Telstra

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Mr John Cosgrove
Commissioner
Productivity Commission
Impact of Competition Policy Reforms Inquiry
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Dear Mr Cosgrove

Impact of Competition Policy Reforms on Rural and Regional Australia

Telstra is pleased to make a submission to the Productivity Commission Inquiry examining the effects of competition policy reforms on regional Australia.

Telstra's submission outlines a range of benefits that have accrued to the Australia economy as a result of liberalisation of the telecommunications sector. In Telstra's view, the benefits of competitive reforms have not been evenly distributed across all geographic markets or all customer groups, partly as a result of the distributional impacts of regulatory reform that have occurred under the current telecommunications regulatory framework.

In Telstra's view, there is scope within the current telecommunications regulatory arrangements to give a greater focus to the trade offs and costs of meeting social policy obligations when regulators make decisions to intervene in the market on competition policy grounds. These issues are outlined in detail in Telstra's submission. Telstra has also made a separate submission to the Senate Select Committee inquiry on the Socioeconomic Consequences on the National Competition Policy.

I would be pleased to discuss aspects of the submission with you at a later date.

Yours sincerely

G. B. Ward.

Graeme B. Ward
GROUP DIRECTOR
REGULATORY & EXTERNAL AFFAIRS

PRODUCTIVITY COMMISSION INQUIRY

IMPACT OF COMPETITION POLICY REFORMS ON RURAL AND REGIONAL AUSTRALIA

CONTENTS

EXECUTIVE SUMMARY

Telstra believes that growing competition in the telecommunications seçtor is delivering benefits for the Australian economy and for users of telecommunications services. Competitive reform of the telecommunications sector has led to significant growth in the industry. Growth in communications sector output was 12%, compared to 4.3% for the economy as a whole for 1997/98.

Significant new investments are being made by the new carriers and service providers, totalling some $338 million in capital expenditure and some $550 million in research and development during 1997[1]. This level of activity has economy-wide benefits in terms of choice of new services, innovation in products, and job creation.

For Telstra's part, of the $10 billion Telstra has invested outside capital cities since 1985, some $3.7 billion has been directed to the provision and maintenance of infrastructure to service rural and remote customers. Telstra's investment per customer in areas outside capital cities is nearly 50% more than for metropolitan customers.

In terms of access to basic telephone services, telephone ownership levels have been increasing over time, with the gap between city and regional users telephone ownership levels narrowing. In 1989, 93% of capital city households had access to a telephone service, compared to 87% of households in rural areas and other towns. By April 1997, this gap had closed to a 3% difference - 96% of households in capital cities had access to a telephone service, compared to 93% in rural areas. Compared to a number of other selected countries, 1997 data indicates that household telephone penetration levels in Australia on average, are comparable or higher than those in other countries

With current market developments in a range of new access technologies, including satellite, radio and mobile technologies, arguably rural and regional consumers now have a wider choice of service providers and access to a range of competing technologies. For example, ISDN links are significantly more widely available in Australia than in Canada and the United States. Telstra expects that it will be able to supply ISDN to over 96% of the Australian population by the end of December 1998. The Canadian and US carriers, on the other hand, can only supply ISDN to respectively 70% and 80% of subscribers. In the US, only 27% of the customers served by the local exchange carriers, which typically serve those areas with 20 or fewer customers per square mile, have access to ISDN.

Competition has also delivered significant price reductions for consumers. During the period of limited duopoly competition, Telstra's retail prices had fallen on average by 23% over the period 1991/92 - 1996/97. Over the past 12 months of full and open competition, Telstra has for example, made permanent price reductions totalling some $90 million in savings to consumers.

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[1] Department of Industry Science and Tourism, Communications Industry Pulse Survey, 1997.

However, the distribution of competitive benefits is not always even across markets and customer groups. The telecommunications regulatory framework provides a range of safeguards, which although not specifically linked to national competition policy reform, either protects consumers from any uneven impacts of competitive reforms, or alternatively redistributes the benefits of competition to particular end users or market participants. The redistribution can take the form of cross subsidies under universal service obligations (USOs) or price controls.

The further development of competition in regional areas is likely to be hindered by regulation that restricts the ability of Telstra and other companies to compete equally. As competition erodes Telstra's margins in profitable areas, the ability to fund community service obligations in rural areas and make the necessary investments to compete with new players, becomes increasingly constrained.

The interaction between different regulatory requirements inhibits competitors from providing alternatives services and developing facilities based competition, where they cannot compete on charges which are set under price control arrangements, below the cost of supply. There is also a welfare cost where price controls compel Telstra to charge economically inefficient prices.

Failure to take these CSOs into account in competition regulation puts into doubt the long term funding and efficient delivery of these social obligations in a multi-carrier environment.

In Telstra's view, a better balance between competitive outcomes and consumer interest, including those of regional consumers, could be achieved where the ACCC is explicitly required to recognise the cost of meeting CSOs when applying the long term interest of end users criteria in its administration of Part XIC of the Trade Practices Act or in exercising its competition functions and powers under the Telecommunications Act.

To ensure that the policy trade offs between supporting social obligations and promoting competition are explicitly recognised, Telstra recommends amendments to the Trade Practices Act to ensure that the ACCC considers the cost of these social obligations in relation to

- assessing the long term interest of end users;
- assessing the reasonableness of access undertakings; and
- arbitrating on the terms of access to services and facilities.

Specifically Telstra recommends

- a new provision, section 152AB(2)(f) of the Trade Practices Act be enacted to ensure that in determining whether a particular thing promotes the long term interests of end users, both in respect of assessing whether to declare access to services under s.152AL of the Trade Practices Act and in undertaking long-term interest of end-users assessments where required under ss 384(5) and 458(5) and sch1, s17(3) of the Telecommunications Act, the ACCC have regard to

  "recognition of the CSOs fulfilled by an access provider - including recognition of the costs and funding arrangements associated with those CSOs."

- a new provision, section 152AH(1)(g) of the Trade Practices Act be enacted to ensure that in assessing the reasonableness of an access undertaking, the ACCC have regard to

  "whether the access provider fulfils any CSOs, including the costs and funding arrangements associated with those CSOs."

- a new provision, section 152CR(1)(h) of the Trade Practices Act be enacted to ensure that in making an access determination, the ACCC have regard to

  "whether the access provider fulfils any CSOs, including the costs and funding arrangements associated with those CSOs."

1. INTRODUCTION

1.1. The Productivity Commission's Issues Paper makes reference to the reform of markets and the reform of government monopolies, including Telstra, as elements of implementing National Competition Policy (NCP) principles. Telstra's submission addresses the impacts of competition reform in the telecommunications industry, and the impacts on Telstra, whilst primarily focussing on the distributional impacts of competition policy reforms in telecommunications. The submission examines the Inquiry issues dealing with the following:

- effects on service delivery in country Australia of reform of government monopolies;
- the distribution of the benefits and costs from National Competition Policy (NCP) between metropolitan and country Australia; and measures to facilitate the flow of benefits or reduce the costs to country Australia
- possible differences between country and metropolitan Australia in the nature and operation of major markets as a result of NCP reforms, including the cost of provision of telecommunications services, service standard, employment and opportunities for business locations.

