

Submission

by



to the

Ministry of Economic Development

on

**TSO Reform & Funding
Telecommunications Development**

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**TSO REFORM & FUNDING TELECOMMUNICATIONS DEVELOPMENT
SUBMISSION BY BUSINESS NEW ZEALAND¹
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1. INTRODUCTION

- 1.1 Business New Zealand welcomes the opportunity to comment on the Ministry of Economic Development's (MED) *TSO Reform and Funding Telecommunications Development* (referred to as the 'discussion document').
- 1.2 Since it began as an entity in 2001, Business NZ has advocated a major review of the Telecommunications Service Obligation (TSO), given this and its predecessor (the KiwiShare) have brought about a combination of uncertainty, unintended consequences and a lack of transparency. While there are aspects of the discussion document with which we do not entirely accept, the release of the document is the largest positive step forward for many years.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 Business New Zealand makes the following **recommendations** with regard to the draft discussion document, namely that:
- (a) ***By December 2010, MED commission an independent economics consultancy agency to review the effectiveness of the Kiwi Share and local service TSO and to make recommendations to MED as to whether the Kiwi Share and the local service TSO should be abolished by the end of 2015 (p.3);***
 - (b) ***MED scope any Requests For Proposals or tendering arrangements in a way that lends itself to technology neutral solutions – especially for access technologies linking customers with the publicly funded fibre broadband node (p.4);***
 - (c) ***Any changes to the TSO take into account issues regarding primary costs and benefits, transparency and accountability as part of good public policy (p.6);***
 - (d) ***There is a direct link between the \$300m earmarked for the RBI and the aspirational consultation questions asked in the Infrastructure Plan document (p.8); and***
 - (e) ***A formal review of the TSO and Kiwi Share is conducted no later than 31 December 2015 to ascertain whether those policies are promoting economic growth and higher productivity (p.8).***

¹ Background information on Business New Zealand is attached in the appendix.

3. KEY CONCERNS & COMMENTS

Local telephone service objectives & first principles approach

- 3.1 Ensuring the right outcome from a revamped TSO is certainly not an easy task, and we congratulate MED for issuing a discussion document as the first step for change.
- 3.2 One of the first issues in the discussion document relates to local telephone service objectives, with paragraph 15 noting the local service TSO ensures that the residential local telephone service:
- Is available to rural communities throughout New Zealand;
 - Is available in rural areas at a price and quality comparable to local service available in urban areas;
 - Offers households the option of toll free local calling;
 - Limits price rises to no more than the rate of inflation; and
 - Enables households to make emergency 111 calls.
- 3.3 The list in 3.2 covers a diverse range of requirements, and the discussion document initially asks *whether there are any aspects of these objectives which should not be retained?* The first point we would like to make is that Business New Zealand is not in a position to categorically say which objective(s) should or should not be retained. However, we are disappointed that there is no attempt by MED to take a first principles approach at the start of the review by asking if a local service TSO is still required/justified. This would raise such issues as the existence of broad costs/benefits, significant market failure, the level of regulatory intervention etc.
- 3.4 Overall feedback from submitters would likely show that either there is no continuing need for a TSO, or that TSO remains an integral part of the telecommunications landscape. Not having this discussion at the beginning means an automatic capture of submitters who must choose between the existing TSO structure or a new TSO charge methodology and the associated Telecommunications Development Levy outlined in the discussion document.
- 3.5 Putting our views regarding a first principles approach to the TSO to one side, MED's first question for submitters in relation to the removal of one or more of the TSO objectives could have significant impacts on not only the current TSO structure, but also on the alternative policy options are proposed in the discussion document.
- 3.6 For instance, at one level Business New Zealand would take the view that at the very least customers nationwide should have ways in which to make emergency 111 calls. In no respect should households or businesses be left 'stranded' from a communications point of view in respect to such essential services it may be literally a matter of life or death.

