

# MERCATUS ON POLICY

## Reforming the FCC's Low-Income Phone Subsidies

by Jerry Ellig



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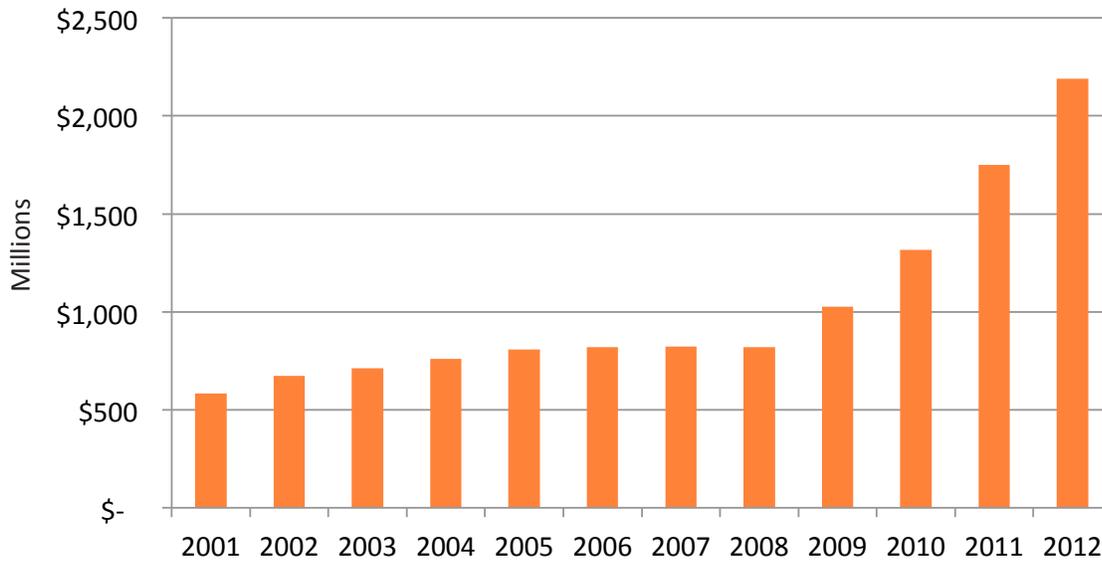
**T**HE FEDERAL COMMUNICATIONS Commission (FCC) subsidizes phone service for low-income households, funded by the universal service charge assessed on all consumers' phone bills. The cost of this program ballooned from \$819 million in 2008 to \$2.19 billion in 2012. Controlling costs while continuing to serve low-income households will likely require some combination of a reduction in the per-line subsidy, a program participation fee for all households, and a cap on the program's budget.

### THE FCC'S LOW-INCOME UNIVERSAL SERVICE PROGRAM

Historically, the FCC's Universal Service Fund has paid for two programs that subsidize telephone service for low-income households. Lifeline, the larger program, pays phone companies to reduce monthly subscription fees for low-income households by an average of \$9.25 per month, with some states providing additional funding.<sup>1</sup> Link Up subsidizes one-time connection charges by up to \$30.<sup>2</sup> In 2012, the FCC voted to phase out Link Up.

General federal tax revenues do not fund these subsidies. Instead, the FCC assesses a "contribution factor" on phone companies' interstate and international revenues. Though not called a tax, the contribution factor acts like a percentage tax on wired and wireless phone companies' revenues. Phone companies generally break out universal service charges as a separate line item on customers' bills. In 2012, the contribution factor averaged approximately 17 percent.<sup>3</sup> If the cost of any universal service program changes substantially, the FCC adjusts the contribution factor, and the size of the universal service charge on phone bills changes.

FIGURE 1: FCC LOW-INCOME PHONE SUBSIDY COSTS



Source: 2001–11 data are from Federal-State Joint Board on Universal Service, Universal Service Monitoring Report, CC Docket No. 98-202 (2012), 1-19. 2012 figure is from Testimony of Billy Jack Gregg, Universal Consulting, before the Subcommittee on Communications and Technology, US House Committee on Energy and Commerce (April 25, 2013), 3.