1.2. Part 2 of Telstra's submission examines the current market structure in the communications industry and impacts of regulatory reforms on market opportunities

1.3. Part 3 of this submission looks at competitive outcomes in the metropolitan and regional consumer markets across a range of key indicators such as access, quality of service, pricing, investment and employment opportunities.

1.4. Part 4 of the submission examines the distribution of benefits that have been achieved under competition, as well as measures that could be employed to ensure that regional users of telecommunications services fully share in the benefits of price reductions and service availability arising from competitive markets.

2. INDUSTRY STRUCTURE

National Competition Policy Principles in the Telecommunications Sector

2.1. NCP Principles have been broadly applied in the telecommunications sector through

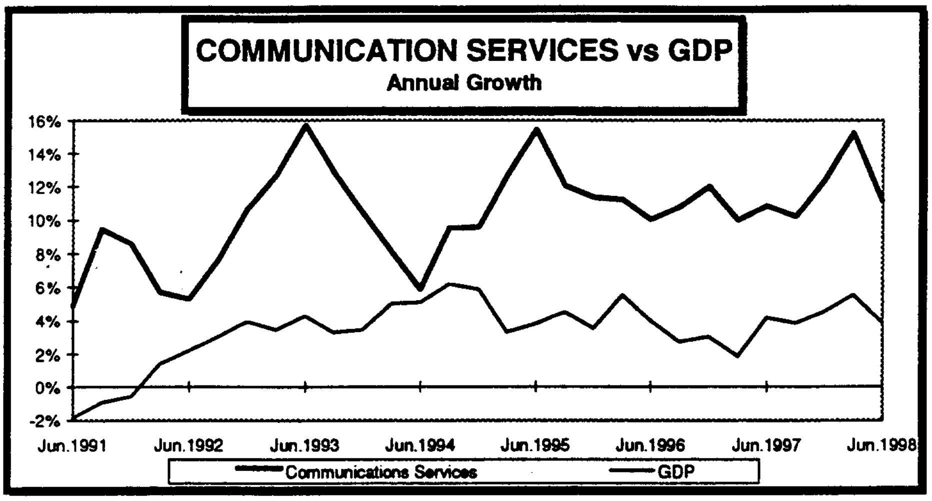
- establishment of an access regime to allow third parties to gain access to telecommunications infrastructure under Part XIC of the Trade Practices Act; and
- competitive neutrality by removing carrier powers and immunities, and subjecting all carriers to State, Territory and local government planning laws. Telstra was already subject to all State and Federal taxes.

2.2. Although not specifically part of NCP principles, additional telecommunications-specific conduct rules have also been established under Part XIB of the Trade Practices Act. While government monopoly reform has also been a plank of NCP reform, Telstra has been operating as an incorporated company since 1988, been subject to market competition since 1991, and was partially privatised in November 1998.

2.3. Since the current regulatory regime was established some 15 months ago, there are now more than 25 licensed carriers, more than 50 service providers and more than 500 Internet Service Providers operating across residential and corporate markets in metropolitan and regional Australia. There are a range of companies now operating at different levels in the market - as infrastructure providers, service providers and content/software providers. The following diagram represents one view of the degree of service competition.

Converging Industries	*Communications Infrastructure Owners and Other Telcos*		*Service Providers*
IT	**Pre '97 Fixed Carriers**	**Global Telcos**	**Internet SPs**
Microsoft	Telstra	BT	Ozemail
EDS	C&W Optus	Global One	Connect.com
Andersen		AT&T	*Others*
		WorldCom/MCI	
		WorldXchange	
Media	**Mobiles Carriers**		**Telecoms SPs**
News Corporation	Vodafone		Macquarie
PBL	Post auction?		Supersaver
Others			One.Tel
			Others
Consumer Electronics	**New Licensed Carriers**	**Utility Telcos**	**Niche SPs**
Motorola	AAPT	Transgrid	Adcom
Ericsson	Primus	Powernet	Digiplus
NEC	Macrocom	ACTEW	*Others*
Sony	Horizon		
Others	Omniconnect		
	United Energy		
	Austar		
	Northgate Oz Telecom		

2.4. The telecommunications sector is a growth industry in the Australian economy. In 1996/97, growth in communications services output was 12% compared to 4.3% for the economy as a whole. As market competition has stimulated industry growth, the benefits are economy-wide, in terms of access to new services, new investment opportunities and job creation.



2.5. Many of the new entrants are niche marketing either on a geographic basis through regional suppliers (eg Horizon Telecommunications) through customer segmentation, or targeting particular revenue streams such as international or long distance business, or through choice of alternative access technologies (wireless data services, Internet telephony).

2.6. In addition to regulatory reform, technological developments have eliminated the natural monopoly features of telecommunications. For example there are multiple and competing access technologies currently deployed by Telstra and by other carriers operating in metropolitan and regional markets. These include the copper network, satellite, Internet Protocol networks, ADSL, ISDN, wireless, radio and digital mobile networks. Open network protocols like the Internet means that there are fewer technical barriers to entry to the communications market.

2.7. In summary, in the 15 months of open market competition, there is a growing diversity in the communications industry structure, competing access technologies and continuing new investment in products and market segments. This combination of market competition and rapid technological development has created contestable markets across regional Australia.

Telstra's Ownership Structure - Reform of Government Monopolies

2.8. Telstra has operated as an incorporated company since 1988 and is required to comply with a range of company and public accountability requirements. For example, Telstra is subject to:

- Corporations law
- ASX Listing Rules, including continuous disclosure
- Accounting standards
- external Audit.

2.9. Since Telstra's partial privatisation in November 1997, the Government's interest has been reduced to a 66.7% shareholding in the company. But the Government also acts as regulator and policy maker for the industry as a whole, and is required to balance a range of competing competition and social policy objectives. There is not always clarity or transparency in the way that Telstra as a partially privatised government business enterprise is used as a tool to meet social policy objectives of the Government.

2.10. Telstra does not resile from meeting all its legislative social obligations. Regardless of its ownership structure, Telstra sees considerable benefit both for the company and consumers in terms of understanding the expected accountability and the costs of meeting service requirements. These should be transparent and clearly articulated in legislation.

Other Regulatory Requirements

2.11. Telecommunications regulation also imposes other obligations on Telstra. These regulatory requirements are not linked to national competition policy reforms, but have been put in place, either to protect consumers from any uneven impacts of market competition, or to redistribute the benefits of competition to particular end users or to specific market participants. These regulatory requirements include access and equity obligations, such as the Universal Service Obligation, provision of Directory Assistance, and emergency services, Customer Service Guarantees, provision of an option of an untimed local call, including residential data calls, rebate schemes for Pastoral call users, and metro-regional price parity for Telstra's local calls provided to residential and charity customers.

2.12. Prior to the full liberalisation of the telecommunications industry the limited nature of competition meant that Telstra could more easily recoup the costs of meeting these CSOs through cross subsidies, than under the current competitive market. Further the cost of meeting these CSOs and providing a service standard judged necessary by the community, is not equitably distributed amongst Telstra and its competitors. Telstra believes that these CSOs should be funded in a more competitively neutral way. The risk of the current arrangements is that Telstra will be further constrained by competition from funding these CSOs, whilst also needing to make the necessary investments to compete across markets. These issues are discussed further under Section 4.