- 3.7 However, objectives such as toll free local calling, or rural areas having telephone services at a price and quality comparable to local services in urban areas, leave more room for debate. As an example, in our submission on Local Loop Unbundling in 2003, we mentioned at that time a recently published NZIER report on the KiwiShare Obligation (KSO), which recommended the KSO's abolition². The research concluded that the costs of what Telecom provided under the KSO outweighed the benefits, and that in the absence of a KSO, line rentals would rise for a small group of customers but would likely fall for 80% of customers. Also, NZIER found that the argument that the KSO helps low income families does not appear to be substantiated, as average household incomes in the areas which benefiting from the cap on monthly line rentals tend to be above the national average.
- 3.8 Business New Zealand does not hold any views as to the ongoing accuracy of the report mentioned in 3.7 above, as any such research into these areas would obviously need to be repeated to ensure its continued relevance. However, such work does highlight the first principles approach that needs to be taken when examining the TSO and their relevance going forward.
- 3.9 Overall, we stress we are not in a position to comment as to whether any of the objectives should or should not be retained. However, if there are consistent recommendations from other submitters that a number or indeed all objectives not be retained, MED should look to conduct first principles research (either in-house or by an independent source) into the economic costs/benefits of the Kiwi Share and local service TSO as it currently stands.

Recommendation: That, by December 2010, MED commission an independent economics consultancy agency to review the effectiveness of the Kiwi Share and local service TSO and to make recommendations as to whether the Kiwi Share and the local service TSO should be abolished by the end of 2015.

TSO and neutral technology

- 3.10 One of the common recommendations many submitters have historically made (including Business New Zealand) in regards to changes to the TSO is that they should be technology neutral. That is, the minimum standard of communication technology customers receive should involve a raft of communications technology that is not simply confined to a landline. The advent of mobile and wireless technologies has meant the potential for choice in the communications markets has grown beyond anything the TSO (and in particular the Kiwi Share) was designed for.
- 3.11 Making the TSO technology neutral would provide to numerous possibilities for reform. As an example, an alternative approach to the current TSO policy settings would be a simple auctioning off for a set period of time of those customers identified as non-viable to other providers who use alternative forms of technology (thereby turning them into viable customers). This would remove the 'cost' to Telecom as part of the TSO deed, as well as ensuring all customers have a minimum standard of communications technology at hand.

² NZIER, *The Economic Impact of the Telecommunications Service Obligation: Report to Vodafone NZ Ltd*, September 2003.

- 3.12 Beyond some form of first-principles based research that we recommend take place, MED should be conscious of existing research in this space. For instance, the Telecommunications Carriers Forum produced a report in 2008 entitled ‘*Report on the TSO for local service*’. While there were areas in which there was still disagreement, the report provided a strong basis for a TSO model going forward that was generally contestable, transparent and technology neutral, with close to full support from the major players within the political and legislative landscape at that time.
- 3.13 Obviously, the report was done against the backdrop of a previous Government, with the new administration making significant policy moves to generate investment in rural areas and to allow competition in delivery of rural services. However, if there are aspects that could be learned from or used in the new settings, then Business New Zealand would support such moves.
- 3.14 Lastly, we note the proposed Telecommunication Development Levy (TDL) will help fund the deployment of fibre broadband spurs into rural areas. A key issue is the way in which that fibre spur interconnects with mobile, satellite, or fixed line service providers. The deployment of the publicly-funded fibre spur should take into account how it can best promote competition, economic efficiency and technology neutral delivery to consumers.

Recommendation: That MED scope any Requests For Proposals or tendering arrangements in a way that lends itself to technology neutral solutions – especially for access technologies linking customers with the fibre broadband node.

4. TSO CHARGE METHODOLOGY

- 4.1 The current methodology for determining TSO compensation has created numerous problems over the last decade for many suppliers to the market. The discussion document outlines the current path in terms of how the methodology is delivered, and highlights two issues:
- The methodology attributes the costs incurred by Telecom but does not count all the benefits gained, and
 - There is a lack of transparency and accounting for where losses are incurred and where TSO compensation is spent.
- 4.2 Businesses (and individuals in general) will typically make an equivalent response to the regulatory settings put upon them. Regulatory settings that are principles-based or voluntary in nature will typically elicit a response by business that adheres to the main reasons why the settings were introduced. Prescriptive and/or poor quality regulatory settings will often see businesses become prescriptive themselves and/or maximise the settings to their individual advantage.
- 4.3 Since its inception, the Telecommunications Act (2001) has outlined the strict regulatory path Telecom must follow in terms of the TSO charge methodology. Therefore, Telecom has simply responded to the regulatory settings it faces.

A better overall approach is needed, but this should be based on what is best for enhancing New Zealand's productivity and growth.

