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SPEECH

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Productivity the new goal, not just competitiveness

Good morning and thank you for inviting me to join you.

Sometimes when we think we have done something very clever, we become blinded by this success. During that blindness, we think the world around us has changed and our conceit may make us incapable of moving along. Over the next few minutes, I would like you to stand back with me a while and look at just what we have achieved in this country... and why. Much more importantly, we should open our eyes to our new circumstances and maybe think in new ways if we are to move forward rather than drift backwards on yesterday's conceits.

Twenty years ago, Cork was a centre of heavy industry. This was, for example the city in which car manufacturing had a serious presence in Ireland. The early 1980's saw major employers close. It was just not possible for this small island nation to compete effectively in the export of heavy goods. At that time, popular opinion took it as a 'given' that Ireland was doomed for the doldrums for ever and a day. Working quietly underneath the surface were the far-sighted generators of a new industrial strategy. Despite the overwhelming public mood of resignation, despite the pressures for short-term solutions, there were enough people in this country in the right places with enough vision to head off on a new path.

Quite simply, we attracted inward investment for industries where transport costs were not a huge element of cost. You only have to take a short drive from where we are now to see where that has led us. Almost every major pharmaceutical company in the world has a presence in Ireland and very many of them down the road from here. Similarly, Ireland is now a major world exporter of software. Our food industry is regearing itself, adding value to product at home and abroad, rather than just exporting slabs of beef. We have competed very successfully with our trading partners. As global markets liberalised, Ireland succeeded further. The bigger the stage, the better we prospered.

Yes... we did this. We had a vision and we followed it. It worked. In the last 5 years, Ireland's standard of living as measured by GDP per capita has increased by over 50%. From once being the poor mouth of Europe, we have now a GDP per capita above the EU average.

We did this by taking a different route. It is just possible though that we are a little blinded by our conceit to recognise that we now have to change course again. It is time to look at other ways of furthering prosperity.

Traditionally the view has been that Irish industry needs to remain 'competitive' as if this is an end in itself. The over-riding concept in our industrial policy has been that to compete in international markets Irish exports will have to improve their cost position in response to the growing threat from low cost economies. Fine so far. However, this simple thought accounts for only a part of the game. If we allow it to dominate all our thinking we can end up seeing international trade as a zero-sum game - that is that one country's gain can only come at the expense of others. A continued scramble to undercut and compete with low cost economies is just unsustainable in the long term.

What really determines a nation's standard of living is the productivity of its economy. This is measured by the value of the goods and services produced per unit of the nation's human capital and natural resources. Improvements in productivity allow a nation to support higher wages, earn attractive returns on capital, which in turn support a higher standard of living. Thus, the goal should be to increase productivity and not just exports *per se*. The central challenge for Irish firms and Ireland as a nation therefore is how to create the right conditions for rapid and sustained productivity growth.

Up to now Ireland's approach towards creating those conditions has focused on improving the factors of production. This has resulted in an emphasis on Ireland's highly expandable low cost labour force and its lower cost capital structure (IDA grants, favourable tax regime). This **Factor-Driven** approach has been hugely successful, but in what is now clearly a higher cost economy, such an approach will become increasingly untenable. To be quite clear, when Ireland had an unemployment rate of almost 20% and a readily available low cost workforce, this was a far-sighted and successful strategy that brought us prosperity. However, to continue to focus on this now would be to revel in our yesterday's.

It is now time for a new vision. Ireland needs to move to the next stage of development. This stage, characterised by countries such as Korea and Singapore, is where efficiency in producing products and services becomes the dominant source of competitive advantage.

In such an **Investment-Driven** economy, we need to move the focus from cheap labour and capital to heavy investment in efficient infrastructure and business-friendly government administration with strong incentives for the private sector to invest in productivity enhancing

technologies and processes. Such a move involves change - with firms implementing new strategies, investment priorities shifting and Government policies to support these moves changing.

Ok... that is thought number one for this morning. Turn the mind towards increasing productivity rather than just simply improving our cost competitiveness.

How we get there

So how do we do this?

