

Business
Council of
Australia



Business Council of Australia

**Submission to the
Department of Broadband, Communications and the
Digital Economy
on the
NBN Implementation Study**

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OVERVIEW

- Improvements in Australia's high-speed broadband networks can contribute to productivity and economic growth, but rigorous and sound policy development will be critical to support efficient investment and better consumer outcomes.
- The NBN Implementation Study findings confirm the need for a cost–benefit analysis of the National Broadband Network to demonstrate that the proposed way forward is in the national interest.
- The study's assumptions about costs, take-up rates and competitor responses are subject to variability and would place a high degree of uncertainty over the NBN Co. business plan if adopted.
- The NBN Co.'s expected return at just 6 to 7 per cent is below a commercial rate of return and raises a question over whether this is an appropriate allocation of resources, especially given the re-emergence of capacity constraints across the Australian economy.
- The government's competitive neutrality policy is designed to prevent distortions in resource allocation from public companies gaining an unfair advantage due to public ownership. It is important that the policy is applied fully to the NBN Co.
- The study findings suggest the viability of the NBN could rest on the government using its legislative and financial power to confer a competitive advantage on NBN Co. – specifically the recommendations around regulatory flexibility, the lower than commercial rate of return and a possible guarantee on government debt.
- The government should assess the study's recommendations against its COAG competition policy commitments and should clearly state the process by which NBN Co. will be regularly assessed against its competitive neutrality policy obligations while in public ownership.
- It will be important that the Australian government fulfils its commitments to report on the competitive neutrality compliance of its Government Business Enterprises (GBEs), as highlighted recently by the COAG Reform Council.
- The study suggests one of the ways to manage uncertainty during the NBN rollout is to retain regulatory and policy flexibility – this could, in turn, create regulatory risk for other businesses and have wider consequences for investment and growth. Any future changes to regulation or policy must take into account the wider impacts on the market.
- The government should release publicly and in full the forthcoming NBN Co. business plan.

ABOUT THE BUSINESS COUNCIL OF AUSTRALIA

The Business Council of Australia is an association of the CEOs of 100 of Australia's leading corporations with a combined workforce of one million people. It was established in 1983 as a forum for Australia's business leaders to contribute to public policy debates to build Australia as the best place in which to live, to learn, to work and do business.

TELECOMMUNICATIONS POLICY SHOULD ENCOURAGE EFFICIENT INVESTMENT AND COMPETITION AND SUPPORT PRODUCTIVITY AND GROWTH

We believe that investment that raises the speed, quality and coverage of high-speed broadband provision in Australia has the potential to contribute to innovation, productivity and economic growth in the coming decades.

Australia's telecommunications policy framework should encourage competition and efficient investment to meet the long-term needs of consumers as technology and market conditions evolve. Rigorous and sound policy development is critical to ensure that government regulation and spending measures are supportive of these aims and that they do not divert resources to inefficient means, especially as signs of capacity constraints re-emerge in the Australian economy.

THE IMPLEMENTATION STUDY FINDINGS CONFIRM NEED FOR A COST-BENEFIT ANALYSIS OF THE NBN

The findings of the NBN implementation study confirm the need for a supporting cost-benefit analysis of the \$43 billion National Broadband Network to demonstrate that the project is in the national interest.

The BCA has made several submissions on the digital economy and the development of the NBN.

The BCA has consistently advocated for:¹

- A cost–benefit analysis that sets out the investment case for the NBN rollout and the broader economic costs and benefits to demonstrate that this large-scale government investment is in the national interest and that the proposed approach is the best way forward.
- The implementation of the NBN to be consistent with established competition policy principles, notably the government’s own commitments to competitive neutrality and the governance of GBEs.² This will support efficient resource allocation and will assure Australia’s wireless and fixed line network operators that NBN Co. will not receive unfair advantage due to its public ownership.

The government is to be commended for publicly releasing the NBN Implementation Study. The BCA supports regular public reporting and a high level of transparency for the NBN Co. while it is in majority government ownership. We urge the government to also release publicly and in full the forthcoming NBN Co. business plan.

The implementation study, undertaken by McKinsey & Company and KPMG, outlines a scenario under which the estimated \$43 billion fibre-to-the-node project could provide the government with a return on investment of around 6 to 7 per cent.

While the study findings are in some areas based on ‘conservative’ assumptions, it nevertheless makes a number of critical assumptions about costs, take-up rates and competitor behaviour that are subject to a high degree of variability. As the study acknowledges, seemingly small decisions have a substantial impact on the results of the business case. This would make any final NBN Co. business case based on the recommendations of the study subject to a high degree of uncertainty.

