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A Response to the ACCC Discussion Paper: "Key Performance Indicators for Non-Price Terms and Conditions"

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Introduction

The Discussion Paper seeks to enhance "the telecommunications-specific competition policy regime". This short paper raises doubts about that regime and shows how those doubts manifest in the attempt to make Telstra deal with other firms, at arm's length, as they deal with their own retail division. In brief, there is good theory to say that the two will be different for good reason. That theory is based on the proposition that the force of competition is limited by partner-specific transaction costs, that firms arise or grow to economise on these costs and that the value of such economising is ignored in the Discussion Paper. The ACCC approach is simply too pro-competition.

Some Economic Theory

There is a considerable and growing body of academic literature which falls under the rubric of the New Institutional Economics (key references are in the bibliography which follows) and which proposes that economic institutional arrangements, the forms of economic organisation in operation, arise predominantly as means to enhance efficiency. This contrasts sharply with the more conventional approach, implicit in the ACCC's policies, which says that the growth of organisations represent a break down of independence so that organisations are predominantly means of reducing competition. In other words, if we have one firm rather than competing individuals, this can be because it is the most efficient way of organising the economic activity or because it benefits its instigator most at the expense of competitors. The ACCC considers only the latter but if the New Institutionalists are right, indeed, to the extent that they are right, an insistence on enhancing competition will reduce efficiency.

The argument runs as follows. We can imagine simple economic tasks where it is possible for the customer and supplier to switch trading partners at low cost. Hiring day labour to load wheat bags onto a ship is a good example – the task is obvious, requires no training, screening potential wharfies is a simple matter of observing physiques, the costs of a wrong decision are felt only for one day, etc. However, more complicated economic activity requires that parties specify, monitor and enforce contractual arrangements. These arrangements are designed to deal with the potential for self-interested opportunism by others. At least some of the costs associated with these arrangements, so-called transaction costs, are partner-specific ie they are incurred every time two parties arrange some activity. Partner-specific expenses establish costs in switching between partners and these switching costs limit the effectiveness of competition.

Contractual arrangements among parties are needed to the extent that switching costs make competition ineffective and particular kinds of arrangements, such as those found within a firm, can arise to economise on the transaction costs associated with these arrangements. Hence, for example, rather than try to arrange for an arm's length supplier to provide a critical component, the part might be made in-house because the costs of specifying, monitoring and enforcing required arrangements are lower within one firm than between two.

The potential economising purposes and effects of growth of a firm are not recognised in Australia's current policy approach – except inasmuch as the relevant legislation includes the residual provision that competition is not to be promoted if that is counter to the national interest. In short, there are critical, general weaknesses in competition policy and these take a particular form in the current attempt to enhance telecommunications outcomes by making Telstra wholesale to competitors as it does to its own retail division.

Questions Raised in The Discussion Paper

The discussion paper is concerned to find ways for Telstra to demonstrate "non-discriminatory performance in relation to core services", implying that non-discriminatory means the same. However, if the transaction costs of dealing at arm's length are significantly different from those operating if the activity were within a single firm, then it is possible for there to be good reason that performance, terms and conditions are different. It is possible to be non-discriminatory but different: higher transaction costs can mean different performance and different terms and conditions. The point can be made with reference to the performance metrics suggested in the discussion paper.

For example, the paper refers to billing and notifications as possible key performance indicators and the metric of "percentage of calls accuracy charged and billed" (sic). However, it is obvious that the consequence of errors or delays are different if the billing is between two divisions of Telstra rather than between Telstra and some reseller. Hence the optimal terms and conditions that specify, monitor and enforce billing arrangements and the billing outcomes will be different in the two situations. The ACCC approach is to say that the two must be the same and if that is not the case it is because Telstra is acting anti-competitively. It is a view that takes deductions from competition theory to interpret conditions in the real world. That is a dangerous practice if not supported by further investigation, of the sort proposed below.

Another example would be the faults and maintenance metric proposed in the Discussion Paper. Again, the logic is that performance here must be equal for all customers, whether Telstra's own or those of resellers. However, because the costs of specifying, monitoring and enforcing the contractual arrangements governing faults and maintenance at arm's length are different from those within the firm, so will be the terms and conditions and the outcomes. Indeed, the logic says that Telstra will deal with resellers only on terms and conditions which appear to favour it or, but for competition policy, will not deal with them at all because it faces higher costs at arm's length. This difference can be manifest in weaker commitments to respond to faults and maintenance. If Telstra provided exactly the same terms, conditions and performance, it would be absorbing the higher transaction costs merely to conform to policy makers view of the world, not because it advances the national interest. At the least, this might be the case and it is essentially arbitrary for the ACCC to decide that Telstra's faults and maintenance performance and the terms and conditions which govern it must be the same for in house or at arm's length supply.

The Implications for Accounting Separation

We are aware that this response and the ideas that underlie it are outside the process of telecommunications reform as it has been practised in Australia since 1997. Our purpose here is not to call for a complete re-think of that reform agenda, although we might make such a call in some other forum. The immediate point is that the ACCC needs to rethink accounting separation. In particular, it needs to consider reasons for our having a dominant player in telecommunications and, equally, why competition is attenuating in telecommunications other than that Telstra is stifling competition.

In the end, government must make judgements about Telstra's purposes in setting terms and conditions for resellers and in having different performance characteristics when supplying customers directly cf through third parties. Government must make these judgements based on interpretations of motives provided by investigations undertaken by bodies like the ACCC. Presently, the interpretations are limited to the pro-competition view of the world which is increasingly being seen as an inadequate. The ACCC needs to investigate the relevance and strength of efficiency motives that might pertain to the arrangements which Telstra has made.

Bibliography

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