Getting competition into telecommunications in Australia is a classic case of starting from the wrong place.

Indeed, “getting competition into something” is indicative of starting from the wrong place. You don’t have to get competition into most industries. It just happens. You don’t need regulatory action to get it in, although you may need general antitrust action to protect it.

The starting point for telecommunications competition in Australia was a matter of choice as recently as 1991, and the wrong choice was made when the then government set up two firms with a particular structure and opted for a mandated duopoly as a long drawn out transition to open competition. But that time is long past, there’s no use crying over spilt milk, and the choice of starting point is not ours today.

So we started with a dominant, ubiquitous, vertically-integrated full-service incumbent. The other duopolist and new entrants had to deal with:

- not being able to provide full services all at once (just like new entrants in any industry);
- the need to roll out geographically with little hope of ever having ubiquitous networks (not uncommon in other industries); and as a result
- (this is the different part) relying on the incumbent for access to its network, even so that they could provide limited services in limited areas.

The incumbent was told it had to be co-operative, and said it would be, but its incentives were to protect its patch. That’s largely what the literature to which John
Mayo is so distinguished a contributor is all about: incentives. If you like, incentives to be difficult, incentives to commit sabotage. When new entrants have to rely on a dominant incumbent for services so that they can compete with that incumbent, they are up against it, so getting vigorous competition is not going to be easy.

However, in another sense, the starting point for telecommunications competition in Australia was not too bad.

First, industry revenues were large and potentially growing fast. Revolutions in IT and telecommunications technologies were enabling new applications and the promise of vast riches.

Secondly, technological change was allowing new entrants to use better, cheaper means of providing services, and to provide newer services, than the incumbent.

Thirdly, the incumbent’s very size and dominance meant it was potentially vulnerable to attack on a range of fronts. There were bound to be disaffected customers who would give someone new a go. Moreover, the incumbent had the disadvantage of its legacy of public ownership, the status of a public utility, and the constant pressure of numerous interest groups, and consequent political demands, to upgrade services, more or less regardless of cost or potential revenue, on the basis of equity and uniformity across the community.

So the time seemed right for more nimble, even opportunistic, entrants to cherry-pick, outmanoeuvre, and innovate to build up market share and weight. This they did, and for a while capital markets went out of their way to help.

But it’s been a series of limited incursions.

No doubt the incumbent has felt itself under vigorous and constant attack, not least because the attacks come not only from competitors but from customers and their representatives as well. Nevertheless, after eight years of open competition – at least in the sense that entry has not been precluded by government restrictions – and 14 years since the end of government-mandated monopoly, the incumbent is still dominant in substantial areas, in terms of both services and geography.

This is despite what by Australian standards has been a large regulatory effort.
Why was the regulatory effort invoked? Because despite what I have said about the incumbent’s vulnerability to new technologies, new applications and marauding attackers, the fact is that the incumbent’s incentives were to protect itself. It controlled access to its infrastructure. Competitors needed that access. And, as an aside, let us never forget how radical the notion is – now taken for granted – that a company can be obliged to provide access to its infrastructure. No company in history has viewed such a prospect with equanimity.

John Mayo has written persuasively and elegantly about these incentives and the behaviour that can be expected to result, in both price and non-price terms, when an incumbent seeks to protect its markets.

The Australian regulator has sought to assure access on efficient terms. This has involved balancing the interests of static efficiency, which would argue against encouraging the entry – much less guaranteeing the survival – of less efficient competitors, with the interests of dynamic efficiency, where as John has written, the concern is that while new entrants struggle to make a dent in the incumbent’s dominance, we are all getting older and in the long run we are dead.

I am tempted to say that the local loop has defeated those of us – practically everyone – who hoped and expected greater competition to have developed by now. At least in terms of the incumbent’s share of local access – subscriber lines – the dent made by new entrants is so far not very large. The same seems to be true of other countries, with a concomitant level of disappointment.

But how disappointed should we be?

Is there anyone who does not think that telecommunications has been revolutionised, even though we still have a dominant incumbent? Surely we have to concede that we are getting far better services at far better prices than we used to not so long ago. Most of us are getting a fair measure of choice as well.