As Figure 1 shows, low-income phone subsidies have more than doubled since 2008, rising from \$819 million in 2008 to \$2.19 billion in 2012.

## WHY LOW-INCOME PHONE ASSISTANCE GREW

The total cost of the low-income universal service programs grew for four main reasons: (1) the recession created more eligible households, (2) wireless carriers brought in new low-income subscribers, (3) waste, fraud, and abuse inflated costs, and (4) absence of a budget-cap–delayed prioritization.

### 1. The recession created more eligible households.

Figure 2 compares the number of Lifeline subscribers and Link Up beneficiaries with the number of participants in the Agriculture Department’s Supplemental Nutrition Assistance Program (SNAP) during the past decade. They follow roughly the same pattern, with a pronounced upward trend starting after the recession of 2008. The number of SNAP beneficiaries appears to increase at a more rapid rate than Lifeline and Link Up beneficiaries because each member of a

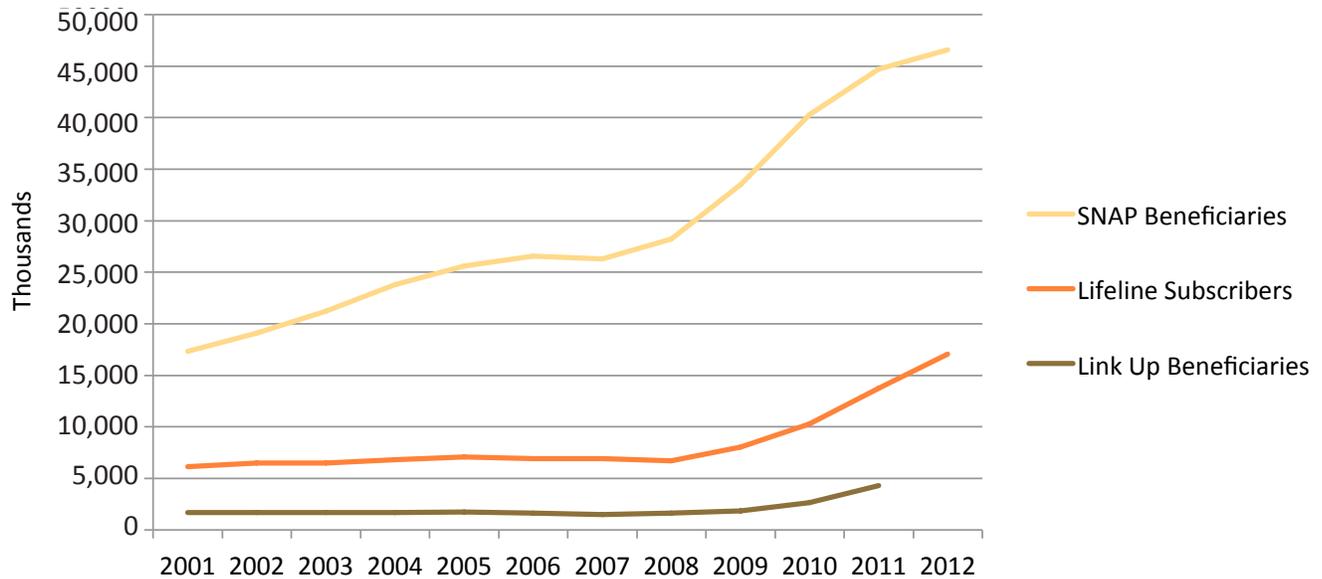
household is counted as a SNAP beneficiary, whereas Lifeline and Link Up are supposed to be limited to one subsidy per household.

### 2. Expansion of the low-income program to new types of wireless carriers brought in new subscribers.

The FCC first authorized low-income subsidies in 2005 for “non-facilities-based” wireless carriers.<sup>4</sup> (Non-facilities-based wireless carriers are wireless companies that lease capacity on the major carriers’ networks instead of building their own.) In 2005, incumbent wireline phone companies received \$735 million in low-income subsidies, and competitive carriers (both wireless and wireline) received \$68 million. By 2011, the competitive carriers’ subsidies had grown more than 18-fold, to \$1.2 billion, while the wireline incumbents’ subsidies fell to \$558 million.

