



Beyond the Safety Net:
A Strategic Review of the

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Executive summary and digest of recommendations

Broadly speaking, one can discern two strategies for delivering better 'equity for the bush':

- 1.

as Finland – show much greater restraint by desisting from regulating telecommunications USO prices and by means testing subsidies.

As the quality and diversity of telephony rises in cities, electorates and politicians are already pursuing an extension of USOs to higher value telephony services.

The USO has already been extended to digital data services. So far the financial damage this threatens has been contained by the avoidance of price controls on

Major improvements in the current structure are very unlikely to occur in the immediate future. Nevertheless an understanding of the various possible strategies can assist decision-makers in negotiating the territory which lies ahead.

3.1 Objectives for USOs

3.1.2 Transparency

It would be a useful transitional strategy to seek to maximise the transparency of the current arrangements, by itemising the USO as a cost or subsidy on all phone bills. It would be most effective if as many carriers as possible did this in concert, many or all of whom agree that the USO should be funded through general revenue.¹

3.1.3 Equity with many - 39560 on all aTD he

tax credit for those in rural and remote areas were to be phased in, it might be

recently commented to the Productivity Commission inquiry into telecommunications specific regulation:

Nothing has been done to develop demand in remote areas although

1. Introduction

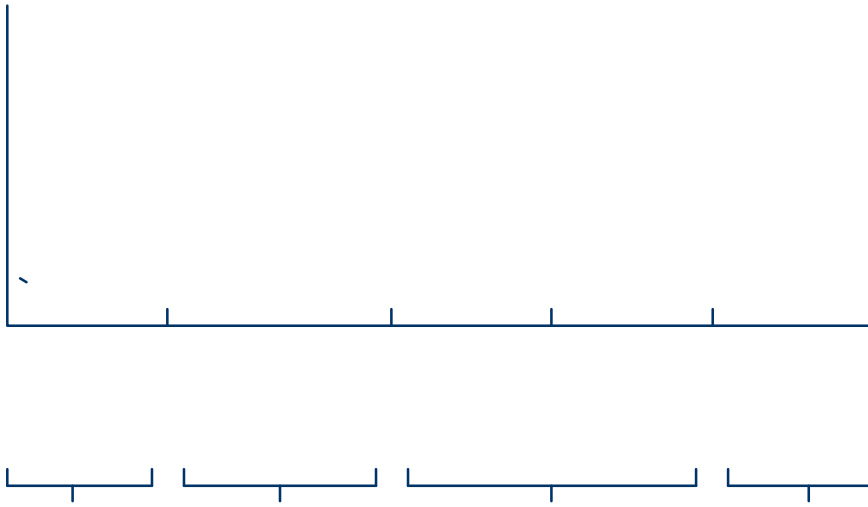
Many developed countries require public or privatised enterprises in the transport, postal, energy and telecommunications industries to undertake non-commercial activities such as USOs. However, there is no agreement on the most appropriate way of providing or funding universal service, or the minimum level of USO.

Firms in the telecommunications industry in a range of countries are typically required to provide a basic telephone service to all who require the telecece, or tharop0 -16.8 T

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Telstra, the only active USO carrier in regional and remote Australia, is constrained by a variety of retail price controls established under the Trade Practices Act 1974 and monitored by the Australian Competition and Consumer

Figure One: Average cost and utility of a telecommunications network as it grows



2. The themes of the study

Our lives are being improved by new technologies which enhance our productivity, our wealth and our lifestyles in ways which were the stuff of science fiction less than a generation ago. It is one of the paradoxes of our time, that just when this is happening, just as whole new pathways from rags to riches are being beaten, concern for equity in our society is intensifying.

Australia has one of the highest technology absorption rates in the world. It is also one of the top five countries in the world in terms of global spending on

A particular concern is that the method for compensating the 'Primary Universal Service Provider' – effectively carrier of last resort – will suffer from the same

At the time the report was published, Australian policy on USOs conformed reasonably with these criteria. This is no longer true. Powerful voices have lobbied hard to extend the USO. From 1 July 1999, the Government introduced a digital data service obligation which provides for:

- a general digital data service as part of the basic rate ISDN service, available on demand to 96 per cent of the population and
- a special digital data service for the 4 per cent of the Australian population not able to access the general digital data service on demand.⁸

It would be possible to argue that USOs – and certainly USOs which are not means tested – are an inefficient means of delivering on equity objectives in any event. But there is greater agreement still that USOs are an inappropriate way to assist business. In addition, mandating ISDN access is an arbitrary definition of a service standard which may become inappropriate. As Oftel observed last year:

Narrowband ISDN . . . is clearly not a service which is currently used by

would now back narrowband ISDN as the future of telecommunications (1999).