Secondly, given the economies of scale and scope and the advantages of incumbency, could we really engineer more competition into telecommunications? If regulation were to restrain the incumbent more strongly, what resources would be needed to do that? How intrusive would that regulation be?
Fundamentally, is it really possible for a regulator to override basic incentives, get inside the largest company in the land, and control its internal decision-making in beneficial ways without causing offsetting inefficiencies?

I think that if we implicitly have an objective of the incumbent’s share of subscriber lines falling from 80 per cent to below 50 per cent, we are setting ourselves up for failure. Moreover, we won’t take enough notice that the state of competition is in fact pretty good.

What do I mean by pretty good? I mean sufficient to keep the incumbent up to the mark, sufficient to drive innovation and ensure it can’t be stifled and that new services and improvements to existing services can’t be unduly delayed, and sufficient to give most customers meaningful choices in most services.

We all know that there is a way of dealing with the problem caused by the incentives facing a full-service vertically-integrated incumbent providing wholesale upstream access to its competitors in downstream retail markets. And that is to prevent it operating in both markets. In Australia regulators do not have the power to enforce that option or even the ability to seek it in the courts. It is an option that resides with the government and the legislature, which may be no bad thing, considering that it is a very drastic option (although I note that it would not have been nearly as drastic when Telstra was fully owned by the government, say when Telstra was put together through the merger of Telecom and OTC).

Anyway, we have to struggle ahead with the possible, and structural separation has been ruled out.

That means, for the regulator, continuing to try to set efficient access prices, based on forward-looking costs; seeking to ensure non-discriminatory access and preventing sabotage; and otherwise acting against anti-competitive conduct. None of that is straightforward in practice. John Mayo’s work shows that ensuring non-discriminatory access is likely to be difficult and, moreover, that the tighter regulation of access prices is, the tighter non-price regulation may need to be.

I digress for a moment to note that providing non-discriminatory access is costly for the vertically-integrated incumbent. It requires new systems and new ways of doing things quite apart from a cultural change within the organisation. In the US, under
regulatory pressure and supervision, enormous efforts and investments were made by incumbents in operational support systems to provide access to competitors on the same basis as for an incumbent’s own downstream operations. That was in context of incumbents needing to satisfy regulators that access had been genuinely opened up before they were allowed into the long-distance market.

We did not have that regulatory lever, and our regulatory efforts were somewhat less formal and detailed. Nevertheless, so far as systems go, much has been achieved. As for the human side, the cultural side: I am no longer close enough to know. But I do know where the incentives lie.

Call me naive, but despite those incentives I always felt that if it had wanted to, Telstra could have made life more difficult than it did for its wholesale customers. Senior Telstra management seemed to me to pay far more than lip service to the ideals of competition. Of course, it must be remembered that there were and are some counter-balancing incentives in the form of potential multi-million dollar penalties for anti-competitive conduct. We should not underplay their effectiveness.

Let me conclude by putting two alternative views.

First, while regulation is not impotent, it has an almost impossible task. It looks as if the harder you try, the harder you have to keep trying. Everything points to more and more regulation. Can this really be sensible? Should we not instead just sit back and let technology do its work? Sure, we may have to put up with near-monopoly for a while – perhaps quite a while – but that will contain the seeds of its own destruction. Eventually monopoly will be by-passed and that is the only way we will get the only competition that really counts: competition based on alternative means of access to customers.

The alternative view is that the opportunity costs of the first alternative are too great. The benefits of greater competition – even if it is at the margin, even if it is not full facilities-based competition – are too great to be willingly forgone. Another of John Mayo’s conclusions is that even resale competition is worthwhile, should be fostered, and can lead to greater things. Consequently, the regulator has no alternative but to battle on in the hope that the competitors will do likewise.

I think there is little doubt that the second view is to be preferred.
So what are the lessons? In regulatory terms, more of the same. A willingness to come down hard on anti-competitive conduct but tempered with reasonable expectations about what is achievable, and trying to make sure that regulation doesn’t get in the way of change.

Of course, that last point is a topic in its own right.