Australian Democrats Minority Report

Introduction

1.1 The Australian Democrats will be voting against the Telstra (Transition to Full Private Ownership) Bill 2003, because the Government has failed to make out a case that this Bill is in the public interest. On all key criteria, the Government has failed to make out a case that the sale is justified, whether it be on competition, service, legal or financial grounds.

1.2 This Inquiry has been very important in that it has provided an opportunity to explore the various arguments presented by the Government in favour of the sale and register community and expert response. The clear conclusion has been that the sale is not justified on the terms proposed by the Government, remains opposed by the overwhelming majority of the Australian population, and should be opposed by the Senate.

1.3 Telstra is not a typical private company - partly for historical reasons and partly because of the regulatory regime – it is one of the most vertically integrated telecommunications carriers in the world, retaining a near monopoly position over the formerly publicly owned Customer Access Network (the CAN), and, as a result, is in a market dominant position in most other sectors of the telecommunications market. It is particularly dominant in regional areas, being the Universal Service Obligation (USO) provider, and frequently the only provider of broadband links and CDMA mobile phone coverage. Telstra's market dominance is highlighted in the following table comparing revenues and market share:

Table 1 Telstra revenues and market share 2002

Item	Revenue ($m)	% total revenue	% Telstra market share
Basic access	$2,734m	13%	90%
Local calls	$1,947m	9%	78%
National long distance	$1,168m	6%	71%
Fixed-to-mobile	$1,419m	6%	75%
International calls	$409m	2%	64%
TOTAL PSTN	*$7,677m*	*37%*	*81%*
Mobile services	$3,575m	17%	52%
Data services	$2,533m	12%	63%
Internet services	$605m	3%	35%
Directories	$1,169m	6%	13%
Customer equipment	$223m	1%	n.a.
Intercarrier services	$1,121m	5%	100%
Controlled entities	$2,001m	10%	n.a.
Other	$1,995m	10%	n.a.

(*Source: ACCC Telecommunications Market Indicators, Emerging Structures Report, Telstra Annual Reports)*

1.4 More importantly Telstra provides a range of services that are absolutely vital to the national security and economic and social development of Australia. Australians are increasingly relying on e-commerce, e-health, and banking. For many businesses, especially small business, efficient and effective communication systems are critical. So for example high speed Internet is essential for successful engagement with the modern economy and society. A cost effective, reliable communications system is especially critical for Australians living in regional, rural and remote areas, where tyranny of distance, isolation and lack of services can be overcome.

1.5 The Democrats have long recognised that government has a significant role to play in the supply of telecommunications infrastructure because it is an essential service. As stated in the Democrat Minority report for the Telstra (Transition To Full Private Ownership) Bill 1998:

> We do not see government ownership and regulation of the industry as incompatible or illogical. The Parliament is the maker of the laws and regulations under which the company operates not the Government of the day. To suggest otherwise is either to underplay the power and role of the Parliament, or overemphasize the government's regulatory functions[1].

1.6 In 1996, the Democrats chaired the Committee into the Telstra (Dilution of Public Ownership) Bill 1996[2]. The Committee found that it was essential for Telstra to remain in full public ownership. The report argued that in full public ownership, Australians will retain:

- access to quality services at competitive prices;
- social benefits flowing from Telstra's revenues to government;
- opportunities for employment and local manufacturing; and
- an interest in developing telecommunications technologies and industry innovation.

1.7 The Democrats supported the Committee’s three key recommendations that:

- Telstra remain in full public ownership;
- the Telstra (Dilution of Public Ownership) Bill be divided into two bills: one concerning the proposed sale; the other concerning the Customer Service Guarantee; and
- environmental programs of the Government be funded from recurrent expenditure or from a proportion of Telstra's profits.

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1 Senate Environment, Recreation, Communications and the Arts Legislation Committee. *Telstra (Transition to Full Private Ownership) Bill 1998*, Minority report by the Australian Democrats and Greens (WA), May 1998.

2 Senate Environment, Recreation, Communications and the Arts References Committee. *Telstra: To Sell or not to Sell?* September 1996.

1.8 In its minority report for the Telstra (Transition To Full Private Ownership) Bill 1998, tabled in May 1998, the Democrats again recommended that Telstra remain in majority public ownership; and that:

- the Bill's Preamble contain reference to the three tiers of the universal service obligation;
- the standard telephone service be immediately upgraded to a 64 kilobits service and its definition be extended to include internet and mobile telephony;
- the ACA be empowered to make changes to the universal service obligation without the need for ministerial direction;
- customers receive automatic compensation in instances where service providers have not met the CSG performance standards;
- regular reviews of the universal service obligation and the customer service guarantees standard be guaranteed in legislation; and
- if contrary to public opinion, the Senate passes the Bill, then Section 9 of the Telecommunication Act 1998, the power of the minister to direct the Telstra Board in the public interest, be retained.[3]

1.9 And again, in the Senate report on Telstra (Transition to Full Private Ownership Bill) 1998, and related bills, tabled on 8 March 1999**,** the Democrats recommended that the remaining two-thirds of Telstra remain in public ownership, and that:

- the Customer Service Guarantee performance standards be the subject of constant review by the Australian Communication Authority and that the ACA be empowered to amend CSG performance standards without receiving Ministerial direction. This should occur regardless of Telstra’s ownership status;
- service providers provide details of the CSG to their customers as a matter of course. Service providers should automatically pay compensation to customers in instances of CSG breaches;
- the price of the 64kps ISDN or equivalent service and the comparable satellite service, supplied as a part of the USO, be capped at an affordable level;
- the definition of the standard telephone service be broadened to include mobile telephony and Internet access. This should occur regardless of Telstra’s ownership status;

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3 Senate Environment, Recreation, Communications and the Arts Legislation Committee. *Telstra (Transition to Full Private Ownership) Bill 1998*, Minority report by the Australian Democrats and Greens (WA), May 1998.

- regular reviews of the USO be guaranteed in legislation. This should occur regardless of Telstra's ownership status;
- a permanent panel of review be established, comprising industry, consumer, legal and departmental representation to conduct regular reviews of the USO.
- the current wide ranging Ministerial power of direction contained in section 9 of the *Telstra Corporation Act 1991* be retained;
- any inquiry into Telstra's performance must be a public process which must include the calling of submissions from the public, the conduct of public hearing and the tabling of the inquiry's report before the Parliament; and
- any proposal for the further sale of any pat of Telstra, regardless of the outcome of an inquiry, be the subject of legislation to be passed by the Parliament.[4]

1.10 It is the Government's focus on debt reduction and shareholder value over the national security, economic and social development of Australia that continues to be of concern to the Democrats and the majority of Australians. The Democrats argue that in its rush to the reduce debt, despite Australia having one of the lowest national debts in the OECD, the Government have not given adequate consideration to the implications of the full privatisation of a vertically integrated monopolistic Telstra, and the alternatives. And until they do so, the Democrats, will again not support the full privatisation of Telstra.