A new Ireland, characterised by increased efficiency, higher productivity and a higher standard of living will not emerge from some detailed centralised plan. It cannot be imposed from above. What we need to do is to unleash the creative energies in our society. We do this by competition.

The creation of effective competition can create an unmatched dynamism, where market forces propel rival players to continually invest in higher productivity technologies and processes. When competition is strong enough and this dynamism takes on a vibrancy of its own, it can spill over into related and supporting industries creating deep and innovative clusters. At this point one has reached the most advanced level of development – the **Innovation Driven** stage - with an economy that is heavily engaged in the upper echelons of high-productivity, high-value activities such as R&D, design and branding.

Few countries have reached this Innovation-driven stage, and for Ireland – still to fully establish itself at the Investment-driven stage, this represents a longer-term goal. For now our current focus must be on high productivity and increased efficiency and competition is the way to bring us there.

Role of competition law and regulation

The basic concept in competition is very simple - competition between suppliers of any product shifts power to the buyer who can make choices, whereas a monopoly supplier makes all the choices – price, quality and quantity to be supplied. There are two fundamental aspects to competition – ease of access to the market, and strength of competition within it. Indeed, the Head of the Competition Authority here, John Fingleton has noted that

competitive pressures come much more from the former – ease of access to markets – than from competitors in the market. Getting into the telecoms market is impossible without regulation, which requires the incumbent to provide access at reasonable prices and the ODTR has concentrated with some significant results on providing for this. However, start-up and investment funding are also critical to market entry and these are currently in short supply, although I believe that 2003 will be better than the current year. It is also the case that every year builds on the previous ones in terms of infrastructure, commercial understanding of market needs and indeed in terms of the users' understanding and willingness to invest in new product.

Competition is not something that just happens. It must be enabled. Those of us entrusted by society to ensure competition must continually and fundamentally upset the status quo. More than this, we must ensure that no new status quo cements itself into place. This role does not reach a cosy understanding with industry interests, but seeks to ensure that long term user interests are always to the forefront. Given the relative strengths of industry and user interests, regulators need to be vigilant in maintaining their independence and objectivity.

ODTR

Throughout Europe, the telecommunications industry was historically characterised by state monoliths providing limited services at exorbitant prices. During the mid to late 1990s, EU Member States gradually liberalised their telecommunications markets. The ODTR was set up as the independent regulator in 1996 to bring Ireland into line with our EU partners. Back then, there was only one major telecoms operator, the state owned Telecom Eireann and only 10% of the population had a mobile phone! Prices were amongst the highest in Europe. But change did come and it came with competition.

It is the role of my Office to vigorously support real competition, to ensure that old monopolies do not give way to new monopolies and to do everything possible to allow new entrants to make it to the marketplace. This is the path to consumer power. I have spoken often of the need for quick acting enforcement powers for I am very concerned by the slow pace at which *eircom* is moving in a number of key areas and was displeased to find extensive off-book pricing by *eircom* in this, the fourth year, of a liberalised market.

Increasing the Productivity of Utilities

As many users outside of Dublin know well, supporting the entry of new operators and facilitating the development of effective competition is not a simple task. The road to effective competition is greatly affected by the economic cycle, while its path can often be obscured by inherent and very often difficult-to-understand conflicts.

In the current environment, possibly the biggest conflict that exists across all regulated sectors is the need to attract investment in leading-edge infrastructure, while at the same time ensuring low utility costs. As noted by the Competitiveness Council recently, Ireland needs to urgently address its infrastructural bottlenecks, while also stemming the rapid acceleration of firm level costs. These, I believe, are necessary objectives and I would not wish to return to the past where often the traditional focus of utilities has been to provide employment, including higher quality employment, on a dispersed basis throughout the state. To date, utilities have made some changes – both in terms of increasing the focus on users and improving efficiencies, but, I do not consider that these have moved with the same speed of the private sector, nor in many cases at the speed of their counterparts overseas. As the speed of technological and commercial change is ever increasing, the effort required in Ireland becomes ever greater, having generally started later and moved more slowly to date. Hence, the impetus now is for utilities to move more quickly and make significant inroads into improving their productivity. This may require increased investment in some areas and increased efficiencies in others, but I believe that utilities are now beginning to realise this need and I hope my Office's actions and specifically the recent consultation on the price cap – more of which later - will support moves in this direction. A more productive and efficient incumbent makes for a more productive and efficient sector, which I believe is critical for attracting investment into the industry.