Part of this change reflects the general consumer shift from wired to wireless phones in recent years. But it also reflects the fact that low-income wireless service with a basic package of minutes is usually free to the subscriber, rather than just discounted. Faced with a choice between free wireless service or discounted wireline service, many low-income households quite sensibly pick the free service.

FIGURE 2: LIFELINE SUBSCRIBERS, LINK UP BENEFICIARIES, AND SNAP BENEFICIARIES



Source: Lifeline and Link Up 2001–11 data are from Federal-State Joint Board on Universal Service, *Universal Service Monitoring Report*, CC Docket No. 98-202 (2012), 2-4. Lifeline figure for 2012 is from Testimony of Billy Jack Gregg, Universal Consulting, before the Subcommittee on Communications and Technology, U.S. House Committee on Energy and Commerce (April 25, 2013). 7. SNAP data from from U.S. Department of Agriculture, "Supplemental Nutrition Assistance Program Participation and Costs (Data as of May 10, 2013), <http://www.fns.usda.gov/pd/SNAPsummary.htm>.

These are the so-called Obama phones that became famous during the 2012 election campaign. They actually stem from a 2005 FCC decision modifying a program created in 1985.

**3. Waste, fraud, and abuse-inflated costs.** Prior to 2013, some households received more than one subsidized telephone line, signed up for Lifeline even though they were not eligible, or remained in Lifeline even though they were no longer eligible. FCC audits revealed 1.5 million duplicate subscriptions costing \$180 million annually. Carriers sometimes received subsidy payments for subscribers who did not actually use the service. In 2012, the FCC terminated \$30 million worth of subsidies for more than 275,000 Lifeline subscribers who were not using their phones.<sup>5</sup>

**4. Absence of a budget cap/delayed prioritization.** In addition to the low-income programs, the FCC's universal service fund subsidizes telecommunications and broadband in high-cost areas, telecommunications for rural health care facilities, and Internet service for schools and libraries. Each of these other components

has a maximum budget cap, which forces the FCC to prioritize expenditures. The low-income programs do not have a cap.

### RECENT FCC REFORMS

Recognizing some of these realities, the FCC in 2011 and 2012 adopted reforms to the low-income programs. The reforms clarified that each household can receive only one subsidy and established processes to eliminate duplicative subsidies.<sup>6</sup> Phone companies must check eligibility of new Lifeline subscribers against social services databases or review documentation provided by the customer, and then customers must annually recertify that they are still eligible.<sup>7</sup> The FCC also adopted performance measures to track both the program's achievements (subscriber rates among eligible households vs. subscriber rates among households in the next-highest income bracket) and its burden (Lifeline expenditures per US household).<sup>8</sup> The FCC eliminated Link Up subsidies on non-tribal lands because many carriers have demonstrated that they will provide service to low-income consumers without charging a connection fee.<sup>9</sup>

These reforms helped reduce the number of Lifeline

subscribers from a high of 18.2 million in August 2012 to 13.2 million in April 2013. The FCC expects the reforms to save \$2 billion through 2014.<sup>10</sup>

## FURTHER PROPOSED REFORMS

**1. Preclude non-facilities-based wireless companies from receiving lifeline subsidies.** This proposal would likely preclude the most efficient providers from offering Lifeline service. They usually offer basic service at no charge to the subscriber, whereas landline Lifeline service is only discounted (even though both receive the same subsidy). If one company receiving the subsidy can afford to offer basic service at no charge, while another company receiving the same subsidy only offers a discount, then the company offering the service at no charge presumably has lower costs. Keeping wireless providers in the Lifeline program would help the program continue to serve low-income households at lower cost, as long as household eligibility is adequately verified and subsidies are truly limited to one per household.

**2. Reconsider the amount of support per line.** The Lifeline program was intended to spare low-income households from fixed monthly rate increases that occurred when the FCC implemented the monthly Subscriber Line Charge in the wake of the 1985 AT&T breakup.<sup>11</sup> Its purpose was to provide a discount on monthly bills, not free telephone service.