¹ The BCA’s earlier submissions are available at www.bca.com.au.

² *Governance Arrangements for Commonwealth Government Business Enterprises 1997 and Australian Government Competitive Neutrality Guidelines for Managers*, February 2004.

The study's findings and recommendations also raise a number of questions about the application of competition policy and the potential for wider market impacts, discussed in more detail below.

The government should now take the opportunity to produce a cost–benefit analysis to unequivocally demonstrate the proposed investment is in the national interest and to dispel any concerns about broader impacts of the NBN and the operations of NBN Co. on competition in the telecommunications sector.

THE STUDY FINDINGS RAISE IMPORTANT QUESTIONS FOR THE APPLICATION OF COMPETITION POLICY

NBN Co. is a Government Business Enterprise (GBE). It is therefore required to comply with the government's competitive neutrality policy, which aims to ensure that GBEs do not receive a competitive advantage over other businesses due to their public ownership. This means:

- NBN Co. should not receive favourable taxation or regulatory treatment;
- NBN Co's cost of debt should be comparable to that of a similar private business and not that of the government; and
- NBN Co.'s prices must be set to fully cover all costs and make a commercial rate of return on the government's investment (defined in the government's guidance material as the Commonwealth long-term bond rate plus an appropriate margin for risk).

The NBN Implementation Study suggests the viability of the project could rest on the government using its legislative and financial power to confer a competitive advantage on NBN Co. It makes a number of recommendations that are potentially at odds with competitive neutrality requirements.

For instance, the study sets out an implementation path based on government equity funding of the NBN Co. at a lower than commercial rate of return, recommends a number of flexible regulatory measures in support of NBN implementation, and contains a

suggestion that NBN Co. could have access to debt funding under a government guarantee.³

The expected project rate of return of around 6 to 7 per cent exceeds the government's cost of borrowing but is, in our view, well below a commercial rate of return for a venture of this type. It is inconsistent with the requirement under the government's competitive neutrality policy that GBEs should seek to make a commercial rate of return, and puts a question mark against the recommended price structures and the estimates of NBN take-up rates.

A commercial rate of return would take into account project risk and for a mature investment would likely be in the order of 10 per cent or more. The study itself acknowledges that private sector investors would require returns of 15 to 25 per cent to compensate for risks during the early rollout phase. It calculates a cost of equity once NBN Co. enters 'operations phase' of between 8.8 per cent and 12.4 per cent. The government's competitive neutrality guidelines suggest a medium risk project should earn a 10 per cent return (constituting a 5 per cent return for the 10 year bond rate and a 5 per cent risk premium).⁴ All of these estimates are well above the study's forecast NBN project return.

Competitive neutrality policy does allow for exemptions from the requirements for neutrality but only where a net public benefit has been demonstrated. For the NBN Co., this can be demonstrated by undertaking a cost-benefit analysis, which the government appears to have deemed unnecessary.

One consequence of potential NBN Co. non-compliance with competitive neutrality principles is that the government could be exposed to a competitive neutrality complaint via the Australian Government Competitive Neutrality Complaints Office (AGCNCO).

³ See NBN Implementation Study discussion on: project rate of return (pp. 39 and 414); the possibility of a government guarantee of debt (p. 404), and a number of regulatory recommendations including mandatory provision of network information by other businesses (Recommendation 56), NBN Co. right of access provisions (Recommendation 9) and consideration of a 'cherry picking levy' for competitor networks (Recommendation 74).

⁴ *Australian Government Competitive Neutrality Guidelines for Managers*, p. 33.

IT IS IMPORTANT THAT THE GOVERNMENT MEETS ITS COMPETITIVE NEUTRALITY REPORTING COMMITMENTS

The Minister for Finance and Deregulation is jointly responsible, along with the Treasurer, for ensuring that NBN Co. complies with competitive neutrality policy. The Minister for Finance is also a joint shareholder in the NBN Co. with the Minister for Broadband, Communications and the Digital Economy.

It will be important for business and community confidence in the NBN that all ministers discharge their shareholder and regulatory responsibilities in full. The lack of recent reporting by the Australian Government on competitive neutrality compliance for its GBEs therefore should be promptly rectified.

The Australian Government is a signatory to the COAG Competition Principles Agreement and is committed to publishing an annual report on competition policy compliance.⁵ The last publicly available report undertaken by the Australian Government was in 2007.⁶

The government is also a signatory to a COAG agreement that Heads of Treasuries would report annually to COAG on competitive neutrality compliance.⁷ The last report by Heads of Treasuries to COAG was over two years ago (in January 2008).