3. IMPACTS OF COMPETITION

3.1. This section addresses the inquiry Terms of Reference examining areas where NCP reforms have affected the economic and social outcomes in rural and regional Australia. It examines benefits arising from competitive market reforms in the telecommunications sector through new network and product investments, job opportunities, price competition and access to services, including telephone ownership and access to higher bandwidth services.

3.2. In a competitive environment, concerns are often expressed about access to new technologies services and service quality. The evidence does not support this contention. Moreover, the regulatory framework ensures the maintenance of service standards in this deregulated environment.

Prices

3.3. Competition is reducing prices in traditional services such as long distance and international services, at the same time that Telstra is reducing its cost base. For example, over the past 5 years, the actual price of making an STD call with Telstra has fallen on average by 25%. The actual price of International calls has reduced on average by more than 30%. In real terms, long distance rates have fallen by 70 % over the past 15 years. Overall, the Productivity Commission found that Telstra's retail prices have fallen on average by 23% over the period 1991/92-1996/97, during a period of limited competition.[2]

3.4. During the last 12 months of full and open competition, Telstra has made more than 50 international and national long distance permanent price reductions or calling specials, totalling some $90 million in savings to consumers. As competition develops further, consumers should benefit from further lowering of prices and the introduction of new products and services.

3.5. Whilst all consumers can take advantage of these general price reductions, regional customers have benefited from some specific pricing initiatives to reduce the cost of telephone calling from the more remote areas of Australia. By international standards, Australia's local call areas provide untimed call access for 25 cents to some of the largest call zones in the world - on average 32 kms local call zones.

3.6. During the 1980s Telstra established extended charging zones (some more than 100 000 square kilometres) under the Countrywide Calling scheme. Under the scheme, calls to all customers within the same extended zone, and regardless of distance, have access to concessionary calling at the Pastoral Call rate (25 cents for 4.5 minutes). Community Call rates are concessionary STD rates that apply between certain areas, such as rural and remote locations to the nearest community service town.

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[2] Productivity Commission, *Performance of Government Trading Enterprises 1991-92 to 1996-97*, October 1998

3.7. Rural and regional consumers have also benefited from capping of long distance calls, applied to STD charging districts. Regardless of the actual distance involved, STD charges within a charging district are capped at the 85-165 km band and between adjoining districts capped at the 165-745 km band.

3.8. In addition to these Telstra initiatives, remote customers who cannot access a local call in outer extended zones, benefit from a $160 a year Pastoral call rebate on their pastoral call spend.

Investment

3.9. The Inquiry Terms of Reference also seek comment on the impact of competition policy reforms on the structure and competitiveness of major industries and markets supplying and supplied by regional Australia.

3.10. Of the $10 billion Telstra has invested outside capital cities since 1985, some $3.7 billion has been directed to the provision and maintenance of infrastructure to service rural and remote customers. Telstra's investment per customer in areas outside capital cities is nearly 50% more than for metropolitan customers.

3.11. In the telecommunications sector, investment by new competitors is also driving new opportunities for the manufacturing and supply industries. Information available from industry development plans and industry analysis indicates that a number of companies are considering development of new facilities and investment in infrastructure that aims to promote competition and innovation in the industry, including specific investments targeted at regional communications markets.

3.12. Along with Telstra, 7 other service providers have invested in the recent 1800 Mhz and 800 Mhz spectrum auctions, which will introduce additional service providers in the regional digital mobiles market. Telstra is also aware that other carriers have specific regional expansion plans such as Horizon, which is targeting regional markets, AAPT's regional cable and points of presence, and Primus with 17 regional points of presence. Therefore, in the telecommunications sector, competition policy reform has created new opportunities for a range of service providers to invest in infrastructure and provide new services to regional areas of Australia.

3.13. In Telstra's view long term sustainable competition and opportunities for the Australian suppliers will be driven by investment from new competitors. Some examples of recent investment announcements drawn from the carriers' industry development plans and public statements are outlined in Attachment 1.

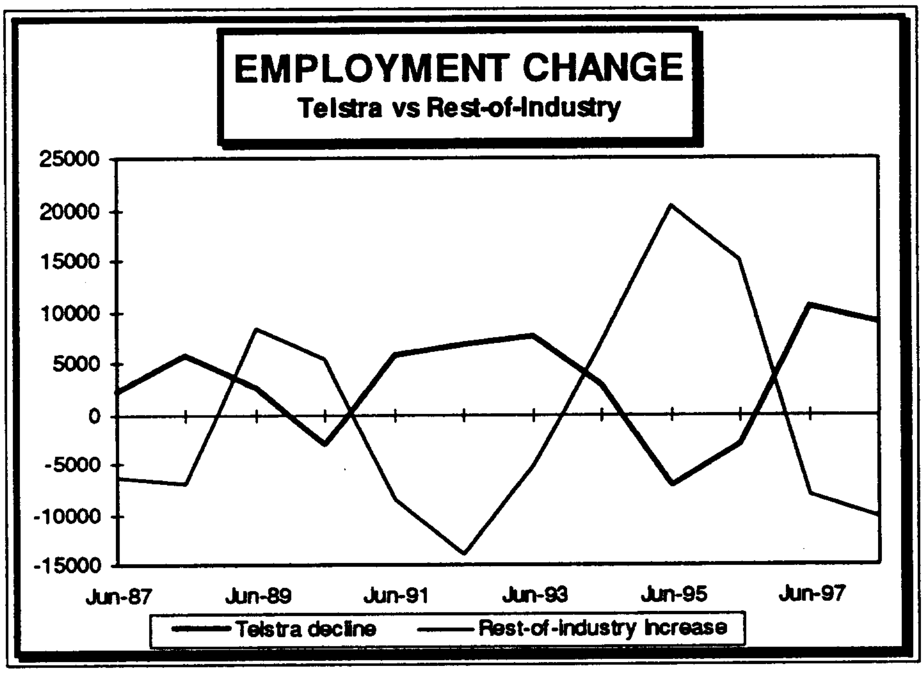
Employment

3.14. Overseas evidence suggests that competitive market structures can lead to changes in employment opportunities within an industry sector. Telstra believes that competition is having an impact on its cost structures and employment within the company, as well as a positive impact on employment across the communications market in Australia.

Impact on Telstra Employment

3.15. Telstra's total employment has varied significantly in recent years in response to the changing market requirements for different skills and labour. It is difficult to substantiate the simple argument that partial privatisation (and National Competition Policy) alone has caused employment reductions in Telstra. From an employment peak of 96 725 full time staff in 1985/86, the trend over the last 13 years has been towards fewer staff numbers, as Telstra operates in an increasingly competitive market. Limited competition to Telstra was introduced in 1989, with competition in the CPE and value-added sector, and reseller competition introduced in 1991. Price caps were also applied from 1989, which initially acted as a proxy for competition, and which were designed to ensure that ongoing productivity gains were achieved by the company, and passed on to consumers in the form of lower real prices.