The Government has stuck more closely to principle in externally funding some other equity based improvements to rural telecommunications services – for

3. From 'first' to 'nth' best: The 'directness' of policy

The bounty to the white herring fishery is a tonnage bounty; and is proportioned to the burden of the ship, not to her diligence or success in the fishery; and it has,

Figure Two: Corden's hierarchy of interventions

Original Inefficiency: Manufacturing wages too low	
Policy	Additional by-product distortion
<p>First Best - subsidy to labour</p>	None *
<p>Second Best - subsidy to production</p>	Manufacturing production too capital intensive
<p>Third Best - tariff plus export subsidy</p>	Too little domestic consumption to manufactures
<p>Fourth best - tariff</p>	Too little exporting of manufactures

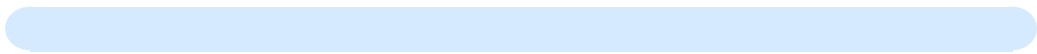
*Assuming no efficiency costs of taxation

In fact, as Corden subsequently makes clear, the first policy is not perfectly efficient because of the efficiency cost of collecting the tax to pay the subsidy. The second best policy draws additional capital to production when the distortion which was being addressed was the reward to labour. The third best policy adds a consumption distortion, whilst the fourth best policy also distorts production – away from export.¹⁰

¹⁰ It is worth noting at the outset that this approach is best regarded as an heuristic rather than a rigorous framework. Strictly speaking the theory of the second best (Lipsey and Lancaster, 1956) holds that, for so long as any distortions remain in an economy – and there are always numerous distortions – one cannot be sure that removing one distortion will make things better. Nevertheless the degree of rigor appealed to by the theory of the second best is a recipe for policy paralysis (

unless there are good reasons to the contrary) underpins virtually all.

communities which, if given the choice, would choose to spend any subsidy they might receive in the name of equity at least partly on things other than



4.



Initially a tax of T_1 is placed on the narrow-based set of goods depicted by demand curve D_1 . The welfare loss of the narrow-based tax is area ABC . Tax revenue is $(P_1 + T_1, A, B, P_1)$. The tax rate can be halved to T_2 if placed on the broader base of goods represented by demand curve D_2 .¹³ The welfare loss from the lower tax rate is reduced to $DEF = \frac{1}{4} ABC$.

Optus performs some 'back of the envelope' calculations based on this logic. Given that telecommunications is a small part of the economy and the policy alternative is basing the tax over the whole economy, Optus calculates that

5. Funding the USO from general revenue.

For those seeking to broaden the base of the USO, the 'Holy Grail' would surely

- The period of liberalisation has coincided with strong political pressure on governments to balance budgets which, until recently, have been in chronic deficit.

It is worth keeping in mind that there are some arguments in favour of keeping the cross subsidy broadly within the industry and/or having it paid in the prices of firms rather than through taxation. These may somewhat qualify the presumption of central funding, but may nevertheless feature in the debate.

- To some extent the subsidisation of new members of the network generates positive 'network externalities' to others in the network, which it then becomes both fair and efficient for them to fund.
- Where they are not perfect competitors, firms can 'Ramsay price' ¹⁶ their funding obligations for the USO, thus minimising the welfare loss. The uniformity of most government revenue raising precludes this.
- The OECD (1995) observes that: "Cross-subsidy regimes require minimal administrative control since welfare transfers take place as part of the operation of the pricing system. By contrast, direct subsidies entail higher administrative costs".

These arguments suggest that the optimal policy from an economy wide

complexities involved in calculating and disbursing a subsidy for non-commercial

\$300 million of revenue raising from prices would reduce the CPI by less than 0.1%.

6.

more appropriate government authority, the Australian Taxation Office.” (Cable and Wireless Optus, 2000, §3.10).

Funding the USO through tax concessions for the USPs

From the perspective of telecommunications carriers, an alternative means of funding would be through a tax concession. This is an approach which has gained some favour in the United States with Senators Rockefeller and Snowe

telecommunications carriers, their role as defenders of the exchequer gives them a conflicting interest to defend. Frequently these departments give precedence to the short-term needs of the budget ahead of their longer-term commitment to efficient resource allocation.