The COAG Reform Council recently noted that a 2009 report on the application of competitive neutrality was agreed out of session by Heads of Treasuries but was not provided to COAG. The CRC said it was important that the 2009 report be ‘released soon’ as it is a ‘key accountability measure.’⁸

⁵ *Competition Principles Agreement – 11 April 1995* (as amended to 13 September 2007) available at www.coag.gov.au. All governments agreed to “publish an annual report” on the implementation of the competition principles (clause 3(10)).

⁶ See Treasury website at www.treasury.gov.au (accessed May 2010).

⁷ COAG, *Competition and Infrastructure Regulation Agreement*, agreed 10 February 2006.

⁸ COAG Reform Council, *National Partnership Agreement to Deliver a Seamless National Economy: Report on Performance 2008–09*, 23 December 2009, p. 276.

The 2008 and 2009 assessments are still yet to be released, and the 2007 review remains the most recent available assessment of competitive neutrality compliance by the Australian Government. As a demonstration of its commitment to competition policy, the government should promptly release the 2009 report on the application of competitive neutrality principles to GBEs as recommended by the COAG Reform Council.

FUTURE NBN CO. DECISIONS MUST CONSIDER COMPETITION IMPACTS

Rigorous application and reporting on compliance with competition policy by government is important. The Competition Principles Agreement states that the objective of competitive neutrality policy is ‘the elimination of resource allocation distortions arising out of the public ownership of entities engaged in significant business activities’. If private business and investment decisions are distorted as a consequence of favourable treatment provided to the NBN Co. then this could lead to inferior consumer and productivity outcomes.

The study recommends the government retain regulatory flexibility throughout the NBN rollout in support of the project. It says that ‘if a lower-return scenario starts to emerge’ one of the options available to government is to ‘be more flexible on policy settings to improve the expected return’.⁹ The greater ability to deploy ‘regulatory flexibility’ is one of the arguments in the study for full public ownership of NBN Co. during its implementation phase.

A critical consideration is how such policy flexibility would impact on long-term investment decisions by private investors given it subjects those decisions to higher levels of regulatory risk.

Regulatory flexibility can create uncertainty for other telecommunications companies and distort incentives to invest and innovate. This is why the BCA, in an earlier submission, disagreed with proposed legislation giving ministerial flexibility in relation to NBN Co.’s ‘wholesale-only’ business charter and which would potentially allow NBN Co. to expand its product offer further into the wholesale and retail markets. We note that the proposed flexibility has been endorsed under Recommendation 68 in the implementation study.

⁹ NBN Implementation Study, p. 345.

Regulatory and policy decisions taken in relation to the NBN implementation need to be carefully assessed for their wider impacts on investment across the telecommunications sector and the wider economy and for their contribution to regulatory risk. For example, any unintended negative impacts on the growth of investment and use of wireless broadband technologies could be harmful to economic growth. As the OECD observes, ‘increased ICT penetration is no longer a major source of productivity growth in developed countries, but new features (such as portability and wireless connectivity) can boost productivity in activities requiring information and communication.’¹⁰

RECOMMENDATIONS

We believe that improvements in Australia’s high-speed broadband networks can contribute to productivity and economic growth, but that rigorous and sound policy development will be critical to support efficient investment and better consumer outcomes.

As the government considers its response to the findings of the NBN Implementation Study, the BCA recommends the following:

- The government should undertake a cost–benefit analysis of the NBN to demonstrate that the NBN investment and any associated impacts on competition in the telecommunications sector are in the national interest.
- Treasury and the Department of Finance should assess the implementation of the NBN against the government’s competition policy requirements – in particular should any of Recommendations 9, 14, 23, 41, 42, 52, 56, 57, 59, 62 and 74 from the NBN Implementation Study be adopted.
- The government should not adopt Recommendation 68 allowing ministerial flexibility to make exceptions to NBN Co.’s wholesale-only restriction. Instead, the government should more clearly define the NBN Co.’s ‘wholesale-

¹⁰ OECD, *Information Technology Outlook*, 2008, p. 298.

only' operations to provide greater certainty for other telecommunications businesses.¹¹

- The government should clearly state the process by which it will regularly assess NBN Co. against its competitive neutrality policy obligations while NBN Co. is in public ownership.
- Given the importance of public reporting of NBN Co.'s compliance with competitive neutrality, it will be important that the government releases its assessment annually. As a demonstration of its commitment to competition policy, the government should promptly release the 2009 report on the application of competitive neutrality principles to GBEs as recommended by the COAG Reform Council.
- The government should release publicly and in full the forthcoming NBN Co. business plan.

¹¹ See Business Council of Australia, *Submission to the Department for Broadband, Communications and the Digital Economy on the Draft legislation for the National Broadband Network Company*, March 2010.