be tolerated beyond the period of absolute necessity. This, combined with the heavy penalty scale and the "likely effect" provision, constitutes an overwhelming case for repeal.

Part XIC

We disagree with the Commission that a sufficient case exists for the retention of Part XIC. We believe that the proposed revised access regime in Part IIIA would provide adequate powers when combined with the other powers under the Act to prohibit and punish anti-competitive conduct.

Looking at the counterfactual, what would happen if Part XIC were not there, it appears likely that the ACCC, with all its existing knowledge and powers, could enforce access promptly and effectively in the few areas where it remains an important potential constraint.

Several other reasons are worth considering:

- The established trend towards greater diversity in communications media and the increasingly effective and powerful competition suggest that the generic provisions of an amended Part IIIA will be proved to be adequate well before another serious policy review is likely. This is a rare opportunity for timely reform.
- The extremely high customer churn figures indicate that the competitors to the incumbent are able to offer attractive products and that customers are footloose and discriminating. Given present levels of regulatory knowledge and experience and the generic provisions we would not expect there to be much "backsliding" in the provision of timely access and the related commercial opportunities.
- The content of Part XIC drives much of the detailed supervision of the sector and of Telstra by the regulator. While these provisions stand, the ACCC almost cannot help intervening in a detailed and heavy-handed way.
- Although the access determinations are detailed they are also slow and unpredictable, adding a layer of uncertainty to commercial calculations and activities. It is possible that, under a generic regime, a clearer and more consistent set of access principles could emerge.
- The expectation of greater competition in the local loop has been disappointed even though CW Optus has had every opportunity and protection to compete and has an extensive network. We believe that the rigorous application of XIC may have had a part in this and that, if it were repealed, duplicate facilities might be more likely to be commissioned.

We have argued elsewhere that there are now two sets of pricing braces (the caps and sub-caps) and two or more competition belts (Parts IIIA and IV and XIB/XIC, including access pricing). We can rid ourselves of one set of braces and one belt (XIB and XIC) without fear of our regulatory trousers falling down. We urge the Commission to reconsider Part XIC and recommend its repeal.

Having said this, the proposal to align Part XIC more closely with a revised Part IIIA is an advance on the current system. The broadening of the objects test, the tighter set of declaration criteria and the convergent pricing principles are all worthwhile reforms (but see below).

Other

We believe that **access holidays** would need to be carefully specified, given their arbitrary nature and potential for amendment or withdrawal in the political processes. Politicians simply cannot be trusted to keep their word over the medium term or to commit their

successors. If access holidays were to be adopted as a part of policy they would need to be expressed in the form of contracts with compensation clauses so that companies could make long term investment decisions that factored in a firm set of rights to the proceeds of their enterprise. It is an unsatisfactory and inefficient outcome of the present regulations that operators can simply sit on the sidelines and make a risk-free application to appropriate part of the reward from the enterprise of others, mobilising popular/political support where necessary to achieve their commercial advantage. There is an appropriation of property rights which is at present uncompensated. The length of the holiday would be determined by the size of the investment, the risks involved compared to the expected profit over time. This would need to take account of any parallel powers held by the regulators to take action, which might vitiate the holiday (eg insistence on further investment or higher levels of product quality). It would also require a strictly time bound process for granting the holiday.

The proposed **tighter declaration criteria** at Draft Recommendation 8.3 do not seem to go far enough. We agree that there is no point in declaration unless the telecommunications service is of significance to the national economy. It appeared that the Commission was also coming to the conclusion that something stronger than a likelihood of improved efficiency would be required. The wording "will clearly substantially improve" rather than "is likely to improve ..... significantly" would confine declaration to those cases worthy of the attention of the regulator.

We strongly support the **removal of access price controls** that lead to the access deficit. Although we believe that price monitoring would be a better way of dealing with terminating charges for mobile markets, we do wonder whether there is a need even for monitoring given the competition in the mobile market. After all, if the operators of small networks charge high prices for access to their subscribers do they not fall foul of the Act? Are they not exercising a non-trivial degree of market power? And if they are not, then does it matter? Are they not likely to be counter-charged in some way? As to the operation of price monitoring, the effect will generally depend upon the degree of exposure of pricing behaviour or the implicit threat of more concrete action by the regulator. We would prefer that a provision for monitoring would contain provision for transparency rather than establishing disguised powers of control as existed under the Prices Surveillance Act.

We have argued for a broadening of the **objects clause of s.152AB (1)** to take account of the general rather than simply consumer welfare. It is becoming clear in current public debate that a focus on first round or one-dimensional targets can result in "collateral damage". Some recent rural reforms show how changes to regulations can produce

uncompensated side effects. Nevertheless, we fear that the Commission's formulation "overall economic efficiency" at Recommendation 8.1, although it actually embraces the general welfare, is not widely understood. Indeed, in the current perverse state of the debate on public policy, it is generally wilfully misunderstood. Moreover, we understand that the Courts are now less likely to seek or countenance specialist advice from economists and more likely to rely on a generally understood meaning of the wording of laws. To the extent that the attacks on so-called "economic rationalism" are an attack on rational thought itself, there is not much we can do about this. But, as this proposed change is likely to be fixed on as diluting the care for consumers, we suggest that a more clearly inclusive formulation be made. Why not replace the word "efficiency" with "welfare". The qualifying word "economic" would remain, along with "promoting efficient use of, and investment in, telecommunications services."

While we agree with Recommendation 10.3 for **public disclosure of costing methodologies**, we think that the idea of an independent expert group is unlikely to lead to agreement on methodologies within a useful time limit. It might turn into an expensive talking shop. It is probable that public disclosure will lead an effective informal peer review.

If the principal recommendations of the Report were to be accepted by the government, we suggest that the remaining areas of special treatment of this sector under competition regulation would be narrowed sufficiently to permit review within a relatively short time frame with a view to further deregulation. We think that a specific time frame for review and further deregulation should be set.

Institute of Public Affairs

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