Encouraging Investment

A lack of appetite for investing in the sector is one of the key constraints currently holding back the development of the telecoms market. More than most Ireland has been particularly impacted by this, and I think it is fair to say that the regions have been hit even harder again. Your members indicate that they are suffering from inadequate telecoms investment in infrastructure here in Cork and I know that the Chamber has some specific concerns. I am aware that businesses here believe that there is simply not enough competition - with just *eircom*, EsatBT and to a limited extent Worldcom having some infrastructure, while two ISPs - Strencom and Opencom – offer some additional choice with some reselling of leased lines.

You may well be right that this lack of competition in the market leaves very little incentive for either of the two major players to invest in their networks.

EC not ED However it is important to put the position in context. The downturn in the economic environment has indeed choked investment in the sector, but it is important to remember that until mid 1997, no operator other than *eircom* in respect of telephony, and the cable operators in respect of cable could invest in telecoms infrastructure. In late 1997/8 a wide range of operators began to make plans to enter the market with full liberalisation on 1 December 1998. Between then and late 2000 when the telecoms bubble began to burst, some several billion were invested in telecoms infrastructure in Ireland.

As the largest city in Ireland, Dublin was always likely to be attractive for investment, but the efforts of Dublin Corporation were also very important. I met last week a Local Authority group who are developing on-line application procedures for telecoms infrastructure development - a group on which Cork is represented. This service, which seeks to make planning and wayleave approvals more transparent, quicker and simpler to attain, is an excellent example of how local communities can increase the attractiveness of their areas for infrastructural investment. I also know that in Cork you have taken advantage of the Main Drainage Scheme to lay ducting that can be used by utility companies without the need for additional disruption to the roads. These initiatives are simple yet highly effective and I would strongly encourage Local Authorities to consider any similar initiatives which can reduce costs and assist operators in rolling out additional infrastructure.

I may also note that, at the end of the 1990s, potential competing infrastructure in Ireland was much weaker than in other EU states. This has had serious implications for Ireland. For example, cable networks in the major cities of the UK, Benelux and Denmark are providing much of the broadband and competitive impetus which is spurring on telecoms incumbents to provide price competitive DSL services. These were ill developed in Ireland, with operators sheltering behind exclusivity in television delivery, and in the case of Dublin, Galway and Waterford, owned by the telecoms incumbent who saw no interest in fibre upgrade. Since 2000, these networks have been upgraded to digital standard, an immediate step which I could require under national legislation. However, funding became tight before the next upgrade to internet/telephony standard was initiated. As technology develops and funding improves, we may see the competitive challenge from cable offering own network internet and telecoms.

Nevertheless we are finally in this year seeing the start of the roll out of DSL services. This is a requirement under EU law, but it is a complex process, offering many opportunities for delay to incumbents - including court proceedings against the ODTR last year which deterred other operators from moving forward as quickly as they might have done otherwise. Happily they were withdrawn earlier this year and with the cooperation of staff in ESAT BT, *eircom* and the ODTR, roll out commenced, part funded by the government. DSL equipment enables the upgrade of ordinary copper lines to deliver broadband. The local loop is the physical circuit between a customer's premises and the telecoms operator's local switch. Unbundling the local loop involves enabling other operators to install their equipment in *eircom* exchanges to manage and sell services using the incumbent's local loops. By last month, Esat BT were providing nearly 200 lines and *eircom* were servicing under 2,000 lines. There are 0.5m lines with DSL currently available in Ireland, that is nearly 1/3 of all the lines in the country – low take up numbers reflecting user concerns about price in particular I believe. I therefore very much welcomed the announcement by ESAT BT of a new product priced at €50 and urge *eircom* to follow suit.

The new 3G licences will provide a significant impetus to the development of broadband on the move. We have also licensed fixed wireless access networks which provide connections for some thousands of customers in areas west /north west of Cork city, but this technology has not yet achieved its promise as equipment has remained expensive. We are currently drafting new regulations to enable operators set up base stations on an individual first come first served basis which we hope will be attractive for some. The ODTR has also exempted the use of wireless LANs which are expanding in many areas including the South and which I feel will play a stronger complementary role to other technologies in the future.