Competition seems to have revealed a lower-cost alternative for basic service—inexpensive wireless phones using 2G/3G spectrum. Since Lifeline’s original purpose was discounted service, not free service, it may be appropriate to reduce the subsidy for Lifeline households.

**3. Make Lifeline voluntary where competition exists.** The FCC required wireline phone companies to offer Lifeline in 1985, when most consumers could only get affordable phone service from their local phone companies. Now that lower-cost alternatives exist, there is no need to require wireline phone companies to offer Lifeline service everywhere. Instead, the FCC should allow wireline phone companies to opt out of Lifeline where competitive alternative Lifeline providers exist.

**4. Impose a participation fee.** This proposal could be complementary to reducing the amount of the Lifeline subsidy. A participation fee would ensure that all Lifeline subscribers pay something for phone service, and it would compensate carriers for revenue lost due to the reduced subsidy.

Some have proposed a participation fee only for wireless Lifeline customers. This would place an artificial handicap on the lowest-cost competitors.

**5. Cap the Lifeline budget.** This would treat Lifeline like all the other universal service programs. It would help accomplish FCC’s goal of balancing intended benefits against costs created by high USF assessments.

**6. Transform Lifeline into a voucher program.** Under the current Lifeline program, phone companies sign up eligible subscribers. A better idea would be to give the purchasing power directly to eligible households in the form of a monthly voucher that they could spend on phone service with any provider willing to accept the voucher. This would make it more difficult for households to obtain duplicate subscriptions, since a household could not obtain Lifeline service from a phone company unless the household had already demonstrated its eligibility to the government entity providing the subsidy.

Whether this approach would lead to less fraud and abuse than requiring phone companies to verify eligibility by consulting a government database is ultimately an empirical question. At a minimum, individual states could be given the flexibility to convert their Lifeline programs to a voucher program. The incidents of fraud and abuse in voucher states could then be compared with the incidence in states that stick with the current program.

## CONCLUSION

Wireless carriers specializing in Lifeline service have dramatically reduced the cost of providing basic phone service. This means it should be possible to serve the same number of subscribers at lower cost, or a larger number of subscribers at the same cost. The universal service reforms most consistent with this reality

are those that would reduce the per-line subsidy, make Lifeline voluntary where competitive alternatives exist, impose an equal participation fee on all subscribers, and cap the budget for Lifeline service. Converting the program to a voucher program also has the potential to eliminate duplicate subscriptions; allowing individual states to experiment with Lifeline vouchers would help determine whether this approach leads to less fraud and abuse.

## ENDNOTES

1. Federal Communications Commission (FCC), *In the Matter of Lifeline and Linkup Reform and Modernization, Report and Order and Further Notice of Proposed Rulemaking* (Jan. 31, 2012), para. 14. Residents of tribal lands can receive an additional discount of up to \$25/month. *Ibid.*
2. FCC, *Lifeline and Linkup Reform*, para. 14. Residents of tribal lands can receive an additional discount of up to \$70. *Ibid.*
3. Federal-State Joint Board on Universal Service, *Universal Service Monitoring Report*, CC Docket No. 98-202 (2012), 1–18.
4. FCC, *Lifeline and Linkup Reform*, para 21.
5. Statement of Julie A. Veach, Chief, Wireline Competition Bureau, before the Subcommittee on Communications and Technology, US House Committee on Energy and Commerce (April 25, 2013), 4-5.
6. FCC, *Lifeline and Linkup Reform*, paras. 69–90; 179–225.
7. *Ibid.*, paras. 60–68; 91–148.
8. *Ibid.*, paras. 24–43.
9. *Ibid.*, paras. 240–53.
10. Statement of Julie A. Veach, 3. Chief, Wireline Competition Bureau, before the Subcommittee on Communications and Technology, US House Committee on Energy and Commerce (April 25, 2013), 3.
11. Robert W. Crandall and Leonard Waverman, *Who Pays for Universal Service?* (Washington, DC: Brookings Institution, 2000), 9.

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