

Universal Service Obligation

Department for Digital, Culture, Media and Sport

RPC rating: fit for purpose

The impact assessment (IA) is now fit for purpose as a result of the Department's response to the RPC's initial review notice. As first submitted, the IA was not fit for purpose.

Description of proposal

The Digital Economy Act 2017 included enabling powers to introduce a broadband universal service obligation (USO) of at least 10 megabits per second (Mbps). The proposal concerns the specifications for such a USO, to be set out in secondary legislation.

The policy will provide faster broadband for homes and businesses in the 'hardest to reach' parts of the UK. The proposal allows individuals and businesses the right to request a broadband speed of at least 10 Mbps and places an obligation on universal service providers (USPs) to meet this request, providing they can do so within a reasonable cost threshold of £3,400 per premise.

The Department has considered a range of options on speed requirements. The preferred option is for a requirement of 10 Mbps downloads and 1 Mbps uploads.

Impacts of proposal

Costs

Costs have been estimated using a model built by Analysys Mason, commissioned by Ofcom for their December 2016 report 'Estimating the cost of a broadband Universal Service Obligation'. The model uses postcode level data on premises and produces estimates of the total deployment costs using a range of different eligible technologies. From this, it can estimate the existing speeds and what needs to be done to add the new infrastructure. The Department assumes a take-up of 80 per cent, based upon the long-term level of take-up of broadband services in the past. On this basis and using a maximum cost threshold of £3,400 per premise, it estimates that the preferred option would cost USPs £1.02 billion in present value terms, across the 17-year appraisal period. This is a direct cost to business that is

included in the calculation of the equivalent annual net direct cost to business (EANDCB).

Benefits

The Department estimates that the measure will provide a benefit to business of £3.51 billion in gross value added (GVA) terms. The Department refers to a report and model produced by consultancy firm SQW, as a basis for this estimation. The model itself incorporates explicit links between the projected broadband speeds available, the projected speeds used, and their projected net impacts. The Department explains that the assumptions within the model have been updated since publication of the SQW report, to reflect information gathered during its consultation with business. A breakdown of the £3.51 billion is not provided within the IA, but the Department explains that the aggregate figure for monetised benefits is likely to include increased teleworker productivity, enterprise productivity growth, local enterprise growth and increased participation in the labour market.

The Department also acknowledges that some of the estimated benefits to business are indirect, for example in activities relating to generating new sales, accessing new customers/markets and exporting goods & services. These impacts are indirect as they are 'second round effects'. To distinguish the direct benefits from the indirect, the Department makes use of a survey that relates to a similar policy, 'BDUK connection voucher scheme', which asked businesses how faster internet had improved their productivity. The Department uses the results of this survey as a basis for treating around 40 per cent of the £3.51 billion benefit to business as a direct impact to be included in the EANDCB.

Quality of submission

Estimation of counterfactual and of number of businesses affected

As originally submitted, the IA stated that the counterfactual chosen by the Department – of zero growth in the number of relevant premises that would receive broadband in the absence of the policy – represented a significant underestimate of the counterfactual growth in light of technological and market developments. It has now explained more clearly why it expects the counterfactual growth to be very small, and why it feels that a counterfactual of zero growth is appropriate. It has also drawn attention to the sensitivity analysis it has conducted, which suggests that the

overall assessment of costs and benefits is relatively insensitive to the counterfactual growth rate. The RPC accepts the department's assurances but notes that it is necessary to make some assessment of counterfactual growth even when the future is very uncertain.

Deriving Costs

Although the IA extensively references the Analysys Mason report, the estimated £1.02 billion cost is not drawn directly from the published report. The Department has updated the information and assumptions used within the model, to provide a more up to date estimate. The IA provides information on some of the key features of the complex bottom-up model, including some examples of the different types of infrastructure and their unit costs. The Department has not, however, provided a precise breakdown of the £1.02 billion, or of the number of businesses that will be affected, due to the complexity of the model and uncertainties around the providers that will be responsible for the roll-out of superfast broadband.

The IA would benefit from providing a more comprehensive breakdown of the costs, though the RPC recognises the difficulties arising from the complexity of the model.