In the Public Interest and Benefit

1.11 In the 1996 Liberal & National Parties Policy on "Privatisation: In the Public Interest and the Public Benefit", the policy states:

> The Liberal and National Parties believe privatisation should only occur where it is demonstrably in the public interest. We do not take the view that privatisation is an end in itself. Indeed there are many Government functions which public interest and accountability considerations demand remain in public ownership and control.

1.12 Under its "Charter for the National Interest"[5], Liberals and Nationals argued that privatisation will be in accordance with principles, to safeguard the national interest, these included:

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4 Senate Environment, Communications, Information Technology and the Arts Legislation Committee. *Telstra (Transition to Full Private Ownership Bill) 1998*, the *Telecommunications (Consumer Protection and Service Standards) Bill 1998*, the *Telecommunications Legislation Amendments Bill 1998*, the *Telecommunications (Universal Service Levy) Amendment Bill 1998* and the *NRS Levy Imposition Amendment Bill 1998*, Minority report by the Australian Democrats, May 1998.

5 Liberal & National Parties Policy on "Privatisation: In the Public Interest and the Public Benefit 1996, pg. 3.

- evidence of a clear public benefit to be derived from the privatisation of a particular sector;
- focus on benefits to consumers, including protection of consumers interests;
- a commitment to maintain community service obligations, recognising the special needs of rural and regional Australians;
- proceeds of privatisation will not be used to fund recurrent expenditure

1.13 As outlined below the Democrats argue that the Government has in fact failed to demonstrate that the full privatisation of Telstra is in the public interest and provides clear public benefit.

1. What 50.1% Government Ownership means

1.14 A key argument against the sale of Telstra is that 49.9% private ownership leaves the company ‘half-pregnant’, already required to act in the commercial interests of all shareholders, but restrained by public ownership from making full commercial investment decisions. As Telstra argued to the Committee:

> The Corporations Act ensures that Telstra’s minority shareholders are protected against government requirements that might otherwise be imposed by virtue of its majority shareholder votes. Telstra, its Board and executive have been required to act in the best interests of all shareholders since 1991when the company was incorporated under the Telstra Corporation Act.[6]

1.15 However, Telstra in its evidence acknowledged that the Government’s 50.1% ownership allows it to decide the composition of Telstra’s Board of Directors. If a director failed to satisfy the Government, it could easily vote them off, which remains a powerful control mechanism for all majority shareholders. As Professor Bob Walker, a shareholder activist told the Committee:

> Majority shareholder have a controlling interests, and are capable of calling the shots on the financing and operating decisions of corporations – regardless of the pious sentiments expressed in the Corporations Act. Indeed, this reality is recognised in accounting standards which are regulations to the Corporations Act – notably those dealing with the application of equity accounting (a shareholder in excess of 20% prima facie conveys the capacity to exercise significant influence and consolidation accounting (majority shareholding confer the capacity to control financial and operating decisions.[7]

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6 Submission no. 144, Telstra, p.4.

7 Submission no. 160. Bob Walker, p. 3-4.

1.16 Professor Quiggin argued that Telstra's majority public ownership, in acting as a break on offshore investment, probably saved the company a large amount of money in that it was unable to fully engage in the carrying of the "dot.com" bubble during the 1990s, and that the loss of wealth in Australia, as a percentage of GDP was small in comparison with the US and elsewhere as a result.[8]

1.17 Government officials also acknowledged to the Committee that majority ownership has resulted in a high level of reporting and interaction between the Department of Finance and Telstra management:

> The Corporations Act sets out quite an intense overlay of reporting to Government as the majority shareholder in terms of annual reporting that private sector companies do not have, and that generates interaction. There is a lot of interaction. It is typically at management level. We do not interact at director level, but we interact at management level.[9]

1.18 It should also be noted that section 9 of the Telstra Corporation Act provides public reporting requirements to the Parliament that private companies do not have, including the requirement of Telstra to submit to scrutiny by Senate Estimates Committee, and to requests for information under the Freedom of Information Act. Part 3 of the Act also provides the ability for the Minister to give certain directions to Telstra in the public interest, a power which is yet to be exercised.

1.19 Under the Bill that is being considered, these public accountability measures will be removed. The Minister's power to direct will cease to apply when Commonwealth's equity has fallen below 50 per cent, as will the application of the Freedom of Information Act and the application of Commonwealth public sector employment and occupational health and safety laws. When the Commonwealth's equity falls below 15% the Bill will repeal:

- the power of the Minister under section 8AS to require Telstra to provide financial reports to the Commonwealth;

- the obligation of Telstra under s8AE to notify the Minister of significant events;

- the obligation under s8AF to keep the Ministers for Communications and Finance informed of the operations of Telstra and its subsidiaries;

- the obligation under s8AG to provide the Minister with its corporate plan;

- the obligation under s8AYA to provide the Commonwealth with prior notice of any action which may dilute the Commonwealth's holding;

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8 Submission no. 67, John Quiggin, p.1.

9 David Yarra, Acting General Manager, Asset Management Group, DOFA, *Proof Committee Hansard*, 7.10.03, p. 9.

1.20 Similarly, there is little evidence around the world that reducing public ownership improves customer outcomes, particularly in markets where the former Government telco retains strong market dominance. Comparing public ownership with the OECD's price domestic phone charges comparator highlights this relationship (all countries judged in relation to Australia's domestic phone cost of $452 US ppp). Three of the four countries with the cheapest phone prices have majority publicly owned telcos, while 3 of the 4 with the highest prices had private ownership rates in excess of 90%.

Table 2. Public ownership and domestic phone charges – selected OECD countries:

Country	% telco public ownership	% difference in domestic phone prices to Australia
Iceland	95%	-54%
Switzerland	62.7%	-36%
Korea	0%	-34.3%
Sweden	70.6%	-33%
UK	0%	-30.7%
Japan	46%	-29.2%
Netherlands	34.7%	-28.3%
Canada	0%	-26%
Norway	77.7%	-14.6%
Finland	53.1%	-14%
Austria	75%	-12.7%
Ireland	0%	-11.3%
US	0%	-10.1%
Germany	42.8%	-8.5%
France	56.5%	-6%
New Zealand	0%	-2.9%
Australia	50.1%	0.0%
Belgium	50.1%	+1.1%
Turkey	100%	+4.4%
Italy	0%	+4.6%
Spain	0%	+10.4%
Portugal	5-19%	+44.3%

(Source: OECD Communications outlook 2003)

1.21 As can be seen, majority public ownership does make a significant impact on Telstra's ability to operate, notwithstanding the obligation on the board to maximise profits. This Bill substantially reduces the requirements of Telstra to interact with Government and the Parliament and thus properly fulfil its public interest obligations.

