
PANEL SESSION 1

Comments and discussion

Philip Williams (Melbourne Business School)

Do the ACCC's pricing guidelines rule out the possibility of recovering common costs from multi-pricing regime? You have seen by having the principle of no price discrimination and prices reflecting costs to rule out the option of recovering common costs through some lump sum charge.

Graeme Woodbridge (Australian Competition and Consumer Commission)

I don't think they do. As I said, people can make commercial negotiations any way they like and we, obviously, would consider an undertaking where someone came along and had a multi-part tariff, that is if they want a price, and we would have to assess it against the criteria. So in terms of that there should not be a problem. So I don't see it does. The only implication that it might is that when we arbitrate we have said we are going to use some sort of long running incremental cost approach, total service lowering incremental costs, and it will be a uniform price based on cost. However, that could be used as a base and people could go and negotiate off that if they want and come up with multi-part tariffs.

Philip Williams

Why ever would you agree to pay incremental costs plus a lump sum if you know that the ACCC is not going to ever require you to pay a lump sum?

Graeme Woodbridge

The question is, what is your multi-part tariff? In other words, is it going to be that uniform price or some other price with a high, up-front fee and a lower marginal cost? We would have no control over people going out and probably have no desire to control people going out and striking such an arrangement, if they think, compared to the price that we set.

Jerome Fahrer (Allen Consulting Group)

I would like to ask Graeme what's the ACCC's interpretation of long term interest of the end-users, which is a rather ambiguous term, and in particular does the ACCC have a view on whether this means a consumer surplus criteria or a global surplus criteria, that is which includes the profits of firms in the industry, which might arguably be in the long term interests of consumers and how you see any conflicts between the short term interests of end-users and the long term interests of end-users being resolved?

Graeme Woodbridge

I guess that the way the thing has been approached is we are looking for outcomes rather than we are thinking of what is in the long term interests of end-users. I would think that what is in the utility function, lower prices that are sustainable I would imagine, high quality service and possibly a greater range of products; that is the fundamental thing you would want to assess, and basically short term versus long term. As said in our pricing principles, what we have taken is a long running, incremental cost here, so it gives a return to investment. So it is looking at the long term interests of end-users in that respect.

Peter Forsyth (Monash University)

A question for Henry. When you look at Telecom New Zealand you would think that it would have a lot of market power, particularly since regulation has been withdrawn, price regulation, and you would imagine that it would have quite a lot of scope to increase its prices. Can you give us a bit of perspective on why it seems to be reducing its prices? Is it that competition is strong enough to force it to do so? Is it potential competition or what? One would have thought that if anything it would take advantage of its position and raise prices, yet it seems to be very well behaved so far.

Henry Ergas (Auckland University)

I think there are two fundamental elements there, Peter. The first is that probably initial prices were above profit maximising monopoly levels and I suspect they were so all the more once the price rebalancing had occurred. Essentially, you had extremely distorted prices in New Zealand, much as you now have in Australia, in that rentals were extremely low, particularly in the mid-1980s because they had not risen at all in line with inflation, and virtually all of the costs were being covered out of toll costs, that is out of STD calls.

The prices which you were left in late 1987 made simply no sense at all, and then you had a substantial increase in all rentals and that created the scope to move prices towards more reasonable, economically reasonable levels even for a monopoly. Of course, on top of that, what you were looking at this very substantial reductions in costs which have been achieved at TCNZ. Then TCNZ went from having about, in effect, 23,000 employees in core telephone service to this year having about 6800 employees in the core telephone service, and capital cost also declined very substantially. So you had very substantial reductions in costs and as cost were stripped out even a monopolist would reduce charges and in reasonably price-elastic markets, in particular toll markets, it made good sense to bring prices down.

So there was that element and then the second element was that, yes, you do have quite significant competitive pressure. Again, it is very difficult to measure it, especially when you try to measure potential competition. But even if you just take market share loss to two entrants, Telecom New Zealand has lost more market share to clear in the toll markets than Telstra has lost to Optus. There has been quite a lot of competition in the market. There is a diversity of players and that has also helped to keep Telecom New Zealand more honest than it might otherwise had been.

Having said that, I think it is also fair to note that Telecom New Zealand is fairly profitable. That might be a rather charitable way of putting it. As you would expect, given that they have achieved very significant productivity gains in a sustained way over the course of a decade and you would hope that the way the regulatory regime would work is that it would provide incentives for those productivity gains to be achieved and one of the means by which that has occurred is that Telecom New Zealand has provided shareholders with what are really rather handsome returns.

