

Abbott still doesn't understand the Internet

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From the perspective of a Coalition Government, exploiting public irrationality over house prices is a great idea. We're returning to bone-headed Howard-Costello economics, writes Ian McAuley

When it comes to broadband, it makes economic sense to have the infrastructure owned by a government monopoly - unless you're the Coalition. Ian McAuley on the future of NBN Co

The dead hand of Tony Abbott's opposition to sound economic policy is all over the Coalition's (so-called) broadband proposals. Also evident is an obsession with "competition" and "privatisation", an obsession which displaces basic economics.

Most media attention so far has focussed on Malcolm Turnbull's demand for the NBN Board to resign. This is perhaps the most defensible aspect of the Government's moves, because the NBN is way behind schedule: on its present projections just over 700,000 premises will be passed by fibre by June next year.

Admittedly some of the delay has been beyond NBN's control, including protracted legal issues with taking over Telstra's copper network and Telstra's five month stoppage in preparing its pits after having found asbestos. But the NBN Board's tardiness has left the venture vulnerable.

The Labor government should have known that Telstra's infrastructure would be in disrepair, because once it was privatised in 1997, short-term commercial incentives were bound to take over from any commitment to maintain its infrastructure. While people can see potholes in their roads and shabbily maintained buses and trains, they have little consciousness of the condition of "invisible" assets, like sewers, pipes and underground cables. That's one strong reason why such assets are far better held in the public sector.

Rather than yielding to such obstacles, the Board could have followed the example of the Snowy Mountains Hydroelectric Authority. In 1949, just months before an election which was bound to bring in a Coalition Government opposed to the scheme, the Authority went all out to make sure that by the time the Menzies was ensconced in power contractual commitments would put the Snowy Mountains Scheme beyond recall. They went to extraordinary lengths to get the project started with the Guthega Power Station, and in 1955 Menzies opened it with great ceremony. The Snowy scheme was politically embedded in the way that the NBN is not.

There is also a great deal of attention being given to the Coalition's fibre-to-the-node (FTTN) model, the cheap alternative to Labor's fibre-to-the-premises (FTTP) model. Most New Matilda readers are well aware of the difference, but it's worthwhile reminding readers that much of the argument put by supporters of FTTN is about download speeds, rather than two-way speeds. For example on ABC Radio last Wednesday David Kennedy of the consulting firm Ovum said that in relation to the NBN "what we're really talking about is entertainment video", and that FTTN would be adequate for every entertainment media short of Ultra High Definition TV.

FTTN proponents seem to be incapable of seeing a role for the NBN beyond entertainment. They see high speed fibre as something for business applications, not needed in people's houses. It's a limited and traditional notion that fails to see how the nature of production is changing and how work is no longer confined to big factories and offices.

In time I believe the Coalition will be forced to confront the economic and political realities that will compel them to accept the need for FTTP.

The economic reality is that Telstra copper network is old and in disrepair. Worse, it is subject to faults, such as induced currents during electrical storms. In times past current surges may have done no more than to destroy a \$20 phone handset, but the consequential damage now can be far worse, and for both personal and business reasons, people's tolerance for communication outages has lessened.

Also there will be political pressure to install FTTP when people in leafy Liberal Party electorates realise that those in the new housing developments on the periphery are getting better broadband. The digital divide is leaving the better-off on the wrong side. If that isn't enough to convince the Coalition, they will surely be looking at Cathy McGowan's success in Indi, where she made the FTTP NBN an important issue distinguishing herself from the Liberals' Sophie Mirabella.

The more important issue is the future of NBN as a publicly-owned monopoly, with a uniform tariff. One does not have to stray into the realm of “left” economics to show that for network hardware a monopoly is the most economically efficient way to provide a service. We would see something absurdly wasteful if we were to have two or more water pipes, sewers, or electricity lines connected to our houses or business premises. Many of us remember how the Keating government allowed Telstra and Optus to string parallel cables along the streets, delivering pay TV.

Those who seek a full economic justification for the NBN to be retained as a natural monopoly, using orthodox economic theory, can find an excellent outline on David Hayatt's blog. That strong case has to find a voice in a political atmosphere dominated by the naive notion that competition and privatisation are always preferable to a publicly-owned monopoly.

If NBN is not left as a government-owned monopoly, there are two likely consequences.

First, the uniform pricing mechanism would be unsustainable, as private providers pick off easy installations, such as new apartment blocks, with FTTP. The NBN would be left with more expensive connections, and would become unprofitable. The cross-subsidies similar to those we accept in services such as post and telephone could not be used to even out the tariffs, and in all probability the NBN would become bankrupt well before it could achieve much penetration. Either many people would be left unconnected or the Government would have to pay special subsidies to connect unprofitable premises – a case of socialised losses and privatised profits.

The other possible consequence is that service providers such as TPG and Optus would provide fibre and content as a bundle, locking out other service providers. Those who follow the stock market will notice that TPC's share price jumped from \$3.50 to \$4.50 on the election of the Coalition (more than making up for the 50 cent fall in June when it was fined for misleading advertising). The irony of the economics of communication networks is that opening up competition in hardware can lead to monopolisation of services. That's why good economic practice involves “structural separation” of communications into the monopoly hardware firm and the competing service providers.

When he was in Opposition Turnbull called for the Productivity Commission to run a cost-benefit analysis of the NBN. Cost-benefit analysis is ideal for incremental projects using established technologies – a new rail line, a new road interchange etc – but it is less suited to projects with developing uses. But the Productivity Commission, if given a sufficiently open reference, would almost certainly conclude that the NBN in whatever form it takes (FTTP or FTTN) should operate as a natural monopoly, separated from service providers. That's the economic orthodoxy for which the Commission is well-renowned.

It appears, however, that Turnbull is under pressure from Abbott not to use the Productivity Commission to undertake a review of the NBN, but to use some other process – presumably to provide a recommendation designed to favour existing content providers and to ignore the economic case for NBN as a natural monopoly.

At great cost to all communications users, domestic and business, the opportunity for structural separation may be lost, due to Abbott's disdain for economically efficient public policy.