How realistic is open competition

John Crook examines the NZ experience and observes the early evidence is encouraging

From the formation of AT&T until recent times the basic economic doctrine was that a single regulated monopoly could provide services more efficiently and effectively in the public interest than the open competitive market.

This approach to the market became the practice throughout most of the developed world with each country having its protected monopoly franchise-holder as a single provider of basic telecommunication services. However, the debate continued as to which services should be best provided by the monopoly telephone company and which should be provided by other market players.

Containing the monopoly

Attempts were made to distinguish between 'basic' services which were part of the basic network where it was felt that economies of scale demanded that a single operator provide services for the entire market, and 'value added' services which it was held were best provided competitively. Generally the monopoly service provider was barred from the competitive market activities in case this led to anti-competitive practices.

During the 1960s the tide slowly began to turn. Firstly in the United States, then subsequently in the United Kingdom and Japan, various parts of the sacred monopoly markets were opened up to competition. Typically this commenced with the provision of customer premises equipment (CPE) and extended into the provision of private network and long distance services.

Another key area of debate has been the question of resale. Resale of basic network services was usually regarded as a 'no-no' unless there was a genuine value added component in the service provided to the end customer. The prohibition of resale arose because of pricing distortions between the rates telephone companies charged for leased lines and private networks compared with the prices for public switched network services. Resale presented a potential 'cream skimming' opportunity for resellers. The telephone companies, on the other hand, used their profits to subsidise universal telephone service and/or services to residential customers.

However, in all of the major markets of the world (including Australia) these sacred truths are again being questioned as policy makers search for market models which will provide the greatest degree of economic efficiency and benefits to customers.

The New Zealand experience

The opening of the market in New Zealand has been advanced extremely rapidly. We have come from a totally protected monopoly service provider in 1987 to the most open and least regulated market in the world from 1 April 1989.

This is part of an overall framework of government policies initiated by our previous Labour government. Their policies sought reduced government intervention in all markets and the promotion of competition throughout the economy. An underlying philosophy was to make competitive market policies neutral as far as possible across all economic sectors.

Although very rapid by world standards, the deregulation was a phased process. The *Telecommunications Act* in 1987 provided for the progressive liberalisation of house wiring, telex machine provision, telephone services, building cabling and PABX systems through to April 1989.

As these markets were liberated, telecommunications-specific regulation and statute were removed from force so that the only rules governing market behaviour were those of general commercial legislation such as our *Fair Trading Act* and *Commerce Act*.

Interestingly, therefore, the main cornerstone of New Zealand's telecommuncation legislation is not found in the *Telecommunication Act* but in the *Commerce Act* (which regulates all market activity). This Act is similiar in concept and principle to the Australian *Trade Practices Act*. The key section of the *Commerce Act* for these purposes is section 36 which reads as follows:

> *"(1) No person who has a dominant position in a market shall use that position for the purpose of—*
> *(a) restricting the entry of any person into that or any other market; or*
> *(b) preventing or deterring any person from engaging in competitive conduct in that or in any other market; or*
> *(c) eliminating any person from that or any other market."*

This legislation forms the cornerstone of the commercially negotiated interconnect agreement between Telecom and our major network competitor Clear Communications Ltd.

In establishing this policy the government indicated to Telecom that it expected it to develop fair arrangements for interconnection and the development of the competitive market place. It indicated it would intervene with pro-competitive policies and regulation if and only if Telecom engaged in anti-competitive behaviour, and existing remedies under the law proved inadequate.

How competitive is the market?

The market for CPE is now intensely competitive. We have never had a specific protection for the 'first telephone' in New Zealand. When the telephone market was opened to competition in May 1988, the market was completely opened for competitive supply. Similarly, the market for PABX systems and business telephone systems was opened from 1 April 1989.

There are many players in the CPE market and customers have a wide variety of choices. Telecom is still the largest supplier in these markets but it is a constant challenge for it to maintain a supply of quality products at prices acceptable to customers.

There are no restraints on resale in New Zealand. Anyone who wishes can acquire basic network facilities from Telecom (or any other network operator and add value to them or not as they choose, selling the resulting services in the competitive market. This also includes the opportunity for businesses to on-sell capacity in their private networks should they so choose. At least two companies, one of them a partially owned subsiduary of Telecom, acquire network capacity from Telecom and offer competing toll services. Usually these are provided at discounted prices compared to Telecom's offering.

Facility based competition in the provision of basic network services is just getting started.