2. Services

1.22 It is clear that customer dissatisfaction with telecommunications services is on the rise. An analysis of the results from Consumer Awareness and Information Needs Surveys conducted by the Australian Communications Authority in 2000, 2001 and 2002, paint a worsening picture of consumer confusion and distrust in the telecommunications marketplace. The Australian Consumer Association noted that:

> all comparable indicators show a decline in consumer regard for the market. There is an explicit and progressive deterioration in consumer confidence (Ref 3).[10]

Table 3. Australian Communications Authority Consumer Awareness and Information Needs Survey 2000-2002

Attitudes about telecommunications issues - residential consumers				
	Per cent agreeing with the statement			
Issue	2000	2001	2002	Change
(Ref 1) Providers of telephone services today are more responsive to my needs than they were five (2000 three) years ago	73	71	63	-10
(Ref 2) I find it difficult to compare the prices and service features of different telephone companies	59	66	68	9
(Ref 3) I feel more confident about making a decision regarding telecommunications now than I would have five (2000 three) years ago	67	66	61	-6
(Ref 4) I am confident that my interests as a consumer are being protected in today's competitive telecommunications environment	n/a	55	50	-5
(Ref 5) I feel it is easier and less hassle to keep all my telecommunications services with one provider	78	80	82	4
(Ref 6) I would be happy to shop around and make use of multiple providers if it meant I got a better deal for my telecommunications services	63	62	62	-1
(Ref 7) It is hard to know where to go to get objective, unbiased information on different telecommunications costs and services	70	71	71	1

(Source: Australian Consumer Association, submission no. 72, pg 2-3.)

1.23 Recent figures from the Telecommunications Industry Ombudsman showed that complaints against Telstra rose by 2.9% in the year to June 30, while complaints overall fell 10.9%[11]. The Australian Communications Authority has reported that customer satisfaction with Telstra fell from 74% to 60% in 2002. The 2003 OECD Communications Outlook showed that Australians are paying more for their phones than most industrialised countries, 44% more than the British, 35% more than Canadians, and 11% more than Americans. The ACA Telecommunications Monitoring Bulletin also showed a downward trend in all indicators of the Customers Service Guarantee (CSG). This is discussed further under Infrastructure Investment.

1.24 There has been some improvement in service and pricing with the extension of untimed local calls to all Australians. However as noted by the National Rural Health Alliance the lack of fixed voice telephony is a major issue for one group of Australians – those living in Indigenous communities:

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10 Submission no. 72, Australian Consumer Association, p. 2-3.

11 Telecommunications Industry Ombudsman, Annual report 2003.

> A significant portion of these communities does not have access to a public payphone and many of these communities are without telecommunications of any kind…… While the RTI [Regional Telecommunications Inquiry][12] report noted the lack of services in these regions the reports recommendations were not very substantial – only noting that "further support will be needed, and that Telstra should place a high priority on the provisions of payphones or alternative community phone systems. [13]

1.25 With respect to Broadband, Australia is behind other countries in penetration and cost. Broadband in Australia is predominately provided using either Hybrid Fibre Coax (cable) or through Telstra's traditional copper network using digital subscriber line (DSL) technologies. Access to Broadband, a key tool for modern business and commerce, and facilitator of e-health and e-education, is still limited and is a contentious issue, especially for regional and rural Australia.

1.26 In terms of the Customer Service Guarantee, there has been a marked decline in Telstra's performance over the last two years, particularly in urban areas:

Table 4. Percentage of Faults repaired by Telstra within CSG timeframes:

Category	June 01	Dec 01	June 02	Dec 02	June 03
Urban areas	8	11	14	11	18
Rural areas	5	6	7	6	8
Remote areas	13	6	3	6	6
National	7	9	12	9	14

(Source: ACA Telecommunications Performance Monitoring Bulletin)

1.27 The ACA has indicated that it is concerned by Telstra's urban faults performance and has "sought assurances from Telstra that they will take the necessary steps to raise the level of performance."[14] It remains to be seen how effective that will be.

1.28 The CEPU questioned the effectiveness of the benchmark of CSG faults, arguing that the emphasis on statistics has resulted in 'quick fix' temporary work being done to clear faults without dealing with underlying problems. The ACA acknowledged that "some, and only some" of the causes of recurring faults relate to remedial work[15], but that the new Network Reliability Framework (NRF) will allow the regulator to "be able to work out where recurring faults were, what sorts of problems were being exhibited and to do something about them."[16] The NRF has only been in operation for nine months, but the ACA has already required Telstra to

12 RTI, Connecting Regional Australia, Report of the Regional Telecommunications Inquiry, November 2002.

13 Submission no. 35, National Rural Health Alliance, p.5.

14 Evidence ACA 7/10/03 p.26

15 Evidence ACA 7/10/03 p.34

16 Evidence ACA 7/10/03 p.28

perform remedial work on 54 poorly performing exchanges and, following an audit of a further 48 exchanges, has identified a further 4 requiring remedial work.

1.29 The Network Reliability Framework is still in its early stages, but could prove to be a powerful tool to require upgrading of the network. As a result of the RTI Report, the ACA was required to prepare a table on improving the effectiveness of the NRF, which was handed to the Minister on 30 September 2003.[17]

1.30 The Democrats urge the Government to respond to that report promptly and support further enhancement and enforcement of the NRF. The fundamental problem remains however the regulatory environment in which the ACA operates. By legislation, the ACA is obliged to a "light" regulator, relying on industry codes and self-regulation as much as possible. Continuing questions arise as to the extent to which a "hands off" regulator can properly regulate a monopoly infrastructure provider. While it is clear that the ACA is taking tentative steps to strengthen its regulatory framework, this work is in its very early stages, and could be hampered by the regulatory environment in which the Government requires it to operate.

3. Regional Rural Australia and Future Proofing

1.31 Telecommunications are an essential economic and social infrastructure in rural and remote areas, and are becoming more important in the context of the "information economy" and the need to access services such as e-commerce, e-learning, e-health and banking[18]. For example a recent survey of rural community needs in Western Australia, conducted by the Communications Expert Group (CEG), showed high levels of use of computers and the Web by rural business and individuals, demonstrated by the high average usage in the Pilbara (81%) and Kimberley (84%) regions compared to average Metropolitan usage 70%.[19]

1.32 While there is evidence to suggest that telecommunications in rural and remote areas have improved significantly in recent years, which advances in technology and a number of government initiatives have contributed to, there is further evidence that services still remain inadequate.