- Tax concessions are not just less economically efficient than subsidies because they undermine the integrity of the tax system. They are also less transparent. Subsidies appear in the budget, whereas tax concessions occur off budget.²⁰ The ATO is a particularly vigorous defender of the integrity of the tax system.
- Tax deductions are not usually capped and as such represent an open-ended risk to government. As the competitive USO pilots proceed and if and when they are extended more widely, there will be greater certainty about the costs of provision in rural and remote areas. Even then, it would probably be difficult to predict the revenue impact of a given tax concession. Today, it would be extremely difficult for governments to be confident they would set the right rate.

Accordingly the use of tax concessions for industry assistance purposes has

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with below – such refundable tax credits or rebates would in effect be subsidies

not including their employees). The purpose of funding the USO is to have the consumers of profitable services fund the consumers of unprofitable services. As such, the relevant considerations are efficiency ones, to do with the least

Essentially payments are made or rebates given to targeted end users to

7. Out of the silos: Beyond the Safety net

- the way in which programs to deliver equity in the bush have been divided into 'silos';
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available from Federal, State and Local levels of government in Australia. The Federal Government's recent Regional Australia statement aims to improve access to, and delivery of, programs and services in regional areas, to foster employment and business initiatives, to enhance regional infrastructure and to improve community welfare. Just some of the initiatives with direct

The Regional Solutions Programme offers a menu of funding options from small-scale projects (\$5000 or less) to large-scale projects (up to \$500,000), depending on the needs of the communities and the activities to be undertaken. Up to \$100,000 over two years can be accessed towards the cost of resourcing

program that seeks to address regional disadvantage in telecommunications. Funded from the sale of equity in Telstra at \$250 million over five years from 1 July 1997, the stated objective of NTN is to assist the economic and social development of regional, rural and remote Australia by funding projects that:

- enhance telecommunications infrastructure and services in regional, rural and remote areas;
- increase access to, and promote use of, services available through telecommunications networks in regional, rural and remote areas; or
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The benefits of cashing out are not just the ‘theoretical’ ones arising from optimising consumer utility. The approach would also immensely improve the development of appropriate industry structure and technologies to meet rural and



bank. Such services exist in the United States ³⁵ and could be of substantial benefit to many people living in remote Australia, both on their own account and also because they could reduce critical commercial dependency on postal services. A wide range of other possible goods and services could be imagined in the areas of health, education and other services to citizens. But if it were not commercially viable, how could such an initiative be funded?

Here, Australian rural R&D corporations provide a useful model. The rural research and development corporations compulsorily levy their members – generally the producers of agricultural commodities. The levy is calculated as a percentage of commodity revenue. Those paying the levy are then entitled to vote (in proportion to the levies they pay) in the management of the corporation

letter at a uniform price (which assists affordability and therefore usage in rural and remote areas), and providing it on an Australia-wide basis, increases the attractiveness of the service to all Australians, whether they are located in city ori9 rur3. (45) Tj6 -28-16.8 /F6/F2 12 Tc -08.048 T.0317.28 TTf tCos

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Appendix Two: The Rockefeller/Snowe Bill for tax credits for rural and remote telecommunications providers

The main aim of the Rockefeller/Snowe Bill is to improve telecommunications access and infrastructure in rural America.³⁷ Rockefeller noted that:

New technologies can remove the geographic barriers that have held back rural areas for generations, meaning that places like West Virginia no longer have to be separated from the rest of the world. The implications of

Appendix Three: Some revenue raising alternatives

Some interesting new ideas for generating revenue for new infrastructure development have been explored by Mann (1999) in relation to the water industry in the United States. He explores two kinds of charge

- availability charges and

having to subsidize the new customers. Second, by requiring the customers who have caused the system growth to pay for that growth, the system development charge can allow the water utility to maintain a common rate schedule for both

Appendix Four: Abbreviations

ABS	Australian Bureau of Statistics
ACA	Australian Communications Authority
ACCC	Australian Competition and Consumer Commission
ANTS	Australian National Tax System
ATO	Australian Taxation Office
BARN	Building Additional Rural Networks
Bps	Bits per second
BCA	Business Council of Australia
CAN	Customer access network
CSO	
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