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Broadband blueprint needs to address pricing

The obstacle to better broadband is devising a satisfactory financial model for it, writes John de Ridder

Telecommunications Minister Helen Coonan meets the States tomorrow to put more flesh on her broadband blueprint for Australia. We already know about the $1 billion-plus planned for Connect Australia to be funded out of proposed T3 sales and that she wants the States to chip-in more. We also know that structural separation is off the agenda.

So too, unfortunately, is reforming the pricing of access to infrastructure. The latter is especially important as current pricing principles are deterring investment in other industries as well as telecommunications.

We all want faster broadband for all Australians, but how do we get it?

It is likely that there are significant national economic benefits from the deployment of broadband telecoms networks in the last mile to the end customer. The first problem is that many of the benefits will not be captured on the books of the firms undertaking the required investments. If not enough revenue can be obtained, the investments will not be made.

Note that this externality issue did not arise when telecommunications was a government monopoly. Then, it was possible to build networks in the public interest. The 1960 Community Telephone Plan, which was the blueprint for telecommunications then, could not be contemplated today. Since Telstra’s corporatisation, its managers are required to act like those in any other business. Also, since partial privatisation, the interests of minority shareholders have to be respected too.

Some argue that the good old days could be restored by structurally separating Telstra into a public utility network business and privatising the rest. Then the public network business could invest in next generation broadband customer access networks without worrying about making a profit. But, after buying back the network business the funds earmarked for building new infrastructure would be exhausted. So, new investment will have to be self-funding. Here is where a second problem arises.

Any broadband access network, public or private, will be subject to price regulation. The current regulatory “total service long-run incremental cost” (TSLRIC) access pricing model is inimical to investment. Regulation is supposed to mimic the outcomes that would arise in a competitive market. A criticism of TSLRIC is that since it is based on the hypothetical forward-looking costs of an efficient provider, it sets a benchmark price that is logically impossible to beat. Why build when you can buy it from Telstra at TSLRIC?

However, a more fundamental objection to current access pricing is that it ignores opportunity cost. In competitive, real-world markets opportunity cost is not ignored. For example, if I build a stadium to hold football matches what would I charge the government for holding the Commonwealth Games there? It would certainly not be just the TSLRIC with an agreed return on capital; which is all that the ACCC would allow. Commercially, I would also want the opportunity cost of not holding football games or other events in my stadium.

This is not only a competitive commercial outcome (other stadiums would do the same) but also an efficient economic outcome (presumably the ticket office will draw bigger crowds with the Games, so this is a better alternative use).

Opportunity cost is a real economic cost which has been prohibited by the explanatory memorandum to the Trade Practices Act. This has not been a major problem while the focus of regulation has been on opening-up the existing network to competition. The present regulations reflect a world where Australia had a ubiquitous copper network and it needed competition to provide a spur to the incumbent to increase efficiency, unravel cross-subsides (ie reduce call prices) and to provide choice.

But what Australia needs now is faster customer access networks; without reverting to monopoly (ie open access) and without undermining investment in alternative access networks (eg wireless).

The plan that was cobbled together by Telstra and rejected by the government a year ago was in fact the nearest thing to a broadband blueprint for Australia that we have seen. It depended, however, upon government subsidies and some form of privileged access rights that Telstra rightly dropped in its second metropolitan-only offer. This second offer was withdrawn last month after failure to reach agreement with the ACCC on the price of access.

This access pricing problem is not unique to telecommunications. It is now increasingly recognised that current access pricing is inimical to investment. Any blueprint must address pricing.

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