1.33 The RTI report concluded that telecommunications services in regional, rural and remote Australia were adequate. However this conclusion was made on the basis that strategies were currently in place to improve services over the next few years. The inquiry heard evidence from several individuals and organisations[20], including Dick Estens - author of the RTI report, that Telstra's regional services, as they currently stand, are not up to scratch.

17 Evidence ACA 7/10/03 p.25

18 Submission no. 35, National Rural Health Alliance, p.2.

19 Submission no. 141, Communications Expert Group, p.2.

20 NSW Farmers Federation; National Farmers Federation; and National Rural Health Alliance.

1.34 According to submissions the three biggest issues for people in regional and rural Australia are mobile phone coverage, more Internet speed, and reliability on fixed phones. Survey results by the NSW Farmers Association in 2002, showed that:

> 75 per cent of respondents were dissatisfied with landline and internet speeds, 76 percent were dissatisfied with mobile coverage. Overall satisfaction with Telstra services was 27 percent, with 48 percent dissatisfied with services. Thirty six percent recognised that general services had improved; a further 35 percent disagreed. [21]

1.35 While there are strategies in place coming out of the Telecommunications Service Inquiry (TSI)[22] and RTI, to address some of these issues the Democrats are concerned that these will not be sufficient. For a start, while the Government has pledged funding to support the recommendations from the Esten's report, there are no guarantees that if another government comes into power, that the funding "promises" will be met. There are doubts that funding levels are adequate, for example there are claims that the $16 million funds toward mobile phone coverage will not be sufficient. More importantly there are still telecommunications areas that strategies are currently not in place. For example, the inquiry heard evidence that there was an increasing necessity of higher bandwidth services such as ADSL in rural and regional areas, yet there were no recommendations emanating from the RTI report and no strategy in place to address the issue. Towns such as Gilgandra and Coonabarabran with 2,500 to 3,000 people have been trying to get ADSL rolled out in their towns. Telstra initially told them that if they could get roughly around 20 paying customers, it would be on, however Telstra have since increased the minimum number to 150 paying customers.

1.36 The NSW Farmers Association summed up what many submissions and witness were saying when they stated:

> While the association welcomes the government's announcement that it would adopt all 39 recommendations from the Estens inquiry and would spend $181 million to improve services, the fact remains that until these efforts translate into better services for regional and rural Australia, and at comparable level to city customers, then privatisation should not occur.[23]

1.37 Concerns were also raised by the National Rural Health Alliance that telecommunications benchmarks are identified in terms of cost and carrier convenience – and not in terms of the needs of rural Australians.[24]

1.38 Given the gap that currently exists between regional and rural Australia and metropolitan Australia a case has been made that mechanisms need to be in place to

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21 Mr Brown, NSW Farmers Federation, *Proof Committee Hansard*, 1.10.01, p.42

22 TSI, Connecting Australia, Report of the Telecommunications Services Inquiry, September 2000

23 Mr Brown, NSW Farmers Federation, *Proof Committee Hansard*, 1.10.03, p.43.

24 Submission no. 35, National Rural Health Alliance, p.3.

'future proof' rural and regional Australia to ensure equitable service levels and access to technologies.

1.39 It was argued that Telstra would need to remain a presence in regional areas to maintain an understanding of the needs of regional communities and for it to provide the required level of service.[25] There are concerns that a privatised Telstra will be more demanding of commercial rate of return from all their assets – and so more willing to close down low return assets - as we have seen with many services (eg. banking, air services) withdrawing their presence to regional Australia.[26]

1.40 The Explanatory memorandum states that:

> Item 1 of Schedule 1 to the Bill provides that any licence condition made by the Minister for Communications, Information Technology and the Arts requiring Telstra to maintain a local presence in regional, rural or remote parts of Australia may empower the Minister or the Australian Communications Authority (ACA) to make decisions of an administrative character. Such a licence condition could, for example, require the Minister to approve a draft local presence plan setting out how Telstra will fulfil its obligations to maintain a local presence in regional, rural and remote parts of Australia. [27]

1.41 However, based on the current Government's record, the Democrats believe that the Government would give more weight to the commercial imperative of Telstra and be reluctant to intervene. The current proposal to fully privatise Telstra clearly demonstrates the Government's failure to act in the public interest.

1.42 It has also been argued that market forces on their own can never provide rural Australia with the telecommunications services it needs. The National Farmers Federation (NFF) contend that it is the Government's responsibility to ensure that there are appropriate and adequate services in regional and rural Australia. In their submission the NFF stipulate that:

> The Government should…….. provide targeted Government funding necessary to 'future proof' the ongoing provisions of equitable telecommunication services as new technologies emerge. [28]

1.43 While the Government contends that item 32 of Schedule 1 to the Bill "Part 10 – Independent reviews of regional telecommunications" is a future proofing mechanism, the NFF argue that the provision does not guarantee any meaningful outcome. There are no provisions for a mechanism:

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25 Submission no. 44, Local Government Association of NSW, p.2.

26 Submission no. 35, National Rural Health Alliance, p.10.

27 Explanatory Memorandum Telstra (Transition To Full Private Ownership) Bill 1998.

28 Submission no. 155, National Farmers Federation, p. 6.

- To require implementation of the independent reviews committee recommendations;
- For funding.

4. Research & Development

1.44 There is evidence to suggest that Telstra is reducing its focus on R&D as staff at the Telstra Research Laboratories (TRL) have been cut by almost half since the early 1990s. And it has been argued that, without continued majority ownership by the Government, Telstra will continue to reduce its overall R&D activities and re-direct what remains to short-term stock market driven activities. According to Mr Hinton, who works for Telstra Research Laboratories:

> Since partial privatisation in 1996, TRL management has reflected Telstra's move toward Vendor Management and commodity technologies by re-focusing TRL's research effort away from hardware to software. If Telstra is fully privatised, with its focus on short-term profit and share price, research will be further focused on "value adding" to commodity technologies because this is where the quickest and easiest profits reside." [29]

1.45 Mr Hinton further argues that:

> the demographics of Australia are very different from that of North America and Europe. The equipment that Telstra purchases is principally designed for those markets. Without local expertise to ensure such equipment is either compatible or can be made compatible, to conditions in rural and remote Australia, the most affordable technologies will not be suitable for deployment outside the highly populated and profitable eastern seaboard. [30]

1.46 Without local research to adapt these technologies to Australian conditions, rural and regional Australia may have to wait some time for such technologies and services. Telstra is increasingly relying on vendors to solve technological problems, but it has been reported that there have been many cases where the vendor does not have adequate local expertise to resolve the failure.

1.47 It has also been claimed that Telstra has abandoned its involvement in the development of telecommunications standards. It is argued that:

> if Telstra does not influence standards deliberations, it will find that the equipment it purchases is designed to a standard that is unsuited to Australian conditions, particularly rural and remote Australia. This will either increase costs to telecommunications users or exclude them from the latest technological advances in services.[31]

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[29] Submission no. 25, Kerry Hinton, p. 3.

