

## **AICD Fellows Dinner**

Topic :Making Australia work in the global economy - opportunities and threats.

The Australia economy is but one precinct in the global economy. Our centrality and role in that global economy is a matter for us, our policy makers and leaders. No-one has any illusion that our ability to think and act in terms of global efficiency will be the determining factor in our future prosperity. The question remains to be answered - can we resist domestic nuance and get it right?

Good evening everyone.

This year marks the 200<sup>th</sup> anniversary of Australia's first shipment of wool to the then Mother Country England; Australia's first tentative step into the global market place. As we all know, that first sale began an industry that would for many years be Australia's most important industry. I will speak more of the wool industry, but let me for a moment create context for this evening's discussions.

My topic for this evening "Making Australia work in the global economy – threats and opportunities" or, let me put it another way, "are we prepared as a nation for our industries to be truly globally competitive – or will we allow short term political imperatives to get in the way, as we have in the past."

As many of you know, I began my working life and have spent much of my career in agriculture, and while many think of agriculture and policy intervention in the same breath (and quite rightly in many instances) – the truth is the wool industry was the first industry in Australia to truly understand the need to be able to compete internationally. We had to be world's best, we had to compete on quality, quantity, cost and continuously innovate to hold our markets. Had we not learnt those lessons early, Australia would be a very different country to the one we are today.

Did the wool industry and the government forget some of those hard learnt lessons? Yes – and the penalties have been enormous.

Indeed, wherever our industries – agricultural or other – have been touched by government over the decades, it seems we have made the same mistakes.

Much of the history of industry policy in Australia is a story of good intentions and failed outcomes. Whether governments have been guided by base political self-interest or a genuine desire to promote economic development is an argument for another day.

But I *can* say that government intervention has done more harm than good in many strategically important industries and to the country as a whole.

There is irrefutable proof that government intervention - whether it is through tariffs, subsidies or regulation:

- increases costs;
- hurts consumers with lower quality products and services;
- creates extraordinary and unnecessary complexity;
- distorts investment; and
- stifles innovation.

A very lonely voice in government once said to me “we shouldn’t keep trying to fix one distortion with another – we just compound the problem”. A very lonely government voice indeed.

Now there is a real risk that history may be about to repeat itself today in a sector that is critical to the nation’s future prosperity – and a sector in which I am deeply involved, telecommunications.

Don’t misunderstand me, I am not arguing against regulation per se - governments do have a legitimate role in regulating key strategic industries. That role is well established in market economies.

It is to:

- protect consumers and otherwise stop or contain inappropriate behaviour;
- ensure national standards;
- oversee Health and Safety; and
- promote an environment that encourages investment and fosters real competition.

But let's focus for a moment on the **WOOL INDUSTRY – and let's fast forward some 160 years to more recent policy decisions...**

In 1970 the Federal Government established the *Wool Reserve Price Scheme* to provide stability and a floor price for Australia's woolgrowers. Seems people forgot about a thing called the global market.

By July 1991 – after the price of wool was increased by 70% despite protestations and strong recommendations for reasonable annual price growth – Australia had a wool stockpile of 4.7 million bales and an associated debt of \$2.8 billion - a near fatally wounded industry.

It took us ten years to deplete the stockpile. This distorted price signals and undermined the development of innovative marketing systems, private risk markets, and a wool futures market.

The estimated upfront cost to Australian taxpayers from the collapse of the reserve price scheme was around \$1 billion. The cost to the woolgrowers was incalculable.

And how about the **WHEAT INDUSTRY - speaking from personal experience again** – and the nonsense of the single desk. Innovation in the wheat industry has been absolutely stifled. The AWB decides what grain you grow – forget any brilliant developments in R&D and genetics – we can't take advantage of them.

I could continue but perhaps the best way to illustrate the point is the experience in Western Australia. People in the industry over there own mills in South East Asia – but do you think the AWB, or now the Minister, will let them export their own wheat to be milled in their own facilities – not if they can help it! As a result, the benefits that would be gained from integrated supply chain management are lost.

### **Next up - the SUGAR INDUSTRY**

In the sugar industry, protective import duties were first imposed in 1901.

From 1915 until 1991, various acts of the Queensland parliament imposed compulsory acquisition and marketing of sugar through a single statutory body; compulsory collective bargaining arrangements for cane growers; and various import embargos, quotas, and tariffs.

In 1985, when world sugar prices fell to 2.5 cents/lb, it was a coddled, high cost industry that had no idea of how to deal with it and wasn't prepared for it.

