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Swan's next $10 billion problem

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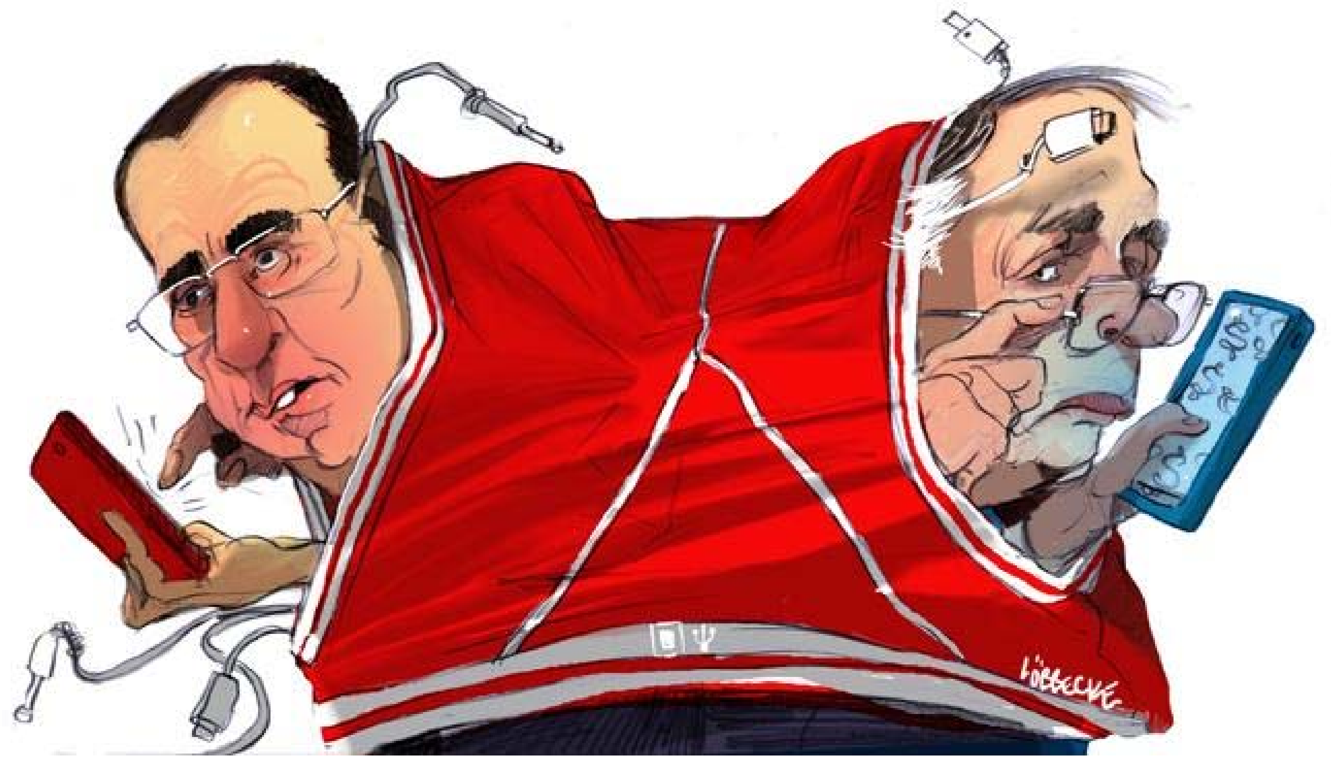

Illustration: Eric Lobbecke Source: The Australian

WAYNE Swan's woes are even worse than they seem. For the National Broadband Network has blown an additional $10 billion hole in Labor's next budget.

Here's how. Until now, the government has claimed the NBN will fully recover its costs. Every dollar the government gave NBN Co would therefore be matched by a dollar of future income. And additional liabilities would be matched by additional assets. Under the public sector accounting rules that meant outlays on the NBN only appeared in the budget as a cash purchase of equity.

