

Telecommunications Inquiry
Productivity Commission
PO Box 80
Belconnen ACT 2616

Our ref PCTelsInqUSOs300101

30 January 2001

Dear Sir

Issues Paper 2 - Universal Service Obligations

The Universal Service Obligation (USO) has generated much emotion, created myths and has been the cause of much political intrigue but in all this there has been limited rational discussion, apart from the noteworthy contributions of the ACA. In the interests of assisting the Productivity Commission to promote a more rational discussion, I would like to offer the following comments from a battle-scarred consultant with considerable experience of the subject.

Subsidy recipients – Regional areas are not the recipients of subsidies under the USO. Telephone service in the towns and cities in regional Australia is almost entirely commercially viable and Telstra has received subsidies for areas of low teledensity usually described as rural and remote net loss areas. Given the politically heated nature of the debate it is vital to maintain this distinction.

USO Costs – the calculation of the Net Universal Service Cost (NUSC) has been based upon a methodology appropriate to determining net loss areas in a monopoly environment, or in a competitive environment if the relevant costs and revenues of all carriers are included. Using Telstra's costs and revenues, including incoming and outgoing long distance call revenues, results in underestimation of the subsidy cost for providing uneconomic access. This has been recognised but not acted upon by the ACA. Use of forward looking technologies to calculate subsidy requirements further undercompensates the incumbent provider for its actual (sunk) costs. There must be a very high probability of failure by service providers entering into competition for provision of the USO on the basis of subsidies calculated in this way.

Maximising revenues – The argument is often advanced that Telstra currently has no incentive to increase revenues. This is correct using the present subsidy arrangements.

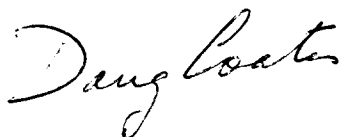
However the answer to this problem is more likely to lie in redefining the subsidy to clearly focus on access costs and revenues rather than subsidising competitive providers of access. The access provider could then provide access to other service providers as currently happens with pre-selection of long distance carriers.

USO Service – There are difficulties in specifying the service to be provided in a competitive environment. In particular, the data speed relevant to Internet usage varies widely from place to place and generally exceeds the specification required specifically for a voice service. Raising the minimum specification is likely to increase costs, whilst not raising it could potentially under some circumstances result in deterioration of performance for some customers.

Economies of scale – Areas subsidised under the USO are characterised by low teledensities and service provision costs escalate quite rapidly with declining density. If competition is introduced for provision of access service to individual USO customers, then the density of customers served by any individual provider will decrease with a consequent likely increase in costs. When this situation is combined with inadequate subsidies, then there is a strong incentive for new Universal Service Providers to select (“cherry pick”) less unprofitable customers. When introducing competition it is essential that not only the specification of service requirements and obligations is transparent, but that a mechanism is used to balance benefits and costs which recognises loss of economies of scale. This might be achieved through tendering arrangements.

These comments are offered with a view to assisting to focuss the deliberations of the Commission on the critical few issues in what is a very complex environment.

Yours sincerely



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Director