- 4.4 Any significant policy changes such as those indicated in the discussion document will obviously create regulatory uncertainty in the market. The time it takes to receive feedback and make final decisions as to the final policy framework can stifle investment plans and reduce share prices. Therefore, we would assume the Government is transparent in their process going forward, and outline timeframes for processes/decisions when decided upon.

Full range of TSO benefits

- 4.5 At its simplest level, any proposed policy setting should have regard to both the costs and benefits associated with its implementation. This provides policy makers with a balanced view of the likely outcome to the economy as a whole, and is integral in determining what changes need to be made, and fundamentally whether the policy should be accepted.
- 4.6 With this in mind, the discussion document notes that while the costs of the obligations Telecom must undertake when determining the TSO charge are taken into account, the benefits are not. Therefore, as the discussion document notes, *'the large surpluses Telecom makes for many urban areas do not go to offset the unprofitable customers in remote rural areas'*.
- 4.7 The main question in the discussion document asks *'Do you consider the current TSO methodology for calculating TSO charges for local service over-compensates Telecom?'*. We do not believe this is the correct question to ask. Instead, the question should be *'In terms of public policy settings, should the main costs and benefits of the current TSO methodology for calculating TSO charges be taken into account?'*. On balance, we believe they should.

Transparency & accounting

- 4.8 Regarding transparency and accounting examined in paragraphs 39 to 42 of the discussion document, transparency of actions and information are also fundamental aspects of good public policy.
- 4.9 Again, the question asked in the discussion on this issue is off the mark. Instead, of *'Do you consider public disclosure by Telecom at a customer cluster level to be adequate'*, it should instead be *'Do you believe there should be a higher degree of transparency regarding customer clusters that are non-viable?'*
- 4.10 Ambiguity regarding such issues has led to problems in the past. One example within the sector involved the number of new wholesale customers through other providers Telecom was supposed to achieve by a certain timeframe during the Local Loop Unbundling process from 2003-2006. At the time, there was disagreement between Telecom and the Government about what one-third of connections wholesaled through other providers was, which led to Telecom believing their objectives had been met, while the Government

thought otherwise. Therefore, clear and unambiguous definitions need to be included.

Recommendation: That any changes to the TSO take into account issues regarding primary costs and benefits, transparency and accountability as part of good public policy.

5. TSO DETERMINATION PROCESS

- 5.1 Paragraphs 47-53 of the discussion document outline a new TSO determination process. As paragraph 50 points out *‘a dynamic process is proposed where a TSO charge calculation is only made at the request of Telecom, who should only have an incentive to request such a calculation when it considers it has an arguable case’*.
- 5.2 As discussed above, Business New Zealand believes a first principles approach should first be taken into account. However, if the proposals outlined in the discussion document were to proceed, broadly speaking, we would support moves to leave the decision as to whether such charge determinations are to be made up to the industry as opposed to an automatic requirement by the Government.

6. TELECOMMUNICATIONS DEVELOPMENT LEVY

- 6.1 The last section of the discussion document outlines the introduction of a new industry levy (the TDL) supported by Government appropriations to source funding for subsidies for achieving the Government’s telecommunications objectives. Simply put, the current TSO levy will be replaced by a new levy that is mainly used to fund rural broadband.
- 6.2 As paragraph 57 of the discussion document points out, the TDL would contribute funding for subsidising rural and other community telecommunications facilities, with revenue collected disbursed for the purposes of:
- Paying TSO charges;
 - Making grants to improve the emergency call service system; and
 - Making grants for the deployment of rural telecommunications infrastructure.
- 6.3 In terms of the impact on the telecommunications industry, section 3.5 of the discussion document rightly points out that the financial impact across the major players will be diverse. Telecom would most probably be worse off while for other players the impact could be expected to be neutral or financially favourable, depending on the amount recovered through the new levy. However, the full and final costs to any provider will be dependant on the allocation of the tenders for the RBI, which are fully contestable.
- 6.4 The primary question asked in the discussion document is whether *‘the process outlined for applying the new industry levy is feasible?’*. As is often the case, views on how successful the new levy will be will depend on further details to be provided. Therefore, this question is best answered by the

companies themselves who will be in a better position to understand how successful or otherwise the proposed process will be for them.