Martin Algie (Minter Ellison)

It is a question for Henry. It really follows on from the last question focusing on potential competition. You painted a fairly stark distinction between the regulatory structure as its been growing and growing in Australia and a regulatory structure in New Zealand. The 24 pages of legislation, or whatever you said there was, seems to me to neglect one thing and probably a fairly important thing and that is access. Clear communications has had a very difficult time in gaining access. It seems to me that the New Zealand legislature has relied on, I was going to say the good grace of New Zealand Telecom, to either let a potential a entrant in or not, and you can't refuse if you're misusing your market power, your position of dominance under Section 36 of the

Commerce Act. But that mechanism does not really appear to have worked. Have you any comment on that?

Michael Cunningham (Queensland Treasury)

Could I perhaps asked a related question and we might get answers to the two questions together? Henry said that the intention of the New Zealand legislation was to constrain Telecom not to shift market share to new engines. The Australian legislation, by contrast, is looking to promote competition of a somewhat different objective. I would just like to hear from Graeme and Henry how they think this difference might work out in terms of getting the gains in Australia which have been realised in New Zealand.

Henry Ergas

The approach, rightly or wrongly taken in New Zealand, has been that of starting from the premise that probably for a very long period of time Telecom New Zealand will be the predominant supplier of most telecommunications services in New Zealand, bearing in mind, of course, that New Zealand is a fairly small country. One implication of that is that you gain - the social welfare gains from productivity improvements at Telecom New Zealand are very large, relative to those which would arise simply from shifting a bit of market share from Telecom New Zealand to Clear or to anyone else. In the sense, if you can bring whole cost structure of Telecom New Zealand down then you get very big gains in terms of the economy and that's really been the primary concern and the primary means or benchmark in terms of which policy has been assessed has been, what has the influence been in terms of getting Telecom New Zealand to be as good as a supplier as it can be.

Obviously not a perfect supplier by any means but to make it as good as it can. There has been much less concern with trying to make life particularly easy for Telecom New Zealand's competitors, and that doesn't mean that Telecom New Zealand can do anything it wants. As you say, there are the protections of the *Commerce Act*, under section 36 of the *Commerce Act* in particular, which prevent Telecom New Zealand from using its market power to all together exclude entry. The result of that has been - Clear has had, I think, a fairly hard time getting access, certainly a harder time than Optus has had in the Australia. Here Optus was handed access on a plate. Whether at the end of the day that has really constrained Clear terribly much is another question.

I don't think it is in terms of access, though not as generous perhaps as they might have been, there has certainly not been such as to blockade or prevent

competition from developing in the market. One result of that is that actually Clear has done rather well. I think that one consequence of the New Zealand regime has been to put a great deal of pressure on Clear for Clear to be a well-managed competitor and Clear is a much leaner, meaner firm than, with due respect, I would say Optus is in Australia. Much more focused image in its product range and its marketing efforts and I think been ultimately more successful.

In Australia, in contrast, there's been somewhat of a tendency to confuse the protection of competitors with the protection of competition and what we have had is a regime which has all too often leaned backwards to, almost artificially, create opportunities for the shifting of market share to Telstra's competitors. One important result of that has been that those competitors haven't often needed to compete terribly vigorously to earn reasonable returns to their shareholders. Another result of it has been that those competitors have not had sort of a blow torch applied to them which might have directed them more to consistently take sensible decisions. I think it's really quite striking that despite the fact that inter-connection costs are slightly higher in New Zealand than they are in Australia, you wouldn't find Clear engaging in the kind of whole scale duplication of local loop which Optus chose to engage in.

There's absolutely nothing comparable to this vast investment brace which we have had in HFC in New Zealand. Rather, what is happening is that much more sensibly, there are competitors putting in wireless local loop. The only reason to my mind that we have had this duplication which we observed today in Australia is because of a regime which in seeking to promote competitors provided them both first with the incentives and the means to engage in what was ultimately entirely, socially irrational conduct.

Graeme Woodbridge

I tend to agree with Henry in the sense that it seems the legislation is designed to promote competition where in Australia the early integrated player has control over bottlenecks and also of supplying in those dependent markets or downstream markets. The access regime, or one of the objectives of the access regime, is to allow access to those bottleneck facilities, so you know efficient firms can compete in those markets where their efficiency is based on their quality and their cost production. But is basically open to the number of competitors that will end up being in that market. It is just more of a playing field where people can get access to bottlenecks so they can compete if they're more efficient.

Henry Ergas

You also should note that in the New Zealand case it wasn't Clear that didn't have any trouble negotiating access to the local loop for completion of STD calls, it was really only for the completion of competitive calls undertaken in the same local loop. So it wasn't all abysmal for New Zealand.

Stuart Shephard (Telecom New Zealand)

I think one of the interesting things in the transition from a regulated environment to a competitive one is that the constraints often change from being a price cap to being a commercial consideration and sometimes that mixes up the regulatory process rather badly. One of the examples of that is in your model it seemed to me that you were suggesting that the incumbent would retain all access revenues. However, in practice two things are likely to work against that quite severely. One is the costs of technology are dropping so quickly, it's quite tenable for a new entrant to duplicate access in some but not all areas, particularly CBDs and some suburbia.