Estimation of benefits

Following the RPC's initial review notice, the Department had – as the RPC suggested – adjusted its calculations to treat only profits as direct benefits to business, rather than gross value added (GVA). On further consideration of the revised assessment, the RPC notes that different elements of the expected benefits (some of which will be direct, and some indirect) are likely to require different treatment in this respect, and that some aspects of the treatment of these impacts may depend on the choice of metric for the Business Impact Target under the better regulation framework for the current Parliament. The RPC acknowledges this complexity and can agree that the present IA is fit for purpose, on the condition that the Department submits a revised assessment for final validation once the appropriate treatment has been agreed.

Wider societal benefits

The Department has carried out a careful analysis of the wider impacts of the policy, drawing effectively on its consultation and describing in detail how improved connectivity leads to:

- Environmental benefits - relating to more opportunities for teleworking thus reducing carbon footprint
- More access to educational resources
- More economic activity – such as online shopping and wider marketability of suppliers in remote locations so they can market to wider audience
- Greater access to health and social services such as tele-medicine applications
- Access to employment for those who are physically impaired or find it difficult to attend work due to family commitments
- General wellbeing– improved overall quality of life such as connecting with distant family members, rural communities gaining access to more information on local events, and increased connectivity
- Increased community resilience – making it easier for individuals to live, work and interact in rural settings

Assumed take-up rate

The Department has assumed a take-up rate of 80% throughout the IA, based on past take-up of similar policies. There may, however, be some uncertainty around this assumption, due to the change of legal status for demanding broadband, and the positive network effects. The RPC finds this approach to be reasonable, as the Department has used the best available evidence; however, the IA would benefit from factoring changes in this variable into its sensitivity analysis around the number of premises affected by the policy.

Rationale for option choice

The IA now explains more clearly why its preferred option is appropriate although it has considered options with higher monetised net present values overall. The Department explain that the NPVs presented for alternate options do not fully account for the impacts of further delays on customers who have been waiting for broadband for some time already. The preferred option also allows a balance between meeting consumer needs and minimising cost to business and market distortion.

The RPC welcomes the sensitivity analysis conducted around several assumptions and in particular around the choice of “reasonable cost” thresholds, showing that the Department has considered a wide range of impacts at different levels.

Following the RPC’s initial review, the IA now provides justification for the higher optimism bias adjustment used in considering option 1 which was ‘10Mbps connection with zero upload specifications or quality conditions’. Although option 1 is the cheapest option, it is more reliant on newer technology, while the other options use technologies that are largely tried and tested.

Overall, the Department provides a good description of the costs and benefits, and a monetised assessment of a range of implementation options that is proportionate to the significant scale of the policy. Its calculations of the societal net present value and of the overall costs and benefits to business are fit for Parliamentary decision-making. Several additional tests including a small and micro business assessment (SaMBA), a rural-proofing test, and a competition assessment are presented; the RPC is pleased to see this consideration of a broad range of factors alongside the cost-benefit analysis.

The RPC is not yet able to confirm that the EANDCB as presented is fit for the Business Impact Target, given the uncertainties around the proper treatment of some benefits. Exceptionally, the RPC is, however, able to agree that this IA is fit for purpose at this stage, provided that the Department submits an updated IA once these uncertainties have been resolved.

The Department argues that the measure represents the minimum implementation of an EU Directive, the EU Universal Service Directive. However, the IA also states that the Directive gives member states the “flexibility to choose whether to also include broadband connectivity as part of universal service, according to their own national circumstances.” If relevant in the new BIT framework, the department will need to demonstrate that the measure is indeed a minimum requirement of the Directive and not a domestic policy choice.

Departmental assessment

Classification	Qualifying regulatory provision
Equivalent annual net direct cost to business (EANDCB)	£30.5 million Initial estimate (-£23.0m)
Business net present value	-£477 million Initial estimate (£365m)
Overall net present value	£2490 million

RPC assessment

Classification	To be determined once the framework rules for the current parliament have been set
Small and micro business assessment	Sufficient
RPC rating (of IA as initially submitted)	Not fit for purpose



Anthony Browne, Chairman