2004 Structural Separation

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Abstract

A comment by Australian Prime Minister Malcolm Turnbull on 23 October 2017 has re-awakened interest in the possibility that lay open in 2004 for the then Coalition government, of which Mr Turnbull was a member, to have preceded New Zealand in reaping the benefits of structural separation of the incumbent carrier. The paper “Revisiting the Structural Separation of Telstra”, published in the Spring 2004 issue of the Telecommunications Journal of Australia and republished below, provided not just the policy rationale for structural separation, but also detailed how it could have been achieved.

Introduction

A curious comment by Australian Prime Minister Malcolm Turnbull on 23 October 2017 has re-awakened interest in the possibility that lay open in 2004 for the then Australian Coalition government to have preceded New Zealand in reaping the benefits of structural separation of the incumbent carrier. After all, the paper “Revisiting the Structural Separation of Telstra”, published in the Spring 2004 issue of the Telecommunications Journal of Australia and republished below, provided not just the policy rationale for structural separation, but also spelled out in practical detail how it could be achieved.

Furthermore, this historical paper foreshadowed how a government-owned “NetCo”, formed from Telstra’s fixed network wholesale business, would have been able to achieve all that the subsequent NBN Co (2009- ) was chartered to do, but with its costs wholly or largely cross-subsidised from NetCo’s wholesale business. With a conservatively estimated commencement year of 2007 for NetCo, this paper predicted NetCo would have had a good chance of rolling out a national high-speed broadband network by 2015 – five years ahead of the most optimistic prediction for the completion of the current National Broadband Network (NBN).

The Big Mistake

On 23 October 2017, Mr Turnbull admitted it was a “big mistake” to set up a new company to build the NBN, claiming that Labor left the Coalition “a calamitous train wreck” (ABC Breaking News, 2017).

Mr Turnbull made this comment during an interview with the ABC, the morning after the ABC’s current affairs program Four Corners highlighted widespread user dissatisfaction with the NBN. Four Corners reported on an almost 160% increase in NBN complaints over the previous financial year and on how the rollout was creating a digital divide across Australia, with many households unable to access the higher Internet speeds they were paying for (ABC Breaking News, 2017).

In the same interview, Mr Turnbull went on to say that Australia should have followed New Zealand’s model.

“They [the New Zealand Government] basically ensured the incumbent telco, the Telstra equivalent, split its network operations away from its retail operations. And then that network company in effect became the NBN.

“The virtue of that was you actually had a business that knew what it was doing, that was up and running, that had 100 years of experience getting on with the job.”

A reminder

In a subsequent blog post, on the Independent Australia website, the author pointed out that it was Mr Turnbull’s party, the Liberal Party, that ensured that this far better solution would never happen.

“The Howard Government had this opportunity up until 2005, while it still owned 51 per cent of Telstra. All of the telecoms industry except for Telstra and its unions were calling for the structural separation of Telstra prior to its full privatisation. [7]
Instead, the Howard Government [5] of which Turnbull had been a member since 2004 opted to close down a Parliamentary inquiry into structural separation. Their overriding objective was to maximise the dollars they could earn in selling off the national carrier and they succeeded. [7]

In 2007, the fully privatised Telstra declined[6] to roll out an NBN, except on quasi-monopolistic terms with reduced price regulation. The incoming Rudd[7] Government then had little choice but to set up a new company, NBN Co[8], to design and build the new wholesale network. (Independent Australia, 2017)

**Epilogue**

In the aftermath of this controversy, Emeritus Professor Trevor Barr suggested to this Journal’s Editorial Board that it would be appropriate for the Journal to republish my 2004 paper, which you will find reproduced below, as part of the Journal’s History section.

It gives me considerable satisfaction to have had the policy recommendation I’d made in 2004 confirmed thirteen years later by such an unlikely source.

**References**


**The Historical Paper**
The benefits of structural separation

The ACCC’s vision of a competitive telecommunications sector is based on the principle of achieving a level playing field for all operators, regardless of whether they are vertically integrated or not. This is achieved through the establishment of a neutral access network, which allows all operators to access the network on equal terms.