Second, it is in the interest of new entrants to gain access because they get customer presence and then can sell other products. So in effect, the revenue that the incumbent would receive from those very inelastic demand schedules that you drew would be constrained by commercial considerations, not the price tag and, therefore, the approach of just raising price caps in some areas to reduce the dead weight loss is unlikely to work in practice. I was wondering if you have considered that and thought about how you could extend your model to take account of that.

Philippa Dee (Industry Commission)

You are right. The model that we have looked at has not treated in a great deal of detail issues to do with what the response of the competitors would be. If you like, we have underlined what we have done as we have implicitly assumed that competitors will actually follow the incumbent when they do all this, which may or may not happen in practice. But to the extent that the lower cost characteristics of potential competitors put commercial constraints on the incumbent, then we would think that that was absolutely precisely what we would want. If, in fact, Telstra can't price up on its crummy old copper wire because somebody else has come in with a wireless local loop then great, that is the way markets work.

Henry Ergas

This is just really a comment on Philippa's charts and builds on the same question. I wonder, Philippa, whether the price elasticity of demand for business lines is actually quite as low you suggest. My main query there is that most business lines are part of multi-line or are held by multi-line businesses and they are used in essentially variable proportions. For example, you can multiplex more or you can use a range of alternatives which allow you to derive much more capacity from single lines. So if you look at the elasticity of demand studies for business lines taking account of multi-line businesses you typically find a relatively high elasticity of demand for the multi-line business.

Philippa Dee

We looked at some of those studies, actually - this is getting a bit technical - studies that we could find suggested a high elasticity over the number of lines given that a decision had already been made to have access of some sort. We weren't sure that that was necessarily relevant to the question of the decision by business to have access at all. But having said that, I take your point and that is why we didn't believe the story about recovering all the overhead costs from business.

Graeme Woodbridge

And I think the efficient process might have relatively, over your kind of sort of quasi-Ramsey process, the lower price for business than for residential consumers.

Chris Pritchard (South Australian Office of Energy Policy)

I would like to ask Graeme Woodbridge a question. There is some emphasis in Australia placed on the ACCC not being terribly interested in arrangements other than undertakings or disputed arrangements or disputed attempts to gain access. Could you just spend a minute or two putting what you said this morning in the context of the broader scope of the *Trade Practices Act* when it might come to looking for being alert to market sharing agreements of the collusive behaviour. How do you put what you said this morning in that broader context?

Graeme Woodbridge

Basically I was trying to draw a distinction between what is under part 11C of the *Trade Practices Act*, which is the set up of the access regime, and that is just a legislative provision. We only have a role in terms of conditions under those two situations, arbitrations and assessing undertakings.

Of course it is quite possible part 11B of the *Trade Practices Act* and other parts of the *Trade Practices Act* may come to play in some sort of anti-competitive behaviour, where in the supply of these declared services or access services generally. So it is not ruling out that type of action. Obviously, the *Trade Practices Act*, they are parts of the *Trade Practices Act* that will apply to those services. It is a question of whether that sort of behaviour goes along with the supplier basis. So that is the context.

Partha Gangopadhyay (University of Western Sydney)

My question is rather clarification. What kind of information structure is there regarding the ...(indistinct)... conditions. Does a new carrier know fully the cost of the incumbent or incumbents?

Henry Ergas

We said many of the entrants, many of the potential entrants, certainly into the Australian market — and if you look at the actual entrants in New Zealand this would be the case — are entities which are involved in telecommunications elsewhere and often as incumbents. For example, in New Zealand we have Bell South which operates a mobile network, Clear which has investment by BT and MCI and so on, and Telstra has a significant presence in New Zealand now. So you would expect that those kind of players would have pretty good information about the cost of providing service and would relatively readily be able to assess what the costs of the incumbent might be.

I think that would also be the case in Australia, certainly given the kind of players which have entered the industry, either in the duopoly years or are doing so now. As far as publicly disclosed information by the incumbent is concerned, not terribly much information is disclosed by incumbents in competitive environments anywhere. I tend to think that that is really quite a good thing in many respects and that it, in particular in cases where might otherwise facilitate coordination between entrants and incumbents, tends to it make somewhat more difficult for that to occur.

But one thing I would say is that, oddly enough, there is more information available in New Zealand than in Australia and one major reason for that is because TCNZ, being publicly listed and having very strong interests in having good quality research being done about it by analysts, actually discloses a very considerable amount of information to analysts. So if you pick up the analysts' reports on TCNZ you get much more information than you could derive by reading the national audits reports on the Telstra accounts.