- 6.5 Although paragraphs 54-56 provide a short background into the options and principles used to ensure the Government's telecommunications objectives are met, Business New Zealand is again disappointed that there has been no attempt by the Government to provide an alternative approach to funding in terms of the \$300m primarily required for rural broadband development, such as simply allocating the funds from general taxation.
- 6.6 On the demand side, extracting public funds to subsidise rural broadband development is a policy decision made by the Government. However, in terms of implementation it is really a matter of working out the best method of collecting the funding. Basic principles of taxation should therefore apply. By far the most efficient method of collecting tax is when the tax is across the broadest possible base of payers and is a relatively low amount so as to minimise any associated compliance issues. In this regard, funding of the subsidies from general taxation would be far more efficient and less distorting to the ICT sector.
- 6.7 On the supply side, a first principles approach as to whether the injection of funds into rural broadband is required to begin with would have been the place to start from a standard public policy point of view. Developing a clear policy problem definition would have been a very useful first step. For example, in what areas of New Zealand are businesses or households currently unable to purchase commercial broadband services? How many households and businesses are involved and where precisely are they? After such questions have been answered, then a policy remedy for any significant identified problem should be developed.
- 6.8 Principles of economic efficiency usually try to associate the costs of an initiative with those who benefit from the initiative. In the case of subsidies for rural broadband the most likely beneficiaries are rural telecommunications users. The uniform regulated (TSO-KSO) retail prices already charged to these users already masks the costs for some rural users and amounts to a hidden subsidy by largely urban consumers and businesses.
- 6.9 To exacerbate this by applying another direct (albeit transparent) TDL subsidy paid for by largely urban and business users (via the telecommunications industry) appears unlikely to result in an efficient allocation of resources or to assist with greater productivity growth.
- 6.10 However, it appears to be a *fait accompli* since the Government has already announced \$300m will be allocated to the RBI.
- 6.11 We note that the Government's recently released infrastructure document entitled '*Infrastructure: Facts and Issues, Towards the First National Infrastructure Plan*' has asked as one of its consultation questions whether for each infrastructure sector, it is possible or desirable to define the service level New Zealand should aspire to. If so, what should the service level be and why? Our response was that some sort of sectoral-based service levels are

inevitable in order for the Infrastructure Plan to provide a meaningful contribution to the public policy landscape.

- 6.12 In short, it is important to measure in value-for-money or net-public benefit terms the contribution that proposals aimed at achieving particular goals will make. Without this, it will be extremely difficult to determine whether the proposals are making a tangible difference in achieving the meta-goal(s). Therefore, we would expect both the \$300m earmarked for the RBI, as well as the much larger \$1.5b ultra-fast broadband initiative, to adhere to the aspirations outlined in the Infrastructure Plan.

Recommendation: That the RBI be reviewed by December 2015 to assess value for money and overall effectiveness in terms of achieving public policy goals such as raising productivity and improving broadband take-up and usage.

7. REVIEW BY 2015

- 7.1 The last issue we would like to raise is that one of the problems with the existing TSO and the obligations associated with it has been the amount of time the current policy settings have been allowed to continue without any type of formal review after, say, 3-5 years. Given those obligations are associated with a sector that experiences some of the most rapid advances in technology that can significantly change the playing field for both players and consumers, participants in the market should have some form of assurance that for the future a similar problem will not be allowed to develop.
- 7.2 Therefore, Business New Zealand requests that the Government undertake another formal review before the end of 2015 to ensure policy settings remain current and do not act as an impediment to the introduction of new technology or to economic growth in general.

Recommendation: That a formal review of the TSO and Kiwi Share is conducted no later than 31 December 2015 to ascertain whether those policies are promoting economic growth and higher productivity.

APPENDIX

8. Background Information on Business New Zealand

- 8.1 Business New Zealand is New Zealand's largest business advocacy organisation.
- 8.2 Through its four founding member organisations – EMA Northern, EMA Central, Canterbury Employers' Chamber of Commerce and the Otago-Southland Employers' Association – and 70 affiliated trade and industry associations, Business NZ represents the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.
- 8.3 In addition to advocacy on behalf of enterprise, Business NZ contributes to Governmental and tripartite working parties and international bodies including the International Labour Organisation, the International Organisation of Employers and the Business and Industry Advisory Council to the Organisation for Economic Cooperation and Development.