Fixed CAN (Customer Access Network)

Inter-Exchange Network

NetCo

Telstra mobile access networks

Telstra international networks

Fig. 1. Proposed structural separation of the current Telstra network into the NetCo Fixed and Inter-Exchange networks and the other Telstra networks as a ‘for order’ implication.
Fig. 2: Interconnection of NetCo network with other carriers, including the new Telstra

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challenges the micro-economies and educational infrastructure of rural and remote Australia (RMN). In addition, since broadband access is critical in supporting change across rural and remote Australia, the competitiveness of the sector is necessarily higher. The Government prefers the regional economy to keep its high 'broadband' under the cost of voice services, to our national disadvantage.

(5) Regional equity

The policy submission to several national reviews, most notably the Turner Regional Telecommunications Inquiry (TRTI) in 2002 and that of the Broadband Advisory Group (BAG) in 2004, have emphasised the social and economic disadvantages suffered by RMN through lack of access to advanced telecommunications services at reasonable cost. Submissions to the Turner and BAG reviews emphasised the need for special measures to support the pricing of broadband services outside the capital cities.

The Federal Government's response, as so often in this past, was essentially a short-term fix to throw some money at the problem, e.g. short-term solutions to very regional areas where hearings are problematic, and extension of the publicly funded AADNet across regional university campuses.

This year marks a significant step forward with the internetworking and increased financial capability of a government-owned entity to roll out new services into RMN. At its heart is the commitment to reach the goal of providing a telephone in every home by 2000, and achieve that goal by 2002. A new NBN could certainly provide affordable broadband access in every home for many years through a combination of satellite, terrestrial radio, ADSL and FTTN solutions. The high wholesale margins obtained in the densely populated parts of Australia and the wholesale cost of providing a broadband service elsewhere would still provide considerable advantage to the Federal Government.

The definition of the national content from 1997 was that the NBN provided that content, and largely devoted to deflect and retain the traditional access of those networks, has been reduced from 25.2% to 11.5% of total revenue. Since 1997, the Telstra Board and management have been under severe pressure from institutional investors to maximise Telstra's short-term earnings. The impact of these funds' demand for short-term gains may be detrimental to the provision of long-term benefits to the Australian economy.

A question is how to achieve the national capital expenditure rates of the late 1990s (typically 25%) and meet an estimated additional $50 per year into the national economy from increased literacy. Assuming conservatively that the commercial expenditure will be at least 25%, this country could benefit from an additional $50 per year.

(6) Limitations of the competition model

Australia has learned the hard way that competitive entrants are essential in order to maintain a stable rate of innovation, to keep the costs of services down, to foster the provision of new services, and to prevent the government from being caught by surprise by new technologies. In short, we need to think about the long term and the future, and be in a position to restructure the telecommunications market as the introduction of competition in 1991.

What is clear is that the current competition model is not sufficient to deliver a satisfactory outcome to meet the needs of residents of the outer suburbs of Australia's capital cities. These communities lack easy access to basic telephone services, and equity is lacking in the capital city. A more rapid transition to the networked capital is necessary.
The most probably result of fully privatising Telstra is in present structure will be an exacerbation of its present pattern of reduced live and competitive business practices leading to increasing complaints from the ACCC, backed up by a boycott from other operators that greatly exceeds that of the ACCC complaints.

These tactics, when challenged, can be fully justified by the Telstra Board as consistent with its obligations to keep increasing shareholder value.

Most dramatically, a fully privatised Telstra would be free to develop vertically, without any restraints from its government shareholder, in ways that further regulatory or legislative constraints, to purchase of non-media outlets, such as a major newspaper chain or a national TV network, would be well justified to its shareholders as a necessary part of its business strategy.

Frequently, these strategies would be further enhanced through fear-based media disinformation, but the available game is more political power than fare share or Rupert Murdoch's attempt to both electoral and legislative outcomes.

Focusing on Telstra's shareholders, the board of the Telstra Corporation has already decided major financial restrictions from major investment in new infrastructure compared to Telstra since 2005, particularly following the commercialisation of Hutch 1999. Until recently, the Telstra Corporation has been a major shareholder of ANZ and the major participant in the commercialisation of the new mobile telephone network.

However, the current investment in the Australian economy due to the disintermediation of the Australian economy can be expected to be significantly less than any previous competitor driven to be more competitive, but its most likely outcome is to be more competitive, and less likely to be seen as a new player in the Australian economy.