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New Directions in Universal Service and Intercarrier Compensation: Are There More Efficient, More Rational Ways Forward?

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P R O C E E D I N G S *

MS. TATE: I am thrilled to be back and to be talking about the titillating topic of universal service. With all the topics that are circulating around, I hope that this one doesn't get lost. We had made a tremendous amount of progress from the Joint Board's recommendations to actually move forward to some kind of consensus, at least among the four commissioners.

Now, with this historic injection of the stimulus spending, it will be interesting to see whether this topic of USF reform continues to be at the forefront.

It's amazing. \$7 billion sounded like a lot of money two years ago when I was on the Hill testifying about it. All of a sudden, almost every day that is overshadowed by the billions of dollars that we are reading about every day.

I don't think that makes it any less important that we continue to reform, not just the USF, but across government, especially the federal government. I am really thrilled that we are doing this panel today.

* This transcript has been edited for purposes of correcting obvious syntax, grammar, and punctuation errors, and eliminating redundancy. None of the meaning was changed in doing so. The editing assistance of FSF Research Assistant Tristan Hardy is gratefully acknowledged.

Obviously, we have heard about both the half-filled and the half-empty cup. As referenced on the previous panel, there are many places across America -- and I certainly am from one of those rural states -- that has a lot more of the empty glasses that we are hoping to fill.

However, I also want to put in a word for those public/private partnerships, like Connected Nation, which I know about because it happens to be in both Tennessee and Kentucky, and the huge increase that we've had in take rates, which you heard Congresswoman Blackburn mention in her remarks.

I am so glad that she joined us today, because I think that there are two topics that sometimes we forget about in this whole discussion about net neutrality and "reasonable network management." The first is piracy, which is very near and dear to both Congresswoman Blackburn's and my heart because it has not only a huge economic impact in Tennessee, but also across entire nation. Then, we have the issue of protecting our children online, something that I am still very involved with internationally.

I have been able to see, firsthand, the incredible opportunities that universal service brings,

coming all the way from the wire being rolled up to our farmhouse where my grandmother lived to the unbelievable opportunities at the FCC, from going to Alaska and Appalachia, and all the unbelievable opportunities that broadband and the Internet afford all of us.

At the same time, I also felt, as an official at the FCC, that it was important to be a good steward and that this was a fiduciary responsibility. That's why I was thrilled when the Chairman asked me to chair the Joint Board on universal service.

I want to thank the state members of the Joint Board who worked so hard. Many of you probably don't even know that at certain junctures along the way, when the federal staff really didn't have either the time or the inclination to be involved, that the state staff stepped up and was actually the one who drafted the formal recommendation. So I want to thank all of them as well.

I also wanted, just for a moment, to talk a little bit about some of what has been going on here in Washington. I was very interested that both Commissioner and now Chairman Copps and Commissioner McDowell have talked about reforming USF and that it continues to be at the forefront.

I am also thrilled that Chairman Copps is not just being a placeholder, but that he actually wants to do something about much of the backlog and much of what he considers to be those issues that we found consensus on. As I said before, this is one of those topics that had a consensus among four commissioners, three of whom are now the commissioners at the FCC. So, I hope that he will continue to push that forward.

With that said, I think that we will go ahead. I thought that the way we would set this up is to allow the academics to go first. Their bios are just extraordinary and I have had the opportunity to work with and call on them many times in the past. I am thrilled that they are here today.

So, with that, Professor Brock from George Washington University, if you will start. I think that Professor Brock is going to deal with intercarrier compensation, something that I didn't mention, but is integrally related to and a part of any type of USF reform.

MR. BROCK: Thank you. And on that last note, it is. But that has been one of our problems. The interrelated nature of intercarrier compensation, universal service, and the relative profitability of

various players in the telecommunication industry has all been one single knot. Many people, including Commissioner Tate and large numbers of people over the years, have attempted to untie that knot with no success.

In many ways, we are still dealing with issues that were first being created in the 1950s, expanded in the 1960s, and focused on as one of the fundamental issues of whether or not to bring any competition into the industry.

And my part of this is on the long-standing effort to get a more unified structure of intercarrier compensation. That has been a stated goal of the Commission for some time, but the agency has not been able to develop it in a politically-acceptable way.

In the way that it was structured, it really is not a feasible goal. To pick up a little bit on Christopher Yoo's comments from the previous session when he was emphasizing the complexity and variation in the different things people want, there are too many different kinds of services and different issues arising to have a single rule-based unified intercarrier compensation system.

On the other hand, our existing system is very

much broken. The access charges are fully obsolete, and the many variations that we have lead to a variety of problems.

My view is that the best way forward, which is easy to say and easy to justify, academically, but difficult to implement, politically, is to clearly separate the question of intercarrier compensation from the question of universal service subsidies.

Many of the problems have been because the access charges were constructed to incorporate subsidies. That was very explicit; no question that that was intended. Many of those have been reduced, but rural carriers continue to depend upon those.

I think we have more possibility of doing that now, in part, because of the broadband stimulus plan. And as wireline voice service becomes less significant in the overall mix, it may be possible to make that separation.