[30] Submission no. 25, Kerry Hinton, p. 1.

[31] Submission no. 25, Kerry Hinton, p. 6.

1.48 In fact it was reported that "staff at TRL have been informed many times that the days of TRL having a role in the 'national interest' are over and TRL's sole responsibility now is to maximise Telstra's share price." [32]

5. Competition

1.49 The Government has argued that privatisation will increase competition in the domestic markets[33]. Yet despite partial privatisation of Telstra in 1997 and 1999, the ACCC has concluded that:

> While reforms implemented to date have been positive in terms of increasing competition in communications services and in increasing benefits to consumers…….competition has not developed as extensively as generally expected after full competition was introduced in 1997 and that various telecommunications markets are not yet effectively competitive.[34]

1.50 In fact during 2001-02 progress towards achieving competitive telecommunications markets slowed.

1.51 The ACCC argues that there are some existing and potential emerging structural impediments to development of effective competition in potential contestable markets. As shown earlier in table 1, Telstra dominates the market in all major telecommunications services. Telstra:

- remains in almost total control of the Customer Access network;
- remains the only supplier of territorials fibre infrastructure into many regional areas;
- in relation to the internet, Telstra not only provides the connection service for the vast majority of subscribers, but is also the biggest single Internet Service provider (ISP), providing such services as web hosting, email accounts and Domain Name Services (DNS);
- through it's Foxtel partnership also dominates content and distribution of pay-TV services. Australia is the only developed country where the incumbent telco is also allowed to operate the cable TV network ;
- is the only company in a strong position in all telecommunications markets and hence is in a position to use leverage in one market to support its activities in another;
- continues to be in a position to protect traditional sources of profits;

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32 Submission no. 25, Kerry Hinton, p. 5.

33 Liberal and National Parties Policy 1996, Privatisation: In the Public Interest and for the Public Benefit, pg. 4.

34 ACCC (2003) ACCC Telecommunications Reports 2001-02. p.7.

- remains the only Universal Service Obligation (USO) provider

1.52 Professor Quiggin argues “given [Telstras] dominance in a wide range of connected markets, it is almost impossible to prevent abuse of market power”.[35] During 2001-02 the ACCC received 210 complaints of anti-competitive conduct, of these, 13 (69% against Telstra) progressed to substantive investigation.[36]

1.53 The Australian Telecommunications User Group (ATUG) identified two major problems:

> Market power – which has remained an issue even in potentially more competitive markets such as urban areas and still requires significant regulatory attention for certain services and in certain markets.
>
> Market failure – which has been a particular issue in non-competitive geographic markets such as regional, rural and remote areas and will continue to require significant regulatory attention and government funding.[37]

1.54 The ACCC identified that without competition between telecommunications infrastructure providers, it is likely that:

- networks will not be developed and used to their full potential;
- new services (such as high speed Internet) will not be introduced as early as they otherwise would; and
- Services will not be provided efficiently and at least cost for consumers. [38]

1.55 While the Government introduced recordkeeping rules to assist the ACCC assess anti-competitive behaviour, consultants Tasman Asia Pacific argue that:

> while these measures are a necessary step towards establishing a ring fencing[39], it will not remove the source of Telstra’s market power and may not be an effective strategy to combat anti-competitive behaviour, which discourages real competition in the telecommunications industry.[40]

1.56 Concerns have also been raised that despite majority share ownership and the Government’s powers under Part 3 of the Telstra Corporation Act 1991, the Government has not intervened in anti-completive behaviour that is obviously against

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35 Submission no. 67, John Quiggin, p.16.

36 ACCC data supplied to Committee, 27.10.03.

37 Submission no. 70, Australian Telecommunications User Group, p.3.

38 ACCC (2003) Emerging Market Structures in the Communications Sector, pg. xvi.

39 Ring fencing essentially allows an accounting separation of the local fixed network.

40 National Competition Council, Inquiry into the Structure of Telstra 2003, submission no. 25, p.2.

the public interest and instead has relied on an often costly process of regulation and court battles. Given the economic and social importance of an effective and efficient telecommunications infrastructure and service, the Communications Expert Group (CEG) argue that the Government still has a significant role in monitoring the effectiveness of competition and securing outcomes that benefit the community. Instead the Bill, under part 2 of schedule 1, proposes to remove Part 3 of the Telstra Corporation Act 1991. The Democrats argue that this provision should not be removed until market power is no longer a problem.

1.57 So not only does the Bill reduce the ability to monitor and intervene in market power abuse, the ACCC gave evidence that no areas of the Bill will improve competition[41].

1.58 The Democrats believe that the Government has provided no evidence to support privatisation as a means of reversing the slow down in competition and benefits to consumers, as observed by the ACCC, and argue that further consideration must be given to structural separation and/or further regulation before any further privatisation occurs – as will be discussed in more depth below.

6. Regulation

1.59 Throughout the inquiry concerns were raised about the adequacy of current telecommunications regulation in ensuring efficient and effective telecommunications services and the ability of regulators to protect consumers interests in a timely manner under current arrangements. The Consumers Federation of Australia (CSF) argued that:

> The current regulatory landscape delivers piecemeal and often unacceptable consumer outcomes….. It is seriously flawed to the extent that a safe, fair market cannot be assured and is not being reliably delivered.[42]

1.60 Concerns have been raised by a number of groups[43] about the reliance the legislative framework has placed on self-regulation and market forces. For example section 4 of the of the Telecommunications Act notes:

> *The Parliament intends that telecommunications be regulated in a manner that:*
>
> *a) promotes the greatest practicable use of industry self-regulation; and*

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41 Mr Willett, ACCC, *Proof Committee Hansard*, 14.10.01, p. 17.

42 Submission no. 129, Consumers Federation of Australia, cover let & p.1.

43 Consumers Federation of Australia, submission no 129. Communications Law Centre, Submission to the Senate Environment, Communications, Information Technology and the Arts Reference Committee – Australian Telecommunications Network Review , August 2002 and the Consumer Law Centre of Victoria submission to the same review, August 2002.

b) *does not impose undue financial and administrative burdens on participants in the Australian telecommunications industry;*

but does not compromise the effectiveness of regulation in achieving the objects mentioned in section 3

1.61 The CSF argues that many of the safeguards are delivered not by reference to the legislation, but by a complex system of self-regulatory codes, that are not accessible to ordinary consumers. Specifically the CSF pointed to problems with Telstra failure in its compliance in its complaints handling, fair contract terms, reliable billing systems and accurate debt collection activities[44]. The disproportionately high rate of complaints to the ACCC about telecommunications issues is another indication that regulation is failing.

