

THE FCC SHOULD IMPOSE A CAP ON THE UNIVERSAL SERVICE FUND

BRENT SKORUP

Senior Research Fellow, Fourth Branch Project, Mercatus Center at George Mason University

Notice of Proposed Rulemaking
Federal Communications Commission
Comment Period Opens: June 13, 2019
Comment Period Closes: August 26, 2019
Comment Submitted: August 26, 2019
WC Docket No. 06-122; FCC 19-46

Thank you for the opportunity to comment on this proceeding. The Fourth Branch project of the Mercatus Center at George Mason University is dedicated to advancing knowledge about the effects of regulation on society, commerce, and innovation. As part of its mission, the project conducts independent legal and economic analyses to assess agency rulemakings and proposals from the perspective of consumers and the public.

In response to the FCC's query, American consumers and taxpayers would benefit if the FCC would cap the Universal Service Fund (the Fund) expenditures and, perhaps, reduce its budget. The Fund has been growing despite an increasingly competitive telecommunications market and the Fund's failure to achieve its core purposes.

BACKGROUND

The Fund was created by Congress in the 1996 Telecommunications Act to subsidize and make telecommunications services broadly available.¹ Telecommunications operators are required by statute to contribute to the Fund, which they do by extracting fees from their subscribers. These fees are collected and disbursed by the Universal Service Administrative Company according to general principles set out by Congress and the FCC. Many of the problems with the Fund described in this comment result from this complicated and industry-specific structure and disbursement mechanisms. There are better ways to structure telecom subsidies. As economists Jerry Hausman and Howard Shelanski have said in a review of Fund objectives, "It is well established that targeted subsidies paid from general income tax revenues are often the most efficient way to fund specific activities."²

¹ 47 U.S.C. § 254 (2018).

² Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 33 (1999).

For more information, contact
Mercatus Outreach, 703-993-4930, mercatusoutreach@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Blvd., 4th Floor, Arlington, VA 22201

While many Fund problems are “baked in” by Congress, the FCC should reform the Fund in ways consistent with the Communications Act, including by capping the Fund to limit the fees extracted from consumers and by increasing scrutiny of Fund program disbursements. Along those lines, the FCC inquiry states,

We seek comment on establishing an annual combined USF cap. For example, should we set the overall cap at \$11.42 billion, which is the sum of the authorized budgets for the four universal service programs in 2018? Should we set it at a different amount? We seek comment on this proposal, as well as other methods for setting the appropriate level of an annual overall USF cap.³

The FCC should halt the growth of the Fund. At the very least, the Fund should be capped at the 2018 levels. Further, the FCC should consider reducing the amount that US residents must pay to sustain the Fund and its various programs and subprograms.

ANALYSIS

The Fund was intended to provide rural and low-income households “reasonably comparable” services at “reasonably comparable” prices.⁴ Members of Congress anticipated that there would be less—not more—need for FCC subsidies as telecom competition increased. At the time of passage of the Telecommunications Act and the creation of the Fund, for instance, the Congressional Budget Office (CBO) expected the cost of Fund programs to decrease over time.⁵ Senator Ted Stevens, in fact, noted during debate on the Telecommunications Act that CBO estimated that the cost of providing universal service would decline by billions of dollars after passage of the act.⁶

More than two decades later, it’s clear that Fund constituencies will fiercely resist any attempt to slow or reduce Fund exactions from consumers, despite CBO prognostications and drafters’ intent. Nevertheless, the FCC should seek to honor that intent by scrutinizing existing programs and reducing the cost of the Fund programs where competition provides pricing pressure.

Facilities-based telecommunications competition is far more prevalent than anticipated by lawmakers in the 1990s. The monopoly telecom networks are long gone. Before the Telecommunications Act, nearly every household had a single option for telecom services—their local phone company. Today, about 90 percent of households can receive telecom services, including voice and broadband, from five or six facilities-based providers⁷—something unimaginable at the

³ Notice of Proposed Rulemaking, 84 Fed. Reg. 27570, 27572 (June 13, 2019).

⁴ 47 U.S.C. § 254(b).

⁵ “The Committee expects that competition and new technologies will greatly reduce the actual cost of providing universal service over time, thus reducing or eliminating the need for universal service support mechanisms as actual costs drop to a level that is at or below the affordable rate for such service in an area. . . .” S. REP. NO. 104-23 (1995); H. R. REP. NO. 104-204, pt. 1, at 60 (1995); “Over time, CBO expects . . . the total amount of [USF] subsidies necessary would decline.” Arnold & Porter Legislative History, S. REP. NO. 104-104, at 60 (1995).

⁶ Said Senator Ted Stevens during debate on the act, “In fact, I find it interesting that the Congressional Budget Office has said that this bill will reduce the cost of universal service from the existing system by at least \$3 billion over the next five years.” 141 CONG. REC., S7,881 (1995); Arnold & Porter Legislative History, S. REP. NO. 104-104, at 210 (1995).

⁷ About 93 percent of census blocks have service from four or more wireless providers. FED. COMM’NS COMM’N, ANNUAL REPORT AND ANALYSIS OF COMPETITIVE MARKET CONDITIONS WITH RESPECT TO MOBILE WIRELESS, INCLUDING COMMERCIAL MOBILE SERVICES 52 CHART III.D.1, WT DKT. NO. 17-69 (2017). Nearly every household also has voice and broadband service offered by a telephone company or cable company.

drafting of the act. Continued funding either subsidizes incumbent operators at the cost of others or, when distributed widely, compels users to subsidize several providers in a market.

Fund deposits should be reduced and redirected at unserved areas because the current program appears ineffective at achieving its intended goals. Over the years, researchers, government auditors, and lawmakers have long criticized the Fund, a complex intercarrier subsidy program, for its distortionary financing,⁸ fraud,⁹ and lack of FCC oversight of disbursements.¹⁰ There is evidence that the programs, despite increasing in cost, are ineffective.