But in order to develop a rational intercarrier compensation plan, I think it is necessary to emphasize the economics of intercarrier compensation and treat universal service subsidies as a separate topic. I would like to see us build on the reciprocal compensation method that is currently used for

compensation among carriers within local areas.

There was some discussion at the time the 1996 act was passed about whether Congress had abolished access charges. That act did not explicitly mention access charges and preserve them nor did it abolish them. It just set up a new method.

Well, what's the difference between a reciprocal compensation and access charges? The FCC decided that, yes, there really is a difference. But, given largely distance insensitive transmission rates, there is no reason for there to be a difference. We have had a lot of experience with those. It's a method that seems to be basically working. That is, reciprocal compensation, starting with free market bargaining, and completed as necessary by arbitration before the state commissions.

The way I would like to see this moving in the future is to take that as a basic starting point, but then to expand it more broadly to all services, and to put it more in the context of guidelines and principles than of rules, because I don't think we can make rules that will fit all the different arrangements. So that the combination would be a presumption that people should be able to work out a reciprocal compensation

agreement, a starting point that results from free bargaining, and then a back-up of mandatory arbitration.

And the change that I would suggest we make is to try to move toward a system of industry arbitration. Now, I recognize there are all kinds of difficulties getting fair arrangements but I think the expertise of people who are actually involved in making these arrangements work can outweigh the difficulties.

I won't go into it now, but in the paper that is the basis for this I developed some economic theory on how to promote neutrality even among interested parties. That's a general interest of mine, the trade-off between expertise and neutrality. I think our government systems tend to emphasize neutrality at the expense of expertise and that is a balance that could be moved back a little bit differently.

So, I am advocating that we proceed forward. I recognize the difficult problem. I am hopeful, but not terribly confident, that the stimulus package provisions will simplify this by emphasizing rural broadband funded through a different method. We will have to see how we can make that work out.

MS. TATE: Thank you, Professor. John Mayo and I had the opportunity to participate in one of

Randy's forums last fall, right before I left the Commission. I'm thrilled to be back on the dais with him and he will speak more pointedly just about USF.

MR. MAYO: Deborah, thank you very much and thanks to Randy and The Free State Foundation for hosting this event.

I have been a student of the telecommunications industry for 25 years and it is an absolutely fascinating industry. It is an industry that is moving very rapidly and evolving very quickly. It's complex. Sometimes it's mind-numbing, especially when you start taking on issues like intercarrier compensation and universal service.

And it is an industry in which I have heard, over 25 years, any number of recommendations for policies that would reform any number of aspects of this industry, including universal service. Very often when I have heard those from either the ideological right or the ideological left, when they have come in the form of too simple a package, I have become really very skeptical of those packages because my sense is that simple solutions are likely to underplay the complexity of this industry.

So, as I put this chapter together that is

coming out in the book that Randy mentioned to you earlier and when I thought about preparing these remarks today, I realized that I am going to run headlong -- if you are like me -- into a skepticism. What I am about to say to you will be very, very simple, and very, very clear, and very, very straightforward. So, if you are like me, you might be very skeptical.

And so, what I want to do, just at the outset, is assure you that what I am about to say, among the academy and among economists that have studied this industry for 25 years, is absolutely not controversial at all. It is not driven by ideology on the left or the right, or any ideology, except insofar as you consider good economics to be an ideology.

So, with that caveat, what I am hoping to do is to suggest to you that, instead of skepticism, what we might do is begin to forge a consensus of a foundation of how to move forward with universal service reform, rather than just raw skepticism.

So, let me turn to the substance of my remarks. The chapter that I have written for this book is entitled, "Universal Service: Can We Do More With Less?" I am going to borrow shamelessly an answer to that question that is very, very popular these days:

"Yes, we can."

Yes, we can do more with less. You only need to consider Deborah's introductory remarks about the billions of dollars that get spent in this country on various things. To economists, dollars that get spent on things represent priorities. Today, it's become very easy, as you mentioned, to toss around numbers like hundreds of billions of dollars.

But it still is the case that \$7 billion amounts to something. Just to put this in perspective, we spend \$7 billion a year on universal service in this country. We spend a tiny fraction of that, \$900 million a year, on trade adjustment assistance, which is arguably our nation's frontline policy tool to retrain our workers that are displaced, as a result of globalization.

We spend \$7 billion a year on universal service and we spend \$1.5 billion a year on Job Corps, which is our nation's principal tool to enable disadvantaged youth to get into the workforce in a meaningful fashion. The money we spend on universal service is on the order of the entire federal expenditure on the Centers for Disease Control in this country.

Now, I don't think you need to have been a long-time student of universal service to come to the position that something is woefully incongruous about those numbers.

That incongruity compels two questions. The first question is, "Should we have a universal service policy?" And the second question would be, "If we are going to have a universal service policy and a necessary set of subsidies that go along with that, are there economic principles or guidelines that we can follow to do it right?"

Now, we've got a relatively short time, and I think we want to preserve time for Q&A, so I am going to skip that first question for the moment. It's an important question, but it becomes a bit academic at this point, because we have, on the books, a set of policy goals that are stated that says we are going to pursue a universal service policy.