In July of 1989, Telecom started negotiating with New Zealand Railways, (NZR) who had built an optical fibre cable system between our two main cities. They wanted to use this for both toll bypass and alternative network services. In December

1989, NZR joined forces with MCI Communications Corporation, a major US telephone company and the Todd Corporation, a major NZ investment company, to form a joint venture. About the same time a joint venture comprising Bell Canada and Broadcast Communications Ltd (a Television NZ subsiduary) began negotiations with Telecom for toll bypass and alternative network services.

These negotiations continued sporadically until May 1990 when the two joint venture groups joined forces to form the Alternative Telecommunications Company Limited, now renamed as Clear Communications Ltd (CCL). In August 1990, an initial memorandum of agreement was signed with CCL and finally the main interconnection agreement was signed in March 1991.

CCL commenced offering private network services (which were not dependant upon interconnection) to customers throughout New Zealand late in 1990 and a competing toll service was started in May this year.

Telecom's customers are now able to sign up with CCL and use the CCL long distant network as an alternative to Telecom's for making toll calls. CCL's toll calls are offered at a price discount relative to those of Telecom. Their customer base is building up progressively, with at least 2000 customers currently using their services. Around the third week of July, CCL celebrated the switching of the millionth toll call in their network.

Now that the competing toll service is up and running, CCL have redirected their attention to the negotiation of further interconnect arrangements which will enable them to provide local telephone services and 0800 services in competition with Telecom.

Telecom's response

The government decision to operate an open market policy sparked off a radical change in Telecom. A new company structure was formed and decision-making authority was delegated to subsidiary companies close to the customer. Many new managers were recruited from outside the organisation to bring in commercial skills complementary to the engineering skills of the former Post Office organisation.

The main changes made were to rationalise operations, increase efficiency and reduce costs. Staff numbers have been progressively reduced from 26,500 in 1987 to around 14,500 today.

A major tariff rebalancing program was instituted to remove cross subsidies and introduce coherent prices. An intensive capital program was launched to exploit new technologies. The conversion of core network to digital technology has been one of the most rapid in the world. Telecom moved from around 35 per cent of lines connected to digital switches in 1987 to nearly 90 per cent today. Substantial investment was also made in new operational support systems such as billing, directory assistance, and network management.

An entrepreneurial business group called the 'New Venture Companies' was established to develop business opportunities in value added services.

Customer safeguards

The government recognised that it would take a little while for competitive services to develop, especially in the markets which serve residential customers. Thus, at the time of privatisation a few extra 'light handed' measures were instituted. These include:

- A set of disclosure regulations which require Telecom to periodically publish the prices and conditions of service for a small number of core network services.
- A set of requirements to protect the interests of residential customers enshrined in the company's Articles of Association, exercised through a special share known as the 'Kiwi Share'. The requirements established are as follows:
  - Local free calling will remain available to all residential customers.
  - The standard residential rental for a phone line will not rise faster than the cost of living unless Telecom's regional operating companies profits are unreasonably affected.
  - Telephone line rentals for residential customers in rural areas will not be higher than in the cities and residential services will remain as widely available as at present.
- A voluntary publication by Telecom of service standards for some of the services used by residential telephone customers, such as new connections, time to restore faults, and directory service answering times.

As competition develops in these markets the above constraints will be progressively removed and consumer protection will be through competition and the primary statutory provisions in the *Commerce* and *Fair Trading Acts*.

Customer benefits

Although I believe that there are many customer benefits including variety and choice, I will dwell only on two of them: quality and price.

Customers are regularly surveyed by an independent research company addressing every aspect of Telecom services. Quality councils throughout the company address the survey results and programs for improving our performance. Each major process in our business is assigned to an 'owner' responsible for monitoring its improvement. A significant component in the remuneration bonus for senior managers derives from the achievement of improvements in quality (as measured by the independent survey).

As Teleom improves its efficiency it will be able to pass on price reduction benefits to its customers. Despite the introduction of local call charging for business customers (previously local calls were free) it has been able to reduce typical business customers' telephone bills in real terms by amounts ranging from 30 per cent to 50 per cent over the period from September 1986 to March 1991.

The benefits already delivered to NZ customers include:

- an average real price reduction in excess of 20%;
- prices more closely related to costs;
- substantially improved installation timings;
- enhanced service quality;
- accelerated introduction of new technology; and
- increased level of customer choice.

All this has been achieved at the same time as an increasing level of profitability for the main telephone company.

'How realistic is open competition?' I feel the jury is still out on the long term consequences of the environment we are creating, but I think all will agree that the early signs are very promising indeed.

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