3.16. The chart below shows that as Telstra has generally down-sized over the last decade or so, the industry has grown at roughly the same rate. This has meant that displaced Telstra workers have found alternative employment in this fast-growing industry. Employment opportunities have also emerged in converging industries such as the computing and IT areas. Moreover, other industries are becoming increasingly technology intensive and require telecoms expertise. Employment levels dropped significantly during this period.



Industry Employment Opportunities

3.17. Telstra acknowledges that there is concern about the impact of job losses in regional Australia. Again this needs to be seen in the context of overall Telstra investment in regional areas, and employment opportunities created by investment from the communications sector as a whole.

3.18. As at the end of June 1998, 76% of Telstra's workforce was located in metropolitan areas compared to 23% in regional areas. In terms of employment reductions over the period December 1996 to August 1998, approximately 80% of total employment reductions have occurred in metropolitan areas, compared to around 20% in country areas. This suggests that rural and regional Australia has not been disproportionately impacted by staff reductions that occurred in Telstra.

3.19. Overall employment in the communications sector (telecommunications, postal and courier services) has been growing at 4.6% per annum compared to employment growth of 2.4% per annum for the rest of the economy over the past 5 years.[3] So whilst Telstra's employment has been declining, opportunities in the sector are expanding.

Access to Services

3.20. Delivery of services to rural and regional areas has been identified as one of the Inquiry concerns. In the telecommunications context there are two main issues to examine here:

- telephone ownership and the standard telephone service; and
- access to higher bandwidth services.

Telephone Ownership and Access to a Standard Telephone Service

3.21. The Issues Paper has sought comment on the view that rural and regional consumer are disadvantaged by not having access to the same services as urban users. In looking at telephone ownership levels, the gap between city and regional users has been closing over time. Telstra commissioned Roy Morgan Research to monitor household telephone penetration levels over the period June 1989 to April 1997. The surveys showed that in 1989, 93% of capital city households had access to a telephone service, compared to 87% of households in rural areas and other towns. By April 1997, this gap had closed to a 3% difference - 96% of households in capital cities had access to a telephone service, compared to 93% in rural areas.

[3] Australian Bureau of Statistics, Labour Force Series, February 1993-98.

3.22. Compared to a number of other selected countries, 1997 data indicates that household telephone ownership levels in Australia on average, are comparable or higher than those in other countries.[4]

Table: Household Telephone Penetration, 1997

	Australia	Canada	New Zealand	United Kingdom	United States
National Average	96.6%	98.7% (excludes Yukon and NW Territories remote customers)	86%	93%	93.9%
Rural Average	94.8%	n/a	n/a	n/a	85%

3.23. The relatively high levels of telephone ownership in Australia has been delivered through a combination of competitive service delivery and government mandated delivery in non-commercial areas, that is the universal service obligation (USO).

3.24. The USO arrangements set out in the Telecommunications Act ensure that in the absence of commercial delivery, every Australian can access a standard telephone service, wherever they reside or carry on business. The USO also includes payphones and prescribed carriage services. Telstra is currently the declared Universal Service Provider.

3.25. Telstra's USO Plan sets out the minimum level of service that it will provide nationally. This is currently defined as a voice grade network providing a minimum transmission speed of 2400 bps. In addition, the standard telephone service provided under the Plan has the following features:

- access to the public switched telephone network
- a unique telephone number (ie no party lines)
- ability to make and receive national and international calls
- 24 hour access to emergency services
- 24 hour access to operators assisted services such as free Directory Assistance, reverse charge calling and service fault reporting
- itemised billing including local calls when requested by the customer.

[4] A report prepared for Telstra by Networks Economics Consulting Group, "*Telecommunications Services in the Bush: Are Rural Consumers Getting a Raw Deal? A Comparison of Rural Telecommunications Services in Australia with Urban Levels of Service in Canada, New Zealand, the United Kingdom and the United States.*", 1998.

3.26. The Government has recently indicated that it intends to include ISDN in USO arrangements, and for those customers who cannot access ISDN, access to a 64 kbs satellite downlink will be included in the USO.

3.27. Where the concern about access to services appears to lie is more with connection timeframes to access standard services, and the availability of higher bandwidth services for rural and regional consumers - that is, whether regional users have access to the latest technologies. The evidence does not substantiate these concerns.

Connection Timeframes

3.28. Connection timeframes have fallen under the current USO arrangements. Prior to 1992, the policy adopted by the then Telecom balanced commercial objectives against the cost to the community of provisioning for universal service obligation commitments. For customers in remote areas, the general policy adopted provided for expenditure over 3 years for a high cost project involving multiple customers in the same locality and over a 5 year timeframe for a high cost project involving a single customer at a location. Post 1992 and pre 1998, where Telstra was not able to provide a service on the customer requested date, the maximum connection timeframe was 27 months where there was no network capacity or existing infrastructure and the customer was outside a recognised town or community of more than 200 people. These orders become held until a permanent service is provided.

3.29. To put this in perspective, Telstra receives over 250 000 applications for service connections each month. Of this total, approximately 400 per month are in rural and remote areas. Held orders have been reducing to about 700 nationally.

3.30. Under the current USO plan, connection timeframes for held orders have been reduced from 27 months to 12 months. In the interim, Telstra offers customers the choice of using a Minisat satellite service to provide interim telephony services until the permanent connection is made. It is expected that the total number of held orders will further reduce as interim solutions and the reduced connection timeframe cut in.

Digital Data and Higher Bandwidth Services

3.31. Another perception of rural disadvantage relates to access to higher bandwidth services, which can be used for Internet, email and other data applications. The recent Digital Data Review by the Australian Communications Authority (ACA) highlighted that different data transmission rates are available across different parts of the Customer Access Network[5].

[5] Australian Communications Authority, *Digital Data Inquiry: Public Inquiry under section 486(1) of the Telecommunications Act 1997*, August 1998

3.32. After thorough analysis, the ACA concluded that the costs of upgrading the CAN to ensure uniform high speed internet access would outweigh the benefits. Telstra's own cost/benefit analysis substantiates this conclusion, and Telstra believes that the competitive market is delivering alternative high bandwidth products to rural and regional markets. For example, Optus has invested in satellite technology to deliver higher bandwidth services to rural Australia. For its part, Telstra is trialing a 64 kbs satellite offering, that will be broadly comparable to ISDN.

3.33. Investment in higher bandwidth services are occurring in a competitive market, and irrespective of minimum service standards prescribed under USO arrangements. On balance, telecommunications reform has opened up access to a range of new services and competing service providers operating across geographic markets.