1.62 The inquiry heard from many individuals and groups about the impact of regulatory failure on regional, rural and remote Australia. Their fear is that without adequate regulation there would be no guarantees that services will be maintained and that new technology would be introduced into regional Australia. The NSW Farmers Association argued at the Dubbo hearing that:

> There is no apparent mechanism within the Bill to ensure that breaches of the USO and CSG would trigger automatic penalties for the carriers – an important issue in terms of reassurance about the effectiveness of these regulatory measures in the post privatisation era.[45]

1.63 In their submission the NSW Farmers Federation stated that they are opposing any further privatisation of Telstra until the following regulations are in place:

1.64 Comparable services and costs between metropolitan and rural Australia are guaranteed in legislation;

- Timely and affordable access to future technology for rural and regional Australia is guaranteed under the Universal Services Obligation (USO);
- The USO include data standards as well as telephony services;
- A permanent trust fund is established with 10% of the proceeds from T3 to support the provision of high quality telecommunications services in rural and regional Australia;
- Each of the Customer Service Guarantees (CSG) criteria are met for each customer category (urban, major regional, minor regional, remote) in each State, rather than just the national average;

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44 Ms Stewart, Consumers Federation of Australia, *Proof Committee Hansard, 2.10.03*, p.3.

45 Mr Brown, NSW Farmers Association, *Proof Committee Hansard*, 1.10.03, p.42.

- The CSG criteria include a better measure of carrier performance and volume faults and new installs, and are based on geographic not demographic criteria;
- Automatic penalties and a rectification process are defined for breaches of the USO and CSG in legislation.[46]

1.65 The National Farmers Federation also argued that item 32 of Schedule 1 to the Bill ”Part 10 – Independent reviews of regional telecommunications”, in addition to being strengthened, should be implemented independently of the Bill and before the Bill is passed.[47]

1.66 The inquiry also heard from economics Professor Bob Walker who argued for greater accountability to Parliament, minority shareholders and the community[48]. Professor Walker, argued for the introduction of a similar regime applied by the State Owned Corporations (SOCs) Act in NSW. Key features of which include:

- Formal statements of the responsibilities of SOCs to the local community; and
- Requirements for the development by SOCs of an annual statement of corporate intent’, indicating inter alia profit and operational targets – to be agreed by shareholding ministers and disclosed to parliament[49].

1.67 The effectiveness of regulators such as ACA and ACCC to prevent and redress anti-competitive behaviour in a timely and cost effective manner has also been questioned. A number of recommendations were made regarding changes to role of regulators including:

- An adjustment to the role of the ACCC to include responsibility for exante price approval of access prices, monitoring and enforcement of the price control regime[50].
- An adjustment of the role of the ACA to that of ensuring pro-competitive outcomes and to strengthen its focus on securing consumer outcomes from the industry[51].
- Strengthen the role of the ACCC, especially in the disclosure of information to enable the quick resolution of access to claims, and to ensure a more equitable or even contract conditions and prices[52].

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46 Submission no. 128, NSW Farmers Federation, cover letter.

47 Mr Needham, National Farmers Federation, *Proof Committee Hansard, 2.10.03.*

48 Submission no. 160, Professor Bob Walker, p.4.

49 Submission no. 160, Professor Bob Walker, p.4.

50 Submission no. 70, Australian Telecommunications User Group, p. 4.

51 Submission no. 70, Australian Telecommunications User Group, p. 4.

52 Submission no. 141, The Communications Expert Group, p.4.

- Appropriate resourcing of the ACA, ACCC and TIO[53].
- The ACCC and ACA should be invited to make recommendations in their annual performance reports, which the Minister should be required to respond to, including explanation were recommendations are not accepted[54].

1.68 The Consumers Federation of Australia also have concerns that:

> if the consumer protection arrangements in telecommunications are inadequate to respond to the current market in which the largest participant is majority public owned, what hope that system responding to the sort of dominance Telstra would have if fully privatised.[55]

1.69 The Government argues that a partial privatised Telstra is like being half pregnant and that the Government is in a difficult role as majority shareholder and regulator. But, government ownership and regulation of the industry is neither incompatible nor illogical. The Parliament is the maker of the laws and regulations under which the company operates not the Government of the day. While the Government argues that the ability to regulate Telstra effectively does not rely on the Government's majority or part ownership of the company, the NSW Farmers Association rightly argues that:

> Post-privatisation, the weight of shareholder expectations and Telstra corporate influence will make it extremely difficult to implement changes or enhancements to the regulatory framework under which the corporation operates. [56]

1.70 In response to a question by Senator Tchen who raised witnesses concerns about the government's ability once Telstra is privatised to effectively regulate the industry; ACCC Commissioner Ed Willett responded by suggesting that:

> It is more consistent with the principles of good policy that these sorts of changes [regulatory] are made prior to privatisation…. That is why we wanted to highlight some issues of concern that we saw in the Emerging Structures Report…It is certainly better to make those sorts of changes now, before full privatisation.[57]

1.71 More importantly the Government has previously stated that it will not privatise unless it is in the public interest, yet the evidence is clear that regulatory failure is occurring. Clearly the regulatory structure needs to be overhauled before full privatisation proceeds. Clearly, at a minimum, the Government needs to make a

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53 Submission no. 70, Australian Telecommunications User Group, p. 4.

54 Submission no. 70, Australian Telecommunications User Group, p. 4.

55 Submission no. 129, Consumers Federation of Australia, cover letter.

56 Submission no. 128, NSW Farmers Federation, cover letter.

57 Mr Willett, ACCC, *Proof Committee Hansard*, 14.10.03, p.11.

comprehensive response to the issues raised by the ACCC as the key industry regulator.

7. Structural Separation

1.72 In the course of its inquiry, the Committee received considerable evidence on whether the telecommunications markets in Australia can ever be fully competitive unless Telstra is structurally separated. It has been pointed out that competition authorities in the US ordered the break-up of the dominant Bell Company, while European authorities have fiercely opposed vertical integration in telcos in Europe.

1.73 The OECD has made strong recommendations that its members should consider structural separation as a means of promoting competition in utilities as an alternative to regulation. On telecommunications, it said:

> There is substantial scope for separation of traditional copperwire services from cable and fibre optic broadband services and for unbundling the local loop to allow separate copper-based networks to develop.[58]

1.74 The National Competition Council in Australia adopts a similar view to the OECD.

1.75 Subclause 4(3) of the Competition Principles Agreement (CPA), states that before a government introduces competition to a market traditionally supplied by a public monopoly, or privatise a monopoly, it will review (amongst other things) 'the merits of separating any natural monopoly elements from potential competitive elements of the public monopoly.'[59] That review is yet to occur in respect of Telstra.