Let me turn to the second of those issues, and that is, "What are the principles that we can use to forward our universal service policies?"

Let me suggest five principles for you and I think we can keep them all in our head. Number one, we need to establish clear goals to be accompanied or to be

accomplished by a universal service subsidies programs. Number two, we need to make the subsidies explicit and transparent. Number three, we need to collect the subsidies from the widest possible source. Number four, we need to target whatever subsidies we employ in a narrow manner to change economic behavior. And, finally, we need to design subsidies to relax the complementary binding constraints that might exist in the achievement of the universal service goals.

I won't go through each of those, but let me just put a little bit of meat on the bones of the first one just so that you know what I am saying, rather than just offering esoteric opinions and goals.

Consider that first goal to establish clear goals to be accomplished by a subsidy scheme. We don't have to think hard to look back at the pursuit of narrowband universal service to say we had a goal in this country of universal service of, first, making telephone service available, which morphed into a goal of making telephone service affordable and available, which morphed into a goal of making telephone service affordable, available, and adopted, which morphed into a goal of making telephone service available, adopted, affordable, and at the lowest possible cost, consistent

with our ability to extract subsidies from other services, which morphed into a policy goal of having telephone service available, adopted, affordable, at the lowest possible cost consistent with the ability to extract subsidies from other services, and for all competitive carriers in this country, however many there are.

I don't believe that if you look at the morphing of that goal, anybody would really be surprised that the budget for universal service ran away from them. It shouldn't be all that surprising. It's not a small wonder. Now, I am quite sure that policymakers did not intend for this to happen. However well meaning policymakers have been, they have violated every single one of these principles even though I've just mentioned the first.

So, where do we go from here? The first observation on the question is that we are at a very special moment in time where technology is allowing and consumers are compelling a turn to broadband and away from narrowband.

We have had a policy of narrowband universal service in this country that has now allowed for 95 percent of the American households to be subscribed to

telephone service. We have 270 million handsets that are deployed across this country. It's simply time to declare victory on that, and move on. We don't need to spend \$7 billion a year any more in the pursuit of that goal.

Second, as we turn to broadband, we need to keep in mind those goals that I just articulated as they apply to broadband. To repeat, number one, we need to make the goals of broadband very clear and explicit, accomplishable goals. Number two, we need to make the funding explicit and transparent. Number three, we need to fund any broadband subsidies from the widest possible source. Number four, we need to target any funds narrowly to change economic behavior. And, number five, we need to design broadband policies in a way that remove complementary constraints. That one may be a little bit obscure to you but it comes into focus a bit if you think about the ability of broadband subsidies to promote the goal, now adopted in the Broadband Data Availability Act, of broadband adoption in this country.

It doesn't matter how much money you throw at broadband if a household does not have a computer. So we need to allow for the fact that there are complementary constraints, like the lack of ownership of

computers.

In closing, let me just remind everybody that, in the last election cycle, then-Senator Obama, speaking about financial matters but it applies more generally, suggested that it would be a problem to try to impose 20th century regulation on 21st century problems.

Today, I think we stand at the precipice of allowing us to put 20th century regulation of narrowband universal service policies in the past and look clearly ahead to adopt a clean principle-based approach to reforming universal service. Thank you.

MS. TATE: Thank you, John. Robert Atkinson is our next panel member. At first, I should have read what the title of the session was. "New Directions in Universal Service And Intercarrier Compensation: Are There More Efficient, More Rational Ways Forward?" We should just say yes and go to lunch, and hear what Blair has to say.

Anyway, with that I want to welcome Rob, founder and president of the Information Technology & Innovation Foundation. I didn't realize that you had a background in Rhode Island, so we will have to discuss that some time if you don't hit it in your remarks.

MR. ATKINSON: Thank you, Deborah. It's nice

to be here. I want to echo somewhat what John said, although I don't know that I'm an academic. I'm a quasi-academic. I think the right way to put it is that I'm sort of between the academics and the companies.

To begin to think about this, there are four key questions. The first question is whether we want to have some sort of policy that responds to these market failures, i.e. USF. I would answer the question in the affirmative. We simply can't leave it up to market prices alone. This is a network economy and you will end up with under-investment.

The second question is how much. John talked about the \$7 billion. I would agree with John that we certainly should not increase that. Although, to be fair, some of that money is schools and libraries, it's not all going to rural phone lines -- some of it is lifeline and link-up -- but I do think that I agree with John. We can do more with less, and I think we need to be thinking about that.

The third question, then, is not just about how much money, but how we go about raising it. I think there we could do a better job as well. The current way we raise it is probably the most distortionary, through intercarrier compensation or through charging businesses

higher rates. It's clear that the most efficient way to raise it would be some sort of general fund subsidy that's broadly distributed, in terms of how it's done.

In reality, that's not going to happen. So the next question is, "What's the next best solution?" and that's where having broader funding, for example as the reform in the 1990s was, to move more of the charge to the subscriber line and move some of it away from intercarrier compensation. I think that's the right direction to go.

The other big distortion in here is how we spend the money, which is the last issue. Where do we spend it and how do we spend