Quality of Service

3.34. The Commission's Issues Paper seeks direct comment on the impact on service standards in regional and metropolitan Australia arising from increased competition in the telecommunications market, and since the partial privatisation of Telstra. Attachment 2 contains a detailed examination of Telstra performance standards over the previous 7 years. Service performance has been monitored publicly over a number of years by AUSTEL and now the Australian Communications Authority. Over the period that performance has been monitored, a different mix of legal/regulatory requirements and commercial imperatives have been operating. For example

1 July 1997	Telstra subject to all State and Territory planning laws for provision of new infrastructure. Carrier powers and immunities withdrawn. Telstra must negotiate with over 750 local councils for the provision of new infrastructure, other than low impact facilities.
1 Nov 1997	Telstra partial privatisation
1 Jan 1998	Customer Service Guarantee scheme introduced
1 May 1998	New Universal Service Plan reduced maximum connection timeframes under the USO from 27 months to 12 months. Telstra also offers interim solutions using Minisat satellite telephony, for customers who are waiting for the provision of a permanent service.
1 August 1998	Revised Customer Service Guarantee scheme with increased penalties applying for failure to meet specified performance standards.

3.35. In addition to regulatory requirements, the size of the market to be served is growing. Between September 1991 and June 1998, the number of access lines grew by 1.5 million lines (approximate) or by more than 18% in total (see Attachment 2).

3.36. Over the period of ACA monitoring, service performance in country areas has improved in the connection of In-place services, been stable in the provision of new services, but declined over time in relation to repair of faults within one day of request by the customer. Further details on service performance are outlined in Attachment 2. However, when considered against the background of regulatory change and a growing market, Telstra is now providing new services in significantly shorter timeframes, at cheaper prices, and with fewer resources at a time when there is a growing number of customer lines to be serviced.

Customer Service Guarantees

3.37. Whilst regulated service standards are designed to protect consumers from uneven impacts of market competition, it may also inhibit innovation and the development of competitive responses in particular markets. The industry is experiencing progressive increase in the penalties applied to carriage service providers for failure to meet specified performance standards. Whilst these penalties are intended to ensure performance standards are maintained and improved, nevertheless a penalty structure also raises a potential barrier for new entrants, and acts as a disincentive to niche market development based on service differentiation.

3.38. Currently, there is a review of the Customer Service Guarantee (CSG) scheme to consider whether the current performance measures should be broadened to include additional services or higher functionality. If the current CSG criteria are broadened further to specify additional service features, Telstra believes the end result is a move to a "vanilla" service standard. Setting immutable performance criteria to particular standards, may act as a disincentive to develop products that meet specific customer needs. One example is Telstra's InContact service which is a basic telephone service with free rental, that permits a customer to receive calls and make emergency calls, but not initiate outgoing calls. It has proved popular with customers as an "Affordability" product. Incentives to develop similar products may be stifled if the CSG bar is set too narrowly.

4. DISTRIBUTING THE BENEFITS OF COMPETITION

4.1. The Inquiry has sought comment on measures which should be taken to facilitate the flow of benefits, or mitigate negative impacts from competition policy reforms in regional areas.

4.2. On the available evidence, competition in the telecommunications sector is delivering direct benefits for Australian telecommunications users. However, different levels of price and service competition are being experienced across geographic areas and customer groups. Arguably, the bulk of new carrier investments and activities have been directed to the metropolitan and major provincial markets, and amongst high value users, rather than small consumer and residential markets.

4.3. The uneven development of competition can be explained in part by the telecommunications regulatory framework which through USO and price regulation redistributes benefits to particular groups of users, but also sends mixed signals to the market and consumers about the relationship of price to costs. For example, price controls are important in achieving government social policy objectives, nevertheless there is a cost to all consumers and to the industry. Price caps currently set the cap for customer access charges below the cost of supply. The Productivity Commission has estimated that customer access charges fail to cover the costs of providing access, much less, make a contribution to unallocated overheads[6]. The access deficit is currently recovered by transfers from local calls, and national and international long distance calls, thereby inflating the costs of these services.

4.4. Whilst the price controls are important in ensuring affordable access, mandating uneconomic pricing raises the barriers to entry in high cost areas and inhibits competitors from providing alternative services.

4.5. There is also a welfare cost where price controls compel Telstra to charge inefficient prices. For 1995/96, the Productivity Commission estimated that this loss of efficiency over the customer access, local call and national long distance and international call markets cost the economy and consumers $402m.[7] As competition cuts Telstra margins in highly contested markets, the ability to fund cross subsidies from these parts of the business, becomes more limited.

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[6] Productivity Commission, *Telecommunications Economics and Policy Issues*, March 1997, p.96.
[7] ibid, p. 100.

4.6. In the case of the USO, the cost claim of $1.8 billion for 1997/98 has highlighted the costs of supporting these CSOs. Currently Telstra bears the majority of this cost. The real costs of rural service provisioning will need to be addressed, because in a competitive multi-carrier environment, where competition reduces Telstra's margins and market share, it will become unsustainable in the long term, to rely on one provider to financially support and deliver USO objectives.

4.7. Telstra does not resile from meeting all its legislated social obligations, but believes that securing workable USO delivery and funding arrangements becomes a greater priority in a competitive multi-carrier environment.

Long Term Interest of End Users Test

4.8. There is a compelling need to reconcile competing government priorities - national competition policy on the one hand and social policy on the other. As competition develops, the tensions are becoming manifest and are potentially unsustainable. The following section considers one way in which these valuable CSOs can be preserved in a competitive environment.

4.9. Telstra believes that there is scope for the economic and social costs of competition policy regulation to be addressed through the application of the long term interests of end users test.

4.10. Key policy goals of industry regulation are to not impose undue financial or administrative burdens on carriers;[8] to promote the efficiency and international competitiveness of the Australian telecommunications industry;[9] and to ensure that STS are supplied as efficiently and economically as practicable.[10]

4.11. These objectives must be seen in the light of the overall purpose of the TPA, which is to:

"... enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection."[11]

4.12. Moreover, the "mission" of the primary industry regulator, the ACCC, is to:

"... enhance the welfare of Australians by fostering competitive, efficient, fair and informed Australian markets."[12]

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[8] See section 4 Telco Act.

[9] See section 3 Telco Act.

[10] *ibid.*

[11] See section 2 TPA.

[12] See ACCC mission statement, http://www.accc.gov.au

4.13. In its access determinations under Part XIC of the TPA, the ACCC must be guided by the legislative touchstone of Part XIC - the long term interests of end users (LTIE test). The LTIE criteria, which under Part XIC apply to determinations in relation to declaration of services;[13] access undertakings;[14] and arbitration of access prices[15] require the regulator to seek -

"... to promote the long-term interests of end-users of carriage services or of services provided by means of carriage services".[16]

4.14. In exercising its competition functions and powers under the Telecommunications Act the ACCC is also required to apply the LTIE criteria when deciding whether to give the ACA a direction to make technical standards[17] or a direction to make rules about number portability,[18] or when determining whether a carrier's request for access to supplementary facilities is reasonable.[19]

4.15. Section 152AB(2) of the TPA provides that, in determining whether a particular thing promotes LTIE, regard must be had to the extent to which thing is likely to result in:

- the objective of promoting competition in relation to listed services;

- the objective of achieving any-to-any connectivity in relation to carriage services that involve communication between end-users; and

- the objective of encouraging the economically efficient use of, and the economically efficient investment in, the infrastructure by which listed services are supplied.