1.76 Similarly, the ACCC in its report to Government in July on competition in telecommunications, concluded that the structural power of Telstra precludes regulation being fully effective in ensuring fair competition and pricing. The Commission warned the Government that:

> …the ongoing lack of effective competition in many telecommunications markets means that consumers continue to pay higher prices and received lower quality services across the entire communications sector than they otherwise would.[60]

1.77 The ACCC argues that Telstra is "one of the most integrated communications companies in the world", making it dominant in the sector. It points out that a powerful incumbent can stymie competition regulation in a range of ways, and

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58 OECD Structural Separation in Regulated Industries April 2001 p.50.

59 National Competition Council (2003) Inquiry into the Structure of Telstra, submission no. 25, p.2.

60 ACCC "Emerging market structures in the communications sector" report to the Minister June 2003 p.xiii

recommends that structural change is needed in the telecommunications market to maximise the potential of competition and consumer benefits.

1.78 ACIL Tasman, in a report tendered to the Committee on behalf of the Competitive Carriers Coalition, came to the view that all forms of structural separation needed to be examined to maximise the potential for competition.[61] Economics Professor John Quiggin also recommended to the Committee that structural separation needed to be considered, arguing that Telstra's range of activities is "unparalleled":

> The anti-competitive implications of Telstra's unparalleled horizontal and vertical integration have been noted on many occasions, both by its competitors and by independent commentators. Given dominance in a wide range of connected markets, it is almost impossible to prevent abuses of power.[62]

1.79 Several models of structural separation could be considered:

- The OECD, the NCC and the Competitive Carriers Coalition mostly focus on 'vertical separation', separating out the wholesale network from the retail service provision. It has been acknowledged by several commentators that such an option carries with it high transitional costs;

- The ACCC and Professor Quiggin have argued instead for 'horizontal separation', separating out whole parts of Telstra's businesses with the potential to compete against the rest of the business.

1.80 The ACCC has recommended to Government that the Foxtel HFC (hybrid fibre cable) network be divested, which it argues could form a new competitor for Telstra. Professor Quiggin goes further and suggests that those segments of Telstra in fully competitive markets should be separated out from the core monopolistic phone company. These could include Telstra's ISP business (Bigpond), the Foxtel cable, the directories and ADSL retailing. Professor Quiggin considers that Mobilenet (where Telstra's market share is less than 50%) might also be considered for separation, but concludes that as many Australians would regard it as part of Telstra's core business, it should be retained.

1.81 Horizontal separation has the potential to reinvigorate competition between different types of telcos and services. Mobile phones, for example, are in increasing competition with landlines. In Finland, for example, one third of households now rely entirely on mobiles. Internet protocols have the potential to offer cheaper voice and data products than the normal phone system. *The Economist's* survey of telecommunications has predicted that trends in wireless, broadband and the convergence of voice and data "will overthrow the local-loop monopolies some time

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[61] Submission no. 52, ACIL Tasman report, p. iv.

[62] Submission no. 67, John Quiggin, p.16

during the next ten years."[63] For Australia to ensure that the opportunities for competitive outcomes are maximised, we need to ask fundamental questions about whether the current structure of the telecommunications market is optimal, and whether the power of a vertically and horizontally integrated Telstra will kill off competition into the future. It is disappointing that, despite the recommendations of the National Competition Council, the ACCC and the OECD, the Government has not yet explored the competitive advantages, costs and benefits of the various structural separation alternatives. We recommend that this needs to occur.

8. Infrastructure Investment

1.82 With ownership of both the copper wire and the HFC network[64], lack of competition and a strategy to maximise shareholder value, there is no incentive for Telstra to invest in its infrastructure. In 2002/03 Telstra reduced its capital expenditure by 7.5%, with plans to further reduce capital expenditure in 2003/04 by 9.1%. Table 2 shows a steady decrease in infrastructure spending as a percentage of Telstra sales revenue, since 1998. This is in a climate where the ACA has ordered Telstra to carry out urgent remedial work on 54 rural exchanges and the September ACA Telecommunications Monitoring Bulletin shows a continuous decline in performance of the infrastructure.

Table 5. Telstra Capital expenditure as percentage of revenue ($m)

	2003	2002	2001	2000	1999	1998
Switching	376	661	735	647	626	739
Transmission	378	416	429	693	602	563
Customer access	959	929	1004	1315	897	769
Mobile telecommunications networks	449	255	390	628	612	332
International telecommunications infrastructure	193	233	100	125	138	136
Capitalised software	555	559	737	599	502	227
Other	454	553	749	823	897	975
Total capital expenditure	3364	3606	4144	4830	4274	3741
Total Revenue	21,616	20,802	22983	20505	18171	17239
Capital expenditure as a % of revenue	15.5%	17.3%	18.0%	23.6%	23.5%	21.7%

(Source: Telstra Corporate and Telstra annual reports)

1.83 By world standards, Australia's investment in telecommunications infrastructure is also falling. Between 1988 and 1999, Australia was investing on average 1.7% more than the OECD average percentage of telecommunications revenue, but in 2000 and 2001 fell to the OECD average. Measured in terms of investment per access path (i.e. phone lines including mobiles), investment was 22.3% above the OECD average (1988-1999) but fell to 4.8% below the OECD average by

63 The Economist October 11 2002, A Survey of Telecoms p.18

64 The ACCC have argued, that in protecting the revenue of both the copper wire and the HFC network, investment will not be made, or will be delayed, in services that would cannibalise the revenue of the other network.

2001 [65]. The reduced investment in infrastructure is and will continue to impact on innovation, new service development, and implementation and maintenance of infrastructure – especially to regional and rural Australia. The RTI report clearly indicated that there is a need for long-term government leadership in Telco infrastructure, as well as the need for ongoing government funding. However with full privatisation the Government cannot ensure incentives, requirements, or obligations will be ongoing when any future government can change them.

1.84 A key question in terms of infrastructure is future proofing. Following the recent Bigpond debacle, Telstra CEO Ziggy Switowski conceded that that Telstra had not paid enough attention to allowing for increased internet traffic and "we will pay more attention to that." [66] This is sympomatic of Telstra's continuing failure to invest the necessary funds to ensure that there is sufficient capacity to meet future needs. This is especially so in rural areas. The roll out of ADSL technology in Australia, much delayed compared with other industrial countries, is failing to get out into regional centres. Telstra has initiated a demand register requiring 150 expressions of interest before it will consider enabling an exchange. This leaves large towns like Coonabaraban and Gilgandra without ADSL, and at a considerable competitive disadvantage. For business, the competitive disadvantage of country towns is about to get worse, with Telstra announcing a new business ADSL product, but which will only be available to all Australian capital cities as well as major regional centres including Townsville, Bendigo, Dubbo, Albany, Mt Gambier, Alice Springs and Launceston.

