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Funding broadband – Digital Britain's idea

The blue-print for the digital economy in the UK proposes a funding mechanism that deserves consideration in Australia. It can address not only the "Final Third" but also uniform pricing.

The Carter Report [1] proposes a levy on all UK fixed lines of 50p ($A1) per month (raising appx. $A350m pa) to reach the "Final Third" of premises with Next Generation Broadband. We can use this approach to reach our own "Final Third' and address Australia's uniform geographical pricing objective.

Is $1 per month enough?

Assume there are 10m lines and the average cost to build and operate the NBN is $50/line/pm (ie appx. $6 bn pa). Further suppose that urban and country areas account for 70 and 30 percent of lines with average monthly costs of $20 and $120 respectively.

As explained previously [2], de-averaged wholesale prices will not lead to take-up in country areas. To cover the costs above, the average wholesale price has to be $50 implying a cross-subsidy from urban to country areas of $2.5bn pa. That is, every fixed (not just NBN) urban line has a levy of $30 on top of the underlying $20 cost so that everybody gets wholesale prices of $50.

Cross-subsidy is inevitable when costs differ markedly across geography and universal service and uniform retail pricing are desired. This has to be done as a levy on all unsubsidised fixed lines to ensure the cross-subsidy is not undermined with bypass.

Mobile broadband will become a strong substitute for fixed broadband. So, there may be a case in technological neutrality for treating all access lines the same way. The Carter Report excludes mobiles from the proposed levy on the basis that mobile operators already contribute with licence coverage requirements. I think there may also be practical issues with the heterogenous nature of the mobiles market, but it is worth debating.

Move toward averaging now

An average wholesale price of $50 is better than some expect for the NBN [3]. But, it is a whole lot worse than the $16 currently paid in urban (Band 2) areas for unbundled local loop (ULLS). Even if this is the cost (which Telstra disputes), it is de-averaged so it will be more competitive than the averaged $50 NBN access price. This would not be infrastructure competition but economically inefficient regulated arbitrage.

These two different access pricing regimes cannot co-exist. There has to be some glide path to get copper-based access pricing on to the same plane as NBN access pricing. Remember also that all (unsubsidised) fixed lines need to contribute equally to the cross-subsidy that supports uniform pricing. The subsidy needs to be factored into the migration path too. The best place to start is for the ACCC to move towards averaged ULLS pricing now; the sooner it starts, the smoother the transition will be.

Infrastructure competition

After the transition to averaged wholesale access pricing inclusive of the levy, ULLS (and HFC) could still be very competitive with the NBN. The costs of existing networks are sunk and the incremental costs of upgrading existing networks will be less than building the NBN (FTTP).

While it looked like Telstra would build the FTTN, access seekers had (and still have) no interest in scrapping their DSLAM investments to replace ULLS with more expensive NBN access. It was (is) in their interests to delay the process and corral Telstra in the event of it building the Government's NBN or its own.

But Optus has woken up to the fact that if Telstra does not have a ring-side (box?) seat in NBN II, fixed infrastructure competition from Telstra will undermine the viability of the NBN. The obvious answer is to use the most efficient investment path for the NBN including existing (upgraded) assets where appropriate.

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[1] *Digital Britain – Building Britain's Future*, Report to Parliament, June 2009
[2] See *Broadband – What's best for Australia and Telstra?* Exchange, 19 May 2009
[3] Concept Economics and Southern Cross Equities estimate average retail prices of over $200 pm (versus around $55 currently) with a wholesale price over $100.