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[13] See section 152AB TPA which states that the object of Part XIC of the TPA is to "promote the long-term interests of end-users of carriage services or of services provided by means of carriage services". See also section 152AL(3)(d) TPA - the ACCC may only declare that a specified eligible service is a declared service if the ACCC is satisfied that the making of the declaration will promote the long-term interests of end-users of carriage services or of services provided by means of carriage services.

[14] See section 152AH(1)(a) TPA in relation to the definition of "reasonableness" of access undertakings.

[15] See section 152CR(1)(a) TPA in relation to matters which the ACCC must take into account in making an arbitrated determination.

[16] Clause 8 of the *Telecommunications (Arbitration) Regulation* 1997 sets out the maters which the ACCC must take into account when issuing an arbitration determination under the provisions of the Telco Act. In particular, clause 8 requires that the ACCC considers whether its determination would promote LTIE. It further states that LTIE is to be determined in the same way as under Part XIC of the TPA.

[17] see section 384(5) and 389 of the Telecommunications Act.

[18] see section 458 of the Telecommunications Act

[19] see sch 1, s17(3) fo the Telecommunications Act

4.16. Telstra considers that the statutory definition of LTIE implicitly (if not explicitly) should require the ACCC to recognise the CSOs in relation to its Part XIC and Schedule 1 of the Telecommunications Act access determinations. The ACCC's failure to recognise the costs of Telstra's CSOs may inhibit Telstra from investment in higher costs regional areas, where there is no prospect of recovering that investment through efficient pricing.

4.17. As the CSOs impose costs upon Telstra, the ACCC should have regard to the CSOs; any failure to do so would disadvantage Telstra relative to its competitors and undermine the future delivery of legislated social obligations. Whilst this may be in the short term interests of developing niche competition, it would not be consistent with the statutory LTIE objective (above) of ensuring that access determinations encourage economically efficient use of, and investment in, infrastructure.

4.18. In Telstra's view, the recent ACCC Discussion Paper on Pricing of Local Telecommunications Services further highlights the need for the LTIE criteria to address the objectives embodied in the CSOs. The Paper suggests that Telstra's competitors should have access to Telstra's local loop on an unbundled basis at prices which reflect the costs of provision in each area. By implication, the Paper notes that charges would be very low in urban areas and could be very high in the remoter parts of Australia.

4.19. In considering these issues it is important to note that Australian consumers, including rural consumers, have substantially greater opportunity than their counterparts overseas to access the Internet using high-speed services. For example, ISDN links are significantly more widely available in Australia than in at least two other countries for which data are available (see Table 1). Telstra expects that it will be able to supply ISDN to over 96% of the Australian population by the end of December 1998. The Canadian and US carriers, on the other hand, can only supply ISDN to respectively 70% and 80% of subscribers. In the US, only 27% of the customers served by the NECA local exchange carriers, which typically serve those areas with 20 or fewer customers per square mile, have access to ISDN.

Table 1: ISDN access by population coverage[20]

Australia	Canada	United States
93%	70%	80%

[20] The USO after 1997 – meeting user needs in an open market, Michael Rocke, Telstra. Forum, November 1996; BT. *How can I get ISDN?*, 1998, http://www.isdn.bt.com/whatis/getmain.htm.

4.20. Even more importantly, Australian rural ISDN users do not get charged more than their urban counterparts. In contrast, US charges for ISDN and T1 lines are significantly higher in rural areas, with one study[21] noting a difference of approximately US$1,800 a month for the same service. In New Zealand users in country areas are charged NZ$360 per year more than urban users for ISDN line rental. Telstra, in other words, provides access to ISDN at a uniform price. However, it is obvious that these pricing arrangements could not survive if the ACCC's proposed approach to charging for unbundled local loops were implemented.

4.21. In effect, as the ACCC itself recognises, Telstra's competitors would drastically undercut Telstra's current charges in the more densely populated areas. This, in turn, would require Telstra to more closely align it prices with the underlying geographical pattern of costs. ISDN charges in rural areas in particular would need to increase very substantially.

4.22. Telstra notes that the ACCC, in adopting this approach, does not question whether eliminating geographically averaged charges would impose economic and social costs which ought to be taken into account. Although the ACCC seeks comments on a wide range of issues, those which bear directly on the economic and social consequences of applying competition policy are ignored.

4.23. Telstra notes that extending the statutory LTIE criteria to recognise CSOs would be consistent with other parts of the TPA. For example, under Part VII of the TPA, the ACCC may "authorise" restrictive trade practices if it is satisfied that the conduct has resulted, or is likely to result in a public benefit which outweighs the detriment of any lessening of competition likely to result from the conduct.[22]

4.24. Similarly, under Part IIIA of the TPA, in making an arbitrated access determination, the ACCC must consider the public interest associated with its determination.[23] Under Part IIIA of the TPA, the National Competition Council ("NCC") may only grant access to a service (or increased access) if it is satisfied that the granting of such access would not be contrary to the public interest.[24] While these provisions in the TPA allow the ACCC or NCC to recognise the public benefit associated with fulfilling CSOs, there is no public benefit assessment specifically embodied in the statutory LTIE criteria in Part XIC of the TPA. Telstra, however, considers that regulators must consider CSOs if they are to promote LTIE.

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[21] 'Telecommunications Services in the Bush, Are Rural Consumers Getting a Raw Deal? A Comparison of Fixed Telecommunications Services in Rural Australia with Urban Levels of Service and with Service Levels in Canada, New Zealand, the United Kingdom and the United States', Report Prepared for Telstra Corporation, Network Economics Consulting Group, Canberra.

[22] See e.g., generally, section 90 TPA. Concerning mergers, the ACCC may assess the public benefit of the proposed merger by reference to criteria including the international competitiveness of any Australian industry. The ACCC cannot, however, authorise allegations of abuse of market power - and the exemption order provision for Competition Notices under section 151AS of the TPA imports no particular assessment criteria.

[23] See section 44X(1)(b) TPA. While section 44X(1) of the TPA is largely mirrored in Part XIC of the TPA (see e.g., section 152CR(1)), the reference to public interest has been omitted from the LTIE criteria in Part XIC.

[24] See section 44G(2)(f) TPA.

4.25. The ACCC has recognised the significance of CSOs in relation to arbitrated access pricing under Part IIIA of the TPA - but it has made no clear statement about the significance of CSOs concerning access determinations under Part XIC of the TPA and Schedule 1 of the Telco Act. For example, in the ACCC's Draft Guide to Access Undertakings under Part IIIA of the TPA, the ACCC states that:

> "When governments require infrastructure providers to supply services to particular customers on a non-commercial basis they do not always provide funding to cover the cost of meeting the CSO requirement. In such cases the provider may be obliged to include CSO funding provisions in an undertaking. But from the perspective of service users any CSO funding requirement is an additional cost. The Commission recognises this potential for conflict of interest and will take it into consideration in assessing undertakings ... Undertakings should clearly identify CSOs, and where possible the cost of providing them and the method of costing and funding them".[25]

4.26. A better balance in ensuring that the economic and social costs of competition regulation are recognised through the statutory LTIE criteria, could be achieved under current regulatory arrangements whenever the ACCC:

- Decides whether to "declare" a service;
- Considers the "reasonableness" of an Access Undertaking.
- Arbitrates access prices in relation to declared services and access to facilities.