1.85 According to evidence to the Committee from Telstra, it will cost Telstra $5 billion to increase Internet speed from 19.2 kilobits per second if the standard were raised to 56 kilobits per second.[67] By contrast, the Government's response to the RTI report provides only $181 million in new funding, which will fall well short of the standards needed to deliver rural services. Even Dick Estens conceded that it will require progressively increasing levels of Government regulation to push up rural standards:

> It (19.2kbps) is a minimum baseline but, obviously it needs to be lifted as time goes on.[68]

1.86 However, the Department emphatically disagreed with this approach arguing it was not practicable to say there should be some kind of mandated service upgrade because services change so quickly.[69] But that is simply a cop-out. Between 1995 and 2000, Telstra's capital investment averaged between 22% and 27% of its revenues. By 2003, it had slumped to just 15.5% of revenue, and is projected to fall to less than 14%

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65 OECD Communications Outlook 2003 p. 114-117.

66 Quoted in "The Australian" 22/10/02 p.3.

67 John Stanhope, Chief Finance Officer, Telstra, *Proof Committee Hansard*, 2.10.03, p.56.

68 Dick Estens, *Proof Committee Hansard* 1.10.03 p.35.

69 Mr Cheah, DCITA, *Proof Committee Hansard* 7.10.02, p.15-16.

this financial year.[70] This compares with the OECD average of around 23% of revenue. If Telstra was required to restore capital expenditure to 20% of revenue, a level it has held for all but the last few years, it would increase capital spending by $1.35 billion a year, allowing, on Telstra's estimates, a full overhaul of the network to a 56kbps standard in just four years. The Democrats believe that this would not be an unreasonable ask for the Minister to use his powers under Part 3 of the Telstra Corporation Act 1991 to direct Telstra in the national interest to upgrade its full network to broadband capacity.

9. Financial

1.87 A key argument that the Government presents in favour of the sale of Telstra is an economic one – that the sale will improve the financial state of the public sector. However, the Democrats question this assertion, and question the basis on which it is made.

1.88 What is clear is that by world standards, Australia does not have a major problem in terms of public sector debt. Indeed, recent OECD data shows that Australia's public sector net financial liabilities are the second lowest in the OECD, and just one-tenth that of the OECD average:

Table 6. General Government Net Financial Liabilities (% of GDP) 2003

Country	% of GDP
Australia	4.8
UK	29.4
Canada	36.9
US	47.1
Japan	80.2
OECD average	*48.7*

(Source: OECD)

1.89 The recently issued *Review of the Commonwealth Government Securities Market* (Commonwealth Treasury, 2002) and the focus on this issue in the 2003-04 Budget papers indicates the difficulties that will result from further reductions in Government debt. Maintaining depth and liquidity within the Commonwealth Government Securities market is necessary for the stability of Australia's financial markets, or, as JP Morgan told the Committee:[71]

> We share the view that a complete cancellation of any Treasury bonds would probably not be optimal for the overall benchmarking and liquidity in bond markets generally.

1.90 Professor of Accounting Bob Walker and Mrs Betty Walker, in their evidence to the Committee, called for a comprehensive financial analysis of the sale to be done,

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70 Telstra annual reports. Capital spending as a percentage of revenue was 23.3%(1995), 26.7% (1996), 28.2% (1997) and 23% (1998).

71 Evidence Stephen Chipkin, JP Morgan Managing Director JP Morgan 30/9/03 p. 72

looking at the net present value of the sale less Telstra's retention value. Professor Walker argued that the sale proceeds should be expressed in net present value terms to cover the likely costs associated with a sale in tranches. The evaluation of 'retention value' should examine not just dividend streams, but accounting earnings, the value of taxes attributable to majority public ownership and the residual value of Telstra shares (to capture re-invested earnings).

1.91 Professor Quiggin agreed with this broad analysis, arguing that the Modigiani-Miller theorem on the valuation of an enterprise suggests looking at the free cashflow rather than just paid dividends. He also argued that there are higher regulatory risks with any privatised body, a higher rate of equity rate of return expected, and a lower level of tax collected due to the release of dividend imputation credits. Taking these factors into account, he estimates that the value of shares in public ownership is about $6.70 a share, suggesting a net loss of value of over $10 billion if shares were sold at their current value of $5 a share.[72]

1.92 DOFA officials said that a cost benefit analysis would be conducted, but the conditions were "highly specific to the circumstances applying at the time" of the sale.[73] The Democrats believe that this is unsatisfactory given the Bill does not provide a clear benchmark as to the conditions of such a cost-benefit analysis and whether a sale would be precluded if they were not met.

1.93 A further concern about the sale is whether the market is sufficient to swallow a float of a $30 billion holding, and what discounts and incentives the Government would need to provide to ensure the float was subscribed. This would be into a world equities market that is somewhat wary about telcos following the 1990s dot.com bubble;[74] into a situation where the 1.6 million "mums and dads" shareholders who bought into Telstra 2 and have lost an average of $2.50 a share would be reluctant buyers; and where there could be a large number of other telco share floats in other countries competing for investment dollars.[75]

1.94 It has been suggested that the Government may need to look to differing types of instruments such as hybrid securities to ensure that the float is fully subscribed. Hybrid securities, as a mixture of debt and equity, would see the Government assuming a higher level of risk to sell securities. Such securities, along with payments by instalments or heavy share price discounts, were conceded by several witnesses as necessary to ensure a 'successful' float. As ABN Amro Rothschild stated, such flexible structuring will be necessary "given the potential size of an offering and the

72 Submission no. 67, John Quiggin, p.6-7.

73 Mr Heazlett, DOFA, 7.10.03, p.11.

74 Economist survey of telcos 11/10/03 p.4.

75 Submission no.137, ABN Amro Rothschild, list of holding for sell down, p.27.

inherent uncertainty of making demand estimates for any market offering at an undetermined time in future”.[76]

Recommendations

1.95 The Australian Democrats recommend:

- That the Telstra (Transition to Full Private Ownership) Bill 2003 be rejected.
- That regulation to protect consumers, increase competition and improve network reliability be strengthened before any further privatisation is considered.
- That in accordance with sub-clause 4(3) of the Competition Principles Agreement (CPA), an independent authoritative review is undertaken on structural separation, including consideration of the ACCC Emerging Market Structures in the Communications report, before any further consideration is given to the full privatisation of Telstra.
- That a comprehensive analysis of Telstra’s investment in infrastructure be undertaken, and that Telstra be directed to increase its investment in infrastructure to meet tougher performance standards.

Senator John Cherry
Australian Democrats

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76 Submission no.137, ABN Amro Rothschild, p.24.