The advent of competition and tightly efficient regulatory pricing have developed and maintained significant pressure on telecoms prices in the last few years. Some would maintain that the imposition of a price cap affects one's ability to invest in infrastructure and that the solution would be to have no price cap and require the other operators to pay more for access to the *eircom* network. I would like to point out that regulatory pricing includes a return of 11-12% on investment, as we fully recognise that investment has to be remunerated. What the pricing does not allow for is the full extent of inefficiency inside *eircom*, and we consider that pressure must be maintained on these.

Price Cap

The theory of these things is simple enough but the devil is in the detail.

Prices have come down, partly in response to competition, but in particular due to the price cap imposed on *eircom*. A price cap is a regulatory tool that encourages higher productivity in utilities that are subject to inadequately strong competition. It does this by requiring incumbents to achieve certain overall targets in terms of its prices and if the company exceeds these it gets the benefits in profits.

eircom was making excessive profits in the parts of the market not exposed to competition and a tough price cap was necessary to encourage a serious effort to tackle inefficiency. One strong reason for maintaining a price cap is that all operators are dependent on *eircom*'s network. If that network is inefficient, Irish users all suffer higher prices and/or lower quality services.

Under the current price cap, *eircom* has had to reduce its prices by on average 8 per cent below the rate of inflation for each of the past three years. This has seen a very significant fall in prices and Irish voice charges have now fallen to the western European average for the last two years.

I am now proposing a new price cap to replace the current retail price cap on *eircom* from eight percentage points below the consumer price index (CPI-8) to a level in the range CPI-2 to CPI -0. This means that *eircom* cannot raise the average price to the consumer of telecommunication services included in the control by more than the rate of inflation (CPI-0) or 2 per cent less than the rate of inflation (CPI-2). In addition to this I also intend to remove the sub-caps on the basket of services upon which the price cap is currently based.

We are also introducing changes in wholesale services aimed at assisting operators to be effective competitors. Alongside other regulatory decisions and developments they should provide the industry greater flexibility in terms of pricing and will allow other operators the breathing space they require to compete more effectively with *eircom*.

Productivity is what we are after. Competition improves productivity. Monopolies and very dominant service providers can slip into the easy option of letting productivity slip and piling charges onto the consumer.

If the dominant player in Ireland – *eircom*, the former state monopoly – is not exposed to vigorous competition, it will not improve its productivity. Given the strategic importance of this player in the Irish telecommunications, and of telecommunications in the Irish economy, very serious consequences would follow.

Demand Issues

Until now I have only addressed supply issues. This, however, is just one half of the equation and we must also be mindful of the demand side. There are numerous issues in relation to the demand for telecom services and high-speed Internet in particular. I note a recent study from the Chambers of Commerce in Ireland on SMEs use of eBusiness in Ireland. Amongst its key findings were:

- Internet penetration amongst SMEs is now at approximately 84%
- 55% of businesses have web sites; an increase of 19 per cent in the last year.
- For over half of companies (57%) their website acted as an information point. However, for almost a quarter (23%) it fulfilled a more sophisticated role – allowing on-line transactions (26%), and with front and back end integration (7%).
- Sourcing information and email are the most common e-business applications for companies with Internet access.
- The majority of companies (92%) expect their use of the Internet and involvement in e-business to increase over the next 5 years, only 8% expect their usage to remain the same.
- The main obstacles to e-business have remained unchanged from last year – “the cost of specialist technical skills in computer/e-business specialist companies” (46%) and “concerns regarding security when passing confidential information electronically” (41%); Legal and regulatory uncertainty (32%) and the lack of broadband services (40%) were also perceived as barriers.

I know that you strongly support the Metropolitan Area Network initiative. I also know that this may have added to your view that it is unrealistic to expect any operator to invest in Cork without public subsidy. It does highlight the need for government to work closely with operators. It is critical to having a ring around the city to have operators providing access into localities/buildings.