However, NBN Co's latest financial report, along with information just published in this paper and in The Australian Financial Review, confirms NBN costs are far higher than initially claimed, while its roll-out is way behind schedule. Combined, the higher upfront costs and slower roll-out mean that cost recovery is completely implausible. With a massive loss now more likely than not, the public sector accounting rules require it be brought to book in the 2013-14 budget and in the Pre-Election Economic and Fiscal Outlook.

The NBN's problems are easily demonstrated. While little data has been released on NBN Co's costs, they are known to be 140 to 190 per cent above projections. As for roll-out, Julia Gillard promised in December 2010 that by June 2013 the fibre network would be available to 1.3 million premises, and in service at over half a million. But as of the end December 2012 only 10,400 households were connected, 98 per cent fewer than Gillard had promised. And both cost blowouts and delays are certain to worsen as the process of forcing customers to shift from copper to fibre gets under way in 2014.

Given the delays, revenues will grow more slowly than claimed in the NBN business case. Already operating revenues are a trivial $6 million, barely 5 per cent of the December 2010 projections, while outlays will reach $7.6 billion by the time of the election.

So, far from moving towards commercial viability, the project is accumulating a crippling burden of losses.

Originally, NBN Co argued those losses would be overcome through strong revenue growth. As Telstra demonstrated in analysis it presented to the Australian Competition and Consumer Commission (which last week rejected NBN Co's proposed pricing plan), those claims assumed the average consumer's real monthly payments to NBN Co would rise from $28 in 2012-13 to $145 (in inflation-adjusted terms) by 2027-28.

But there is no precedent for such enormous increases in consumer payments for fixed network services. Rather, as the OECD recently found, even though line speeds in the advanced economies have been rising by 15 to 20 per cent annually, consumer outlays per line have decreased, in real terms, by 2 to 5 per cent a year. And in Australia, the revenue received by fixed network providers per broadband service has fallen by over 10 per cent in real terms since the end of 2008, despite speeds more than doubling and download limits increasing tenfold.

That Australia would buck the international trend seems unlikely. But even if average payments rose as consumers opt for higher speeds, there is no prospect of an increase sufficient to cover NBN Co's costs. Rather, faced with prices for very high speed services that reflected those costs, consumers would remain longer on the 12 and 25 megabit per second services (whose prices NBN Co is required to reduce in real terms) and/or shift to wireless, which even NBN Co recognises will soon offer reliable high-speed service in most areas.

How large are NBN Co's losses likely to be? A conservative estimate, based on a model Alex Robson and I developed in 2009 (and which has consistently proven more reliable than the government's own claims), suggests a loss of $9.6bn to $18.3bn, equivalent to between 30c and 55c for each dollar of investment required to meet the government's commitments.

Of course, a project that does not fully recover its costs could still be worthwhile. However, taxpayers must be able to assess whether the loss is indeed worth bearing. On that score, the public sector accounting standards, under which the budget papers are prepared, are unambiguous.

They require that once it becomes probable that a government investment in a cash-generating asset (such as the NBN) will earn a return below its cost of capital, the full amount of the expected loss must be recognised in the fiscal balance. In other words, there must be prompt transparency about the loss, exactly as would be required for a private sector entity.

For instance, International Public Sector Accounting Standard 26 requires that when it becomes reasonably likely that the future income stream from an asset will fail to provide "a pre-tax return that reflects current assessments of risk", the net present value of the expected shortfall is to be "recognised immediately in the statement of financial performance."

NBN Co's likely loss must therefore be brought to book. And that must happen now. Directors of a listed company who failed to do so would go to jail.

Unfortunately, Swan and Finance Minister Penny Wong (who signs off on NBN Co's accounts) face no such risk.

That is one reason we have the PEFO, issued under the personal responsibility of the heads of Treasury and Finance. Their 2010 effort hardly covered them in glory. Whether they do better this year will be closely watched.

As for Swan and Wong, if they choose to flout accounting rules, they would not only be ignoring their obligations to taxpayers. They would also make it more difficult for Labor, once it is in opposition, to ever hold future governments to account. And that might prove the greatest loss of all.