4.27. To ensure that these policy trade offs are explicitly addressed, Telstra recommends amendments to the TPA to ensure that the ACCC considers Telstra's CSOs in relation to: declaration of access to services, assessing the "reasonableness" of access undertakings; and arbitration of terms of access for services and facilities. Telstra submits that the following amendments should be made:

- A new provision, section 152AB(2)(f) of the TPA, should be enacted, in relation to the statutory definition of LTIE, and referring to the objective of ensuring:

> *"(f) recognition, of the CSOs fulfilled by an access provider - including recognition of the costs and funding arrangements associated with those CSOs"*

4.28. In Telstra's view, such an amendment would ensure that the ACCC considers Telstra's CSOs and the costs of those CSOs in relation to its decisions about whether to declare access to Telstra's services.

[25] ACCC Draft Guide to Access Undertakings under Part IIIA TPA, Chapter 3, http://www.accc.gov.au.

- A new provision, section 152AH(1)(g) of the TPA, should also be enacted in relation to the ACCC's assessment of the "reasonableness" of Telstra's access undertakings, and referring to:

> *"(g) whether the access provider fulfils any CSOs, including the costs and funding arrangements associated with those CSOs."*

In Telstra's view, such an amendment would ensure that the ACCC considers Telstra's CSOs and the costs of those CSOs when assessing the "reasonableness" of Telstra's access undertakings.

- A new provision, section 152CR(1)(h) should also be enacted, in relation to the ACCC's access determinations and referring to:

> *"(h) whether the access provider fulfils any CSOs, including any costs and funding arrangements associated with those CSOs."*

4.29. In Telstra's view, these changes are consistent with both LTIE and the public benefit assessment of competition embodied elsewhere in the TPA (as described). These amendments would, moreover, ensure that the CSOs are recognised in regulatory decision-making and allow CSOs to be fulfilled.

5. CONCLUSION

5.1. Telecommunications competition is leading to a greater choice of service access, reductions in prices particularly across highly contested routes, new employment opportunities and significant investment in infrastructure and product innovation, both from existing carriers and new entrants.

5.2. Whilst the benefits of competition accrue to the Australian economy as a whole, to date, price and service competition has not developed evenly across all geographic markets or customer groups.

5.3. The current telecommunications regulatory framework promotes competition, but additional mechanisms such as USOs, price controls and specific rural and regional rebates, also redistribute the benefits of competition to particular end users.

5.4. While recognising that there is a strong public reaction against some of the harsher aspects of competition policy reforms, Telstra considers that the significant benefits that have been achieved to date through industry competition should not be discounted. There are important policy trade-offs to be made in delivering on both competition policy and social policy objectives. These trade-offs and their respective impacts on industry and consumers need to be explicitly identified and taken into account by regulators in their administration of competition policy goals.

5.5. Specifically in relation to telecommunications market regulation, Telstra considers that the public benefit test (the Long Term Interests of End Users) applied by the ACCC, should explicitly take into account the cost of meeting community service obligations when considering whether to intervene in the market to promote competition, through declaration of services, accepting an access undertaking or arbitrating on access prices under Parts XIC of the Trade Practices Act.

ATTACHMENT 1

INVESTMENT PLANS OF LICENSED CARRIERS

Optus	$3.4bn cumulative capex to 6/97; recent investments announced about billing system, mobile network upgrades, network digitisation, long distance transmission.
AAPT	$591m spend on infrastructure planned 1997-2001 on a CBD access network and international cable. Also points of presence in 30 regional areas. Focus on small to medium sized business market.
Primus	$400m planned for investment over next 2 years. Regional based switches to be installed. Initially targeted small-medium business, but moving to large business and residential international market.
Powertel	$500m capex. Formed from 3 of Australia's electricity utilities to develop opportunities in telecommunications. CBD areas of Sydney, Melbourne and Brisbane/Gold Coast.
Macrocom	Infrastructure development estimated to be $31.8m over 5 years. Planned Sydney-Melbourne microwave transmission, with planned drop off links to regional centres on the south-east coast. Targeting service providers, ISPs and major corporate users for voice and data.
RSL Com	Targets long distance services at small-medium businesses, niche ethnic and residential markets. Switches in Sydney, Brisbane, Melbourne, and operations in Adelaide and Perth.
Northgate	Overall plan to spend $500m over 4-5 years rolling out cable networks in regional Australia.
ACTEW	$130 m for overhead fibre cable in Canberra to support a range of telecoms services.
United Energy	Developing local telecommunications networks, using the company's distribution assets and fibre cabling to construct data networks for large customers.
Omniconnect	Installing metropolitan area networks (MANs) in Melbourne and Sydney based on wireless and spread spectrum radio technology.
Horizon	Microwave links planned between Eastern Australian capitals and regional centres Focus on provision of high speed data networks and on line service to organisations and individuals located in regional, rural and remote Australia.
WorldxChange	3 year rollout of switches in 21 sites over 3 years in Rockingham, Townsville, Cairns, Mackay, Rockhampton, Lismore, Bendigo, Ballarat, Hobart, Geelong, Mornington and Albury. Focus on corporate users of international long distance, as well as residential ethnic markets.
Omninet	Wireless data connection in Melbourne and Sydney
GlobalOne	Switching facilities in Sydney, Melbourne, Brisbane, Gold Coast, Adelaide, Canberra, Perth. 1400 points of presence internationally. Focus on wholesale and carrier business, but also targeting small business and residential ethnic markets.
WorldCom	$113m capex spend over 5 years. Building optic fibre network in Sydney to provide full service network. Targeted at corporates, ISPs and wholesalers.
OzEmail	Leading provider of internet services in Australia and New Zealand.

ATTACHMENT 2

A REVIEW OF TELSTRA'S PERFORMANCE STANDARDS

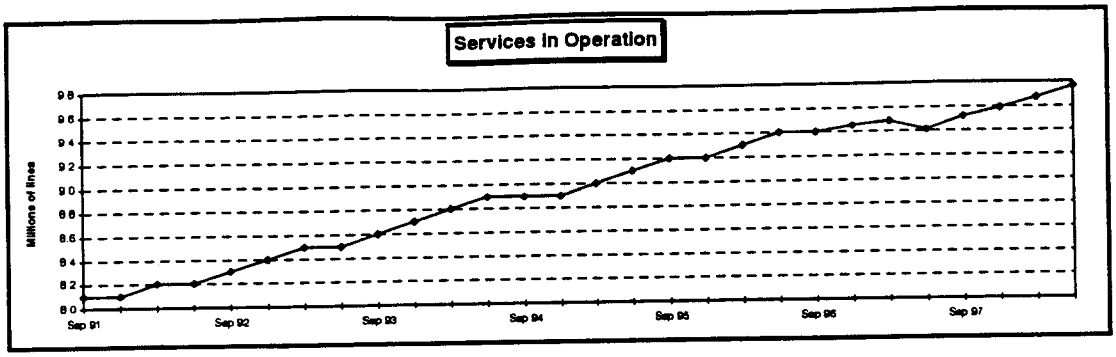
5.6. Service performance has been monitored publicly over a number of years by AUSTEL and now the Australian Communications Authority. Over the period that performance has been monitored, a different mix of legal/regulatory requirements and commercial imperatives have been operating. For example

1 July 1997	Telstra subject to all State and Territory planning laws for provision of new infrastructure. Carrier powers and immunities withdrawn. Telstra must negotiate with over 750 local councils for the provision of new infrastructure.
1 Nov 1997	Telstra partial privatisation
1 Jan 1998	Customer Service Guarantee scheme introduced
1 May 1998	New Universal Service Plan reduced maximum connection timeframes under the USO from 27 months to 12 months. Telstra also offers interim solutions using Minisat satellite telephony, for customers who are waiting for the provision of a permanent service.
1 August 1998	Revised Customer Service Guarantee scheme with increased penalties applying for failure to meet specified performance standards.