Amongst the most important strategic issues for Ireland now is the development of broadband. Simply put broadband is the technology that will give us the capacity to deliver large quantities of information much faster than what we have been used to.

Faster communication will enable us to work more efficiently and therefore be in a position to compete with leading knowledge based economies in other parts of the world, both for opening up new markets and attracting inward investment. It will also make our lifestyles easier.

It is not enough just to say that we want this. The cost of deployment of broadband is quite substantial in terms of both money and disruption. Depending on the type of broadband technology deployed, this may mean the digging up of roads and the erection of masts. We need to have a national debate about how much broadband we need, what we hope to achieve with it and how much as a consumer and as a country we are willing to pay for it.

As Telecommunications Regulator it is my job to regulate the market to ensure vigorous competition. The fact is that private investment is not queuing at the door to bring broadband to every business and every home in Ireland. Why? Because it wouldn't pay to do so in the kind of short term investment timeframes required by their investors. There is a need therefore to look at both the supply and the demand side issues – people will pay more for what they value and investment can be encouraged in various ways.

I note with interest the view of the Competitiveness Council that the Government should consider the need for a stronger State role to ensure provision of broadband. They make interesting proposals on how investment should be prioritised. Amongst their recommendations is that “the national cost and benefit implications of alternative solutions to provide the above should be fully assessed”. Grand. But the hard questions come next and need a full debate. I strongly urge you in this Chamber of Commerce to try to engender debate wherever you can on this issue.

What expenditure will bring real return to the taxpayer in the longer term? What figures are realistic to achieve this? The faster the broadband connection the more expensive it will be. For example, recent benchmark figures suggest that making available speeds of 512kbit/s to 85% of the population would involve a hardware cost alone of €450million with as much again needed to offer and provide a fully fledged commercial venture. For 2MBit/s this rises to €2billion and for 5Mbit/s the cost is estimated at €4.1billion. We need also to look at the demand side, at encouraging SMEs to review the benefits to them of greater uses of bandwidth and to get more resident onto the system. No telecommunications company is going to invest considerably in network deployment unless it sees a compelling business case for it.

A recent survey carried out by MRBI indicated that 46% of people are 'very' or 'fairly' likely to subscribe to broadband services. However a majority of Internet users have yet to fully engage with the Internet and both residential and business use is predominantly for email and research. Perhaps if there was more awareness of the benefits that broadband could bring, more people would be interested in signing up. Price is also one of the key factors in encouraging broadband adoption amongst residential and SMEs users. A recent survey indicated that a broadband

package costing between €40 - €60 per month would attract a relatively high percentage of SMEs while €30-€40 was quoted by residential users.

Recent retail internet offerings by ESAT BT and UTV are working well and the discussions on a wholesale product have made progress between *eircom* and ESAT and Nevadatele. I urge *eircom* in particular to come forward with an appropriate response. I trust that these and the ministerial commitment to encourage the availability of flat rate internet access will see a rise in the number of Irish people going on-line.

My Office has worked hard to ensure that there is more than one operator providing DSL services in the country by allowing other operators provide DSL on *eircom*'s lines. We have also licensed wireless technologies which encourage operators to offer alternative wireless broadband solutions. We have granted 3G licences to mobile operators to enable them to provide broadband services to your handset in time to come. Our work is only one part. An awareness campaign of the myriad opportunities that broadband can provide so we can improve the social and economic fabric of our communities – both locally and nationally is an important cog in this wheel also.

The cost of rolling out broadband is also an important consideration, particularly in today's economic climate.

Conclusion

Ireland now has a telecommunications regime in which new entrants and new services can come to the market for the consumer to judge. An improvement in consumer choice has generated lower prices and better quality.

Telecommunications, the first market to be liberalized in Ireland, is amongst the most complex. There is no other which has come near to matching it in terms of speed of innovation. There is, as your Chamber has pointed out, much more to be done. Nevertheless, if so much can be achieved in so short a time in this sphere, we should look to achieve the same results elsewhere.

This is liberalization not just of markets but of people, freeing up new entrants to bring their innovations of product and service to consumers. This energizes greater productivity, the pathway to prosperity.

Ends