The E-Rate program, for instance, which subsidizes “ed tech” purchases at American schools and libraries, despite distributing tens of billions of dollars does not seem to have an appreciable effect on student achievement.¹¹ This negligible effect of ed tech spending is seen worldwide. Organisation for Economic Co-operation and Development (OECD) researchers, for instance, had similar findings when looking at international spending on technology in schools:¹²

The results . . . show no appreciable improvements in student achievement in reading, mathematics or science in the countries that had invested heavily in ICT [information and communication technology] for education. And perhaps the most disappointing finding of the report is that technology is of little help in bridging the skills divide between advantaged and disadvantaged students.

The ed tech subsidies from the Fund are, under the statute, supposed to be disbursed for spending on “economically reasonable” telecommunications services.¹³ Aside from this “economically reasonable” language, Congress provides little guidance on a limiting principle for the E-Rate program. A cap on the Fund would compel the agency to scrutinize this program. Without a constraint like a Fund cap, the E-Rate program will continue to run on virtual autopilot, while Fund fees continue to increase to fund ed tech services providing dubious educational benefits.

Similar scrutiny is needed for the high-cost program. The high-cost program’s effects on deployment have been modest. For instance, US carriers have received tens of billions of dollars of high-cost funds since passage of the Telecommunications Act, to increase phone penetration a

⁸ The FCC decided to levy the Universal Service Fund tax on long-distance services. The agency currently requires providers to contribute 24.4 percent of interstate and international telecommunications revenue. FED. COMM’NS COMM’N, THIRD QUARTER 2019 UNIVERSAL SERVICE CONTRIBUTION FACTOR, PUBLIC NOTICE, CC DOCKET No. 96-45 (June 12, 2019). This added fee “conflicts with established principles of public finance and welfare economics.” Hausman & Shelanski, *supra* note 2, at 21. The Tax Foundation estimates that the Universal Service Fund fees significantly depress consumer demand for wireless services. SCOTT MACKAY & JOSEPH HENCHMAN, WIRELESS TAX BURDENS RISE FOR THE SECOND STRAIGHT YEAR IN 2016 (2016).

⁹ Problems with the E-Rate Program: Waste, Fraud, and Abuse Concerns in the Wiring of Our Nation’s Schools to the Internet, Hearing before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce, 108th Cong. 2–7 (June 17, 2004). The hearing cites improper or fraudulent multimillion-dollar E-Rate payments in Chicago, San Francisco, New York City, Milwaukee, Houston, and Atlanta.

¹⁰ GOVERNMENT ACCOUNTABILITY OFFICE, GREATER INVOLVEMENT NEEDED BY FCC IN THE MANAGEMENT AND OVERSIGHT OF THE E-RATE PROGRAM (2005). The FCC Office of Inspector General in two separate reports found that the E-Rate program in recent years had an erroneous payment rate of around 13 to 14 percent, significantly larger than the 9 percent rate for all Universal Service Fund programs, and deemed it an “at risk” program. KENT R. NILSSON, SEMI-ANNUAL REPORT TO CONGRESS: APRIL 1, 2007 - SEPTEMBER 30, 2007 17 (September 2007); KENT R. NILSSON, SEMI-ANNUAL REPORT TO CONGRESS: OCTOBER 1, 2008 - MARCH 31, 2009 19 (March 2009).

¹¹ See BRENT SKORUP & RAYMOND RUSSELL, TECHNOLOGY IN SCHOOLS: WHAT DOES \$27 BILLION IN E-RATE SPENDING ACCOMPLISH? (2017) (summarizing the literature).

¹² ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, STUDENTS, COMPUTERS AND LEARNING: MAKING THE CONNECTION (2015).

¹³ 47 U.S.C. § 254(h).

mere 2.1 percent.¹⁴ Further, the high-cost fund appears to be serving fewer beneficiaries at higher cost. I find that in Montana, from 1999 to 2009, subsidized telephone operators lost one-third of their subscribers at the same time the operators received a 40 percent increase in high-cost support.¹⁵ Nearly half of Montana households (46.4 percent) were wireless only in 2016 for voice service, typically receiving voice and broadband services from unsubsidized carriers.¹⁶

If there are similar trends nationwide (falling numbers of beneficiaries and increased public spending), that would suggest an unreasonable and distorted funding of high-cost networks. A cap on the Fund would provide a needed limiting principle and compel the FCC to examine whether additional dollars are better spent on existing high-cost programs or on other programs and areas.

CONCLUSION

For 20 years, the FCC has administered the Fund and its various subprograms. The government audits and scholarly assessments of the Fund over the years have typically been critical. Distortionary financing, increasing costs, and occasional fraud are among the Fund's problems. Despite updates and reforms, there are alarming signals that the Fund is ineffective at its statutory aims. A cap on the program would be a good first step so that interprogram comparisons can more easily be made. In the long term, the FCC should consider larger reforms, including reduction of Fund fees and disbursements, which will take into account the significant changes in the marketplace since the creation of the Fund.

¹⁴ Phone penetration in 1996 was 93.9 percent; in 2018 it was 96.0 percent. FED. COMM'NS COMM'N, UNIVERSAL SERVICE MONITORING REPORT 47 (2018).

¹⁵ BRENT SKORUP, MONTANA SHOULD URGE SCRUTINY AND REFORM OF THE UNIVERSAL SERVICE FUND SUBSIDY PROGRAM 3 (2018).

¹⁶ Centers for Disease Control and Prevention, *National Health Interview Survey Early Release Program*, <https://www.cdc.gov/nchs/nhis/releases.htm> (last visited Aug. 23, 2019).