Anecdotal evidence has often been used in recent public comment about service quality to suggest that Telstra's service quality has declined, particularly in rural and remote areas, following partial privatisation.

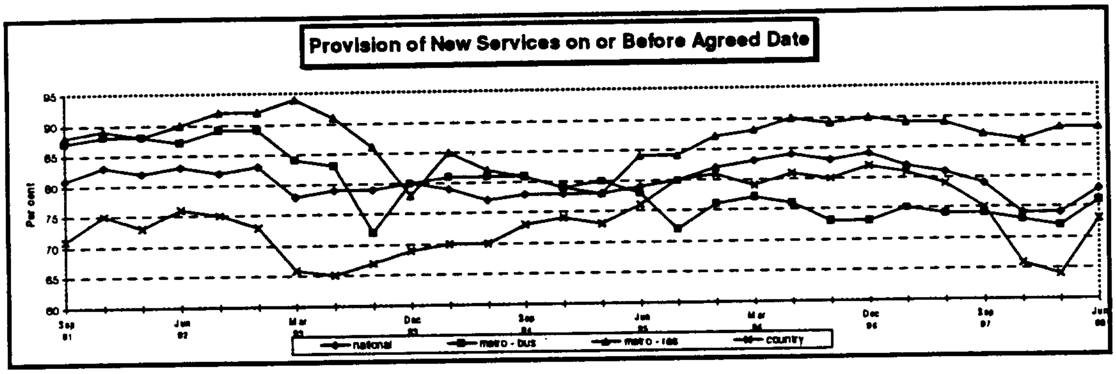
Growth in access lines is one variable that needs to be considered in making performance comparisons. Between September 1991 and June 1998, the number of access lines grew by 1.5 million lines (approximate) or by more than 18% in total (see Table 1). Therefore, over the period that the ACA has been monitoring performance there has been a quantitative change in the base for measurement, which is not taken into account in quarter by quarter comparisons.

Table 1. Growth in new services



On the provision of new services on or before the customers' agreed commitment date, nationally there has been a trending improvement over time, from 81% in September 1991 to 86% in the June 1998 quarter, although there were periods of deterioration in service over the period March 1993-March 1995 and again over the period September 1997- March 1998 (see Table 2)

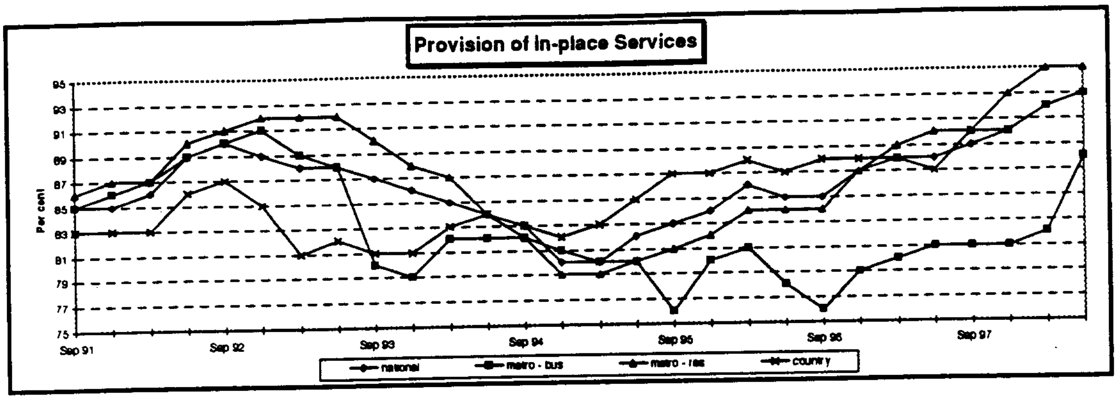
Table 2. Provision of new services on or before the agreed commitment date.



The performance for metropolitan business and residential, and country service connections has also varied significantly over the period, with performance in country areas generally exceeding that of metropolitan areas. Based on service connection timeframes, Telstra believes it is difficult to substantiate claims that there has been a systemic reduction of resources from less contested rural markets to metropolitan markets.

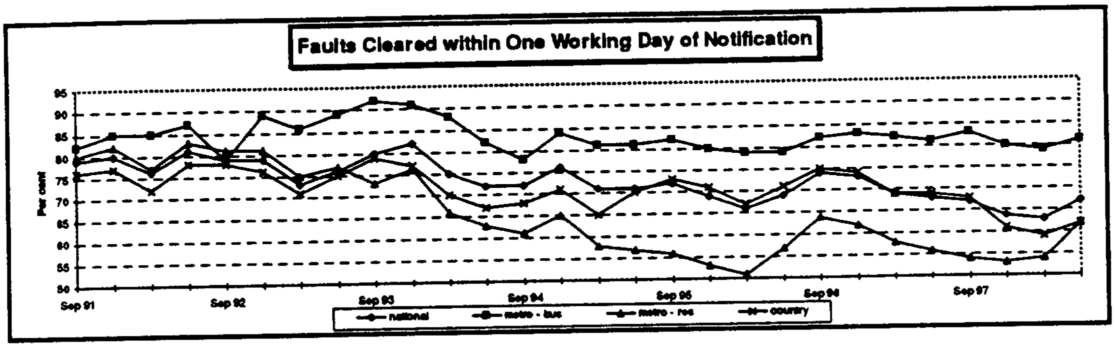
On the provision of In-place services (reconnections and connection of services where existing infrastructure exists), service performance has in general improved over the period September 1991 to June 1998 from 85% nationally to 93% nationally against the customer's agreed commitment date. (see Table 3).

Table 3 Provision of In-place services



However, fault repair clearance rates shows a decline in performance across the period in both metropolitan and rural markets. The most recent June 1998 quarter performance figures showed a slight improvement. (see Table 4)

Table 4 Faults cleared within one working day of notification



There are a number of reasons why the fault rate has not decreased in real terms during the previous 5 years. Some parts of the Customer Access Network are ageing and replacement of the existing plant is required. Lightening strikes and storm damage also affect the network. Finally, work practices may also contribute to some faults where the network is not restored to its original condition.

Under the CAN 2001 program, Telstra is directing an additional $400m over 4 years to reduce fault rates across the network. This is a targeted program to address regions with the highest fault rates and to undertake rehabilitation and reconstruction work This investment is being undertaken on commercial grounds.