A 1991 study found that federal and state government regulation of the sugar industry cost about \$500 million each year in lost sales and \$200 million in income.

In the 1990's Australian sugar productivity had stalled, while in Brazil producers liberated by deregulation were able to adopt and adapt Australian technologies and expand production to take advantage of economies of scale.

Galling news for Queensland's sugar producers in the mid 1990s for whom, according to the Hildebrand Report, average total production costs exceeded estimated returns.

Into the new millennium and sugar industry debt per borrower increased by 15% in the two years to the end of 2001.

A 2005 review by the Centre of International Economics found that the industry's statutory acquisition powers had dampened the development of business management skills, impeded the installation of whole-of-value chain systems in all operations and mitigated against product diversification.

Hardly the foundations for the development of a competitive commercial culture.

But now things are looking up. The combined impact of import tariff reductions, partial market liberalisations, the abolition of centralised pricing and allocation, tens of millions of dollars in infrastructure funding and the eventual abolition of the single desk has seen an industry turnaround.

Unwieldy compulsory collective bargaining and acquisition arrangements were abolished by legislation in 2004. Today the majority of growers use Queensland Sugar Ltd's bulk marketing power to negotiate better deals on international markets.

The industry has benefited from these changes and no one clamours for the old days but more needs to be done.

**I could also talk about the auto industry, energy, water and more.**

I would be remiss if I didn't touch on the economically toxic combination of the fixed exchange rate and the Arbitration Commissions contribution of centralised wage fixing. That diabolical double led to the squandering of the benefits of the last two great commodity booms of the 50's and the 70's, near national economic collapse and ultimately the infamous Paul Keating "banana republic speech" and the momentous reforms of the late 80's and early 90's that significantly wound back government interference.

**Having chosen some examples from the past, I now want to look at some examples from the present. Lets focus firstly on the FOUR PILLARS BANK POLICY.**

In May 1990, the Federal Government opposed merger plans by ANZ Banking Group and National Mutual. The “six pillars” policy was born, ostensibly to maintain diversity and competition in the banking and financial services sectors.

Six years later the Wallis Inquiry Report recommended the abolition of the six pillars policy but the government – this time under the current Treasurer – rejected that recommendation.

A year later the Financial Systems Inquiry again recommended the abolition of the six pillars policy, recommending instead that mergers should be subject to the Trade Practices Act. Under the TPA, the ACCC has all the powers it needs to prevent any consolidation in the banking sector that would substantially lessen competition.

Rather than accepting these recommendations, in April 1997 the Government launched the “four pillars” policy, which would be reviewed “once the Government is satisfied that competition particularly in respect of small business lending has increased sufficiently”.

That was ten years ago.

Today, the trading banks are forced to jostle for SME business with a host of specialist operators, regional banks and credit unions, all of whom are expanding geographically and diversifying their products and would relish the opportunity to take more market share.

Even a merger between two of the major retail banks would leave the banking sector less concentrated than a range of other industries including retail, domestic aviation and brewing.

Meanwhile the four pillars policy is still in place, with major negative consequences.

Size constraints are limiting the ability of Australia's banks to fully participate in large transactions. You can list them off: Coles-Wesfarmers; Qantas; BHP Billiton's WMC acquisition; or the restructurings of Channel Seven and PBL.

Not an Australian trading bank in sight.

Yet those transactions are increasingly important not just in absolute dollar terms, but also in defining major clients' strategic banking relationships. Remember, ANZ has been BHP's house bank for more than a century.

There are now well over a dozen major global players – most of them far larger than the Australian trading banks – competing for the “mega deals”.

Size does matter.

If Australian trading banks are shut out of the big transactions because of their limited size, then a policy designed to enhance competition in our domestic market will have the effect of emasculating Australian banks in the emerging global market for banking services.

It is stifling the chance for an Australian bank to be a lead provider of wealth management services into our region – a region recognised by all as having explosive growth. So we leave to the likes of Holland's ABN Amro to clean up in an area where we have the skills and proven expertise to excel – but not the scale.

Dr David Morgan, the re-tiring CEO of Westpac, once described Four Pillars as "regulatory nostalgia" and a "pointless retardant of growth".

Perhaps we should do some compare and contrasts – you only need to compare the outrageously contrasting efficiency outcomes of the fragmented government/privately owned and heavily regulated infrastructure of the **coal industry** and the privately owned largely unregulated infrastructure of the

**iron ore industry** to get the point. Over the last three years the iron ore industry has increased output by 40% and the coal industry by only 10%.

