

R. S. GILBERT  
ACT

5 February 2001

Telecommunications Inquiry,  
Productivity Commission,  
PO Box 80,  
Belconnen ACT 2616

Dear Sir,

REVIEW OF TELECOMMUNICATIONS SPECIFIC REGULATION  
SUBMISSION ON ADDITIONAL MATTERS UNDER REFERENCE –  
THE EFFECT OF USO's ON COMPETITION IN REGIONAL AREAS

I refer to your circular of 8 Jan, inviting further submissions on matters added to your terms of reference by the Govt.. This submission deals solely with the matter of the Universal Service Obligation (USOs) referred to on page 12 of your circular.

First, what you have said about USOs in your circular could be misinterpreted. You say "Currently, USO payments are made to one carrier (Telstra). Then after a costing exercise by the ACA, other carriers are required to make payments to Telstra". You also say "The Govt. has recently introduced new arrangements that allow carriers other than Telstra to compete to provide USO services".

These statements could give the impression that the Govt. pays Telstra to provide these services - and that any other carrier that successfully competes to provide these services under the new arrangements (whereby the Govt. has called tenders from carriers to provide services) would be paid by Govt. to provide them. ('Payment' for these services means reimbursement to the carrier providing them of the loss it incurs in so doing).

In fact, even though it is the Govt. that requires carriers to provide these unprofitable services (now and under the new arrangements) in the public interest, the Govt. pays nothing at all to have them provided. The full cost, the loss incurred by Telstra (or whoever else might provide the services under new arrangements), is borne by all carriers in proportion to their revenue. This means, in turn, that the cost is borne by the shareholders of the various carriers, or by other consumers of other communication services (through cross-subsidisation).

The real reason for Govt. declining to pay for these services would probably be its simple philosophy of keeping 'off the Budget' as much as it can, to enhance Budget surpluses or reduce Budget deficits. However, if pressed the Govt. would no doubt offer as its reason the philosophy that it is reasonable, as a condition or quid-pro-quo for Govt. granting someone a licence to do something that enables the recipient to earn money, for the Govt. to require the recipient to do something that the Govt. wants to see done in the public interest - and for the recipient to bear the cost of doing it. That is to say, that is a price the licensee must pay to get the licence.

That is an understandable philosophy. But it doesn't sit well with Govts.' responsibilities for economic management, the pursuit of greater efficiency in resource use (the furthering of the 'user pays' principle), or even its responsibility to minimise inequities as between different

sections of the community. It certainly ignores a basic tenet of human endeavour that one should pay for what one gets - in this case, that if Govt. judges something should be done in the public or community interest, the public or the community (that is, the Govt.) should pay for it. Moreover, if the Govt. paid for these services, if their cost were included in the Budget, that would also have the merit of transparency (the public would be clear as to what the Govt. is doing, and what it is costing), and ensuring periodical scrutiny by Parliament of the services provided to judge the extent to which they were still justified.

It might be argued that the cross-subsidisation the USOs involve (i.e. some communication users paying for services others receive) is not uncommon in industry. That's true. But it doesn't escape the fact that cross-subsidisation, while perhaps commercially sound in some circumstances (e.g. to attract business) is not an economically desirable practice. It leads to less efficient resource use, in that the demand for the product being subsidised is artificially stimulated (with resources being diverted from more productive use to satisfy that demand), and the demand for the products whose prices are increased to provide the funds for subsidisation being artificially dampened (again, with a resultant undesirable diversion of resources). Moreover, there is an important difference between cross-subsidisation that a commercial entity judges is commercially worthwhile, and cross-subsidisation *forced* on it by Govt..

Thus on general economic and public administration grounds, the Govt. should finance USOs from the Budget, instead of the present arrangement of the cost being shared among all carriers. But there could also be good competition reasons for the Govt. paying for these services.

Determining the cost of meeting the USO obligation, and hence the cost to be spread over all carriers, depends on the accounting method used. And it is the Govt, with the ACA's assistance, which decides what method will be used, and even the precise amount to be shared between the carriers. This is worrying, particularly given the very considerable amounts involved. It is worrying partly for 'fairness and equity' reasons, *but also because of the opportunity it gives the Govt. to favour Telstra's competitors vis-a-vis Telstra, or viceversa, in the so-called competition the Govt. is trying to create in this industry.* Clearly, if the Govt. sets a figure which is lower than Telstra's actual cost of providing the services, and the other carriers pay only their share of that figure (rather than their share of the higher, actual cost), the Govt. is forcing Telstra, wittingly or otherwise, to provide the other carriers with a 'hidden subsidy'. Conversely, if a figure higher than actual cost is set, the other carriers are subsidising Telstra.

That Govt. can arbitrarily affect the competitive position of particular suppliers in this way, through the mechanism for financing of the USOs, is most unsatisfactory, and not conducive to the achievement of genuine competition in the industry - either generally, or in regional areas.

And the proposed new arrangements, i.e. Govt. calling competitive tenders from all carriers to provide these services instead of simply getting Telstra to provide them, isn't likely to solve the problem, while the losses on these services are borne by the carriers themselves and not the Govt.. While the Govt. is not paying for these services, each carrier's main objective is probably not to actually provide them (particularly with the industry so heavily regulated, and the ACA and ACCC able to exercise tight control over what carriers can and cannot do), but in minimising the amount it has to pay to the provider - presently, Telstra. Each carrier will be aware of the risk that, if he 'wins' the contract and the actual cost to him of providing the

services turns out to be higher than he estimated and quoted, he will have to bear the whole of that higher cost, and not just his proportionate share of it.

For example, if he quotes \$100 to provide the services and they in fact cost that, and his share of those costs is, say, 10%, the net cost to him will be \$10 (the other \$90 being paid to him by the other carriers). But if he successfully quotes \$100 and the actual cost turns out to be \$120, the other carriers will still pay him only \$90, leaving him bearing \$30. In other words, if the cost is 20% higher than estimated, the net cost to him will be 300% higher.

For reasons like this, there is a distinct possibility that each carrier will quote a high price, in the hope that he will not win the contract, that another carrier will 'win' the contract, or that Telstra will continue to be the nominated USO provider and that they will be able to continue pressing the ACA in one way or another to minimise what they pay Telstra.

It will be interesting to see the outcome of this rather peculiar type of 'competition', competition to provide losing services. (And, incidentally, it will also be interesting to see whether, if a carrier other than Telstra 'wins' the competition, the Govt. reimburses Telstra for the so-far un-reimbursed capital cost Telstra has incurred over the years to provide these services at Govt. direction). Certainly it is unlikely to be genuine competition between the carriers to provide these services. And given the circumstances it cannot be assumed that the mere calling of tenders, that alone, will establish real values for the services, with each carrier meeting its proper proportion of the true cost of providing them. In other words, the USO financing arrangements are still likely to fall short of being 'competitively neutral' as between the various carriers.

However, if the Govt. actually paid for the services, there might be a better prospect of establishing real values - *and inducing genuine competition between carriers to provide these services throughout regional Australia*. Providers of a service will be more interested in providing it if they're being paid for doing so, rather than having to pay for it themselves. Thus the Govt. might get genuinely competitive tenders to meet the USOs, and there would no longer be a need for Govt. to arbitrarily decide what the cost is, and run the risk of applying it in a way that upsets the competitive balance between carriers.

This is additional to the more general arguments, mentioned above, in favour of the cost of the USOs being met from the Budget anyway.

Yours faithfully,

(signature)

(R.S. GILBERT)