Both issues are a decade old at least. Ships have been lying at anchor off the NSW and QLD coasts for far too long.

Of course we shouldn't think ourselves unique or special – every country has its own examples of policy colour – the grand daddy of them all perhaps is the introduction of Sarbanes Oxley legislation by the US Government – what an extraordinary job they did – in one stroke of a pen they transferred their own capital markets supremacy to the UK. Very efficient! But back to Australia...

As I said at the beginning of today's speech - governments do have a legitimate role. It is critical that they:

- protect consumers and otherwise stop or contain inappropriate behaviour;
- ensure national standards;
- oversee Occupational Health and Safety; and
- promote an environment that encourages investment and fosters real competition.

However, it is clearly not the job of a regulator to pick technologies, even by default, micro-manage the development of an industry, or intrude in or pick winners and losers among individual businesses.

But history speaks for itself.

The infants sheltered by selective industry policies have usually failed to grow up. Companies spend unhealthy amounts of money on lobbyists to manipulate the regulatory environment rather than competing in the marketplace on the merits of their products and services.

Whether it's securing protection from international competition, or seeking a free ride on your competitors' infrastructure, the result is inefficient resource allocation, less product and service innovation, retarded industry growth and higher prices and fewer choices for consumers.

All harm and have harmed the bottom line for business, but what's more important is that it also harms real people and communities. It means people pay more than they should for products and services, they have less choice, their incomes are lower, they have less time with their families, there is less innovation and their savings get a lower return. Getting policy settings right is not only about business outcomes, but about improving people's lives.

Inefficiency is, ultimately, lacking in compassion and wasteful.

**Now to my third example. Telecommunications Policy failure is damaging the country as much as Telstra.**

But whenever we at Telstra talk about the industry people always tend to say "well they would say that or think that". What I have been attempting to show you is that policy makers get it wrong – in fact mostly get it wrong when they set out to micro-manage. And we believe, from all the global experience, that government policy makers are getting it very wrong again in telco.

I am dismayed when on occasions some business leader or another says something like "well you have brought it on yourselves by challenging government". I am always astounded ...what do they mean...'we bought it on ourselves by challenging government'. If your shareholders and customers are being negatively impacted by government decisions and policy you have a legal and moral obligation to get involved.

And with regard to Telstra - let's be clear: Problems with the regulation of the telco industry and our company in particular began long before we started to push back.

It is sometimes too convenient to forget – when talking about Telstra’s debate with the government and the regulator – that Telstra was the regular and silent departmental and regulatory milking cow long before some of the new members of our management team arrived in July 2005.

There is a long, long list of decisions over decades that have negatively impacted the company and ultimately shareholder value, certainly investment decisions and services. And it’s not to Telstra’s honour to say that – while it may have disagreed with various Government decisions – Telstra’s approach was to compromise and “go quietly” in the vain hope that it would be treated better next time. It didn’t get better – it got worse. Much worse.

Telstra had to make a basic decision. Were we to stand by and let a disaster roll out for our company, our shareholders, the industry and the Australian economy because of inappropriate policies and regulations that have passed their “use by” date? Of course, we cannot – from either fiduciary or public policy points of view.

Let me also say that we cannot allow ourselves to be a country where business doesn’t feel free or safe to debate serious structural and policy issues with government. It shouldn’t be seen as risky or even heroic to stand up for consumer interests or shareholder rights – it should be seen as mandatory to stand up for what you believe, especially if you are truly protecting your shareholders and customers’ interests. Surely the days of ‘Black Jack’ McKewen are over.

Talking about Telstra and the decisions being made at the moment - let me say it loud and clear - what is happening before our very eyes is almost a kind of policy cataracts – no one wants to look at the industry big picture – or perhaps they just can’t see it.

The relevant members of the Government and regulatory bodies will not consider the industry as a whole – they ignore the very real competition occurring across the many technology platforms that are increasingly

integrated and therefore appear seamless to users – and all of us take for granted. And this is a critical point – consumers don't care what they use – they just want it to work.

Let me name them:

- satellite,
- mobile – voice and data (the technology that many industry people think will dominate in the future),
- cable, and lastly
- fixed line – the unhealthy obsession of the ACCC, given the many other competing platforms.

Or think about it from the point of view of the consumer. The consumer thinks about it terms of screens:

- TV
- PDA devices
- Mobile phone devices
- Desktop computer
- Lap-top computer

Policy-making for the telco sector doesn't think the way the consumer thinks – and it doesn't think the way a consumer-centric telco business – such as the New Telstra – is thinking and creating products and services. The failure of regulation to stay aligned with changing technology and changing consumer preferences has distorted investment, stifled innovation, created unnecessary complexity and extraordinary cost anomalies. Consumers have been the losers.

As you know I could talk about Telstra for a long, long time – but let me illustrate a point about international competitiveness and investment distortion triggered by bad policy.

No one can ignore Optus' decision to stop building out or upgrading its existing cable network...why would they keep investing their shareholders' money in a genuinely competitive network when they could buy access from us cheaper than they could deliver it to themselves.

As we sit here tonight, think about the Government's recent policy decision to throw \$1 billion dollars of your tax money on the sub-optimal duplication of broadband infrastructure using redundant technology – again it only serves to underline the fact that Australia has simply failed to learn the lessons of past industry policy failures here and overseas.

I am talking about the Federal Government recent \$1 billion gift to the Singtel Optus / Elders Optus consortium to deliver what the government calls “broadband” to 99% of the population.

There is no way Singtel Optus or Elders would use their own money – they had to have government money / tax payers money – and their build will only cover key, or should I say the most lucrative, population centres.

This was and is an appalling decision. But don't just take my word for it. To quote a well known business columnist, John Durie from *The Australian*, “On any reading, the decision based on a tender in which only one company was allowed to bid was an atrocious piece of public administration that has gone largely unnoticed. Imagine the outcry if Singapore Airlines was given a couple of the new big jumbo planes and \$1 billion and told to compete with Qantas on the Pacific route.” I couldn't have said it better myself.

But it gets worse – *The Australian* newspaper again – but this time the National Affairs commentator Jennifer Hewitt, revealed two weeks ago, and she was quoting an Elders spokesperson, that in fact the Government had signed over the \$1 billion of tax payers money without there being a contract between Singtel Optus and Elders, no viable business or operating plan, no management structure and no CEO, and no workable technology.

And, as we sit here this evening, nothing has changed. What a shambles, what a disgrace, what an “appalling piece of public policy”.

So in a sector where the economy can least afford a disaster, we have a policy failure of extra-ordinary proportions. We have – if OPEL can get its act together – taxpayer funded infrastructure duplication – and vastly inferior duplicate infrastructure it will be. There will indeed be competition but it seems that the taxpayer is funding Singtel Optus Opel to compete with Telstra...and it gets worse...

The new \$1 billion taxpayer funded broadband network is delivered via WiMax – a technology demonstrably inferior to Telstra’s Next G network or even the Austar/Unwired WiMax solution.

The SingTel OPEL WiMax is a technology already rejected by 80% of the OECD as not suitable for commercial broadband usage in low density areas.

But if the new network is smaller and has performance issues, why is Telstra concerned? Won’t consumers simply vote with their wallets? Probably – but lets think for a moment why Singtel Optus and Elders would be wasting management resources on this...

What if Singtel Opel uses that otherwise redundant \$1 billion taxpayer funded “broadband” network to subsidise its own third generation mobile phone network – yes it will have a new government funded backbone. Why pay for it yourself if the Government will do it for you?

Let me tell you what if.

Telstra’s 1.6 million taxpayer/shareholders will watch the value of their investment in Telstra’s Next G network be seriously eroded by \$1 billion dollars worth of their own taxes in the form of the “Broadband Connect” program.

On top of that, every other investor, private equity player and telco in the world will look at the Australian telecommunications market and see unacceptable levels of sovereign risk. This is an issue for more than just Telstra – look at the issues raised for BHP and Rio with respect to their rail infrastructure.

When - as it surely will in the not too distant future - the next technological advance is ready to be delivered to Australia's telecommunications users, who would risk an investment that may be worth significantly less come the next election campaign?

No one...and the Australian economy – and the Australian people – will be the poorer for it.

But how likely is this scenario? Singtel Opel thinks it's likely – likely enough to be telling communities around Australia that it's a done deal. And from Canberra – apparently meaningless assurances that nothing bad or uncommercial will happen. That doesn't help me sleep.

That's why I am greatly concerned about the future of competition in the current environment – and with it the future of product and service innovation, telecommunications coverage, and in the end Australia's ability to compete in a world of ever-increasing productivity.

Time will tell – but history is a disturbing guide. “I am from the government and I am here to help” still sends a chill down my spine.

History is repeating itself.

We in the business community can and should do more with Government – if government won't learn the lessons of commercial history – we can, we should, and we have an obligation to help them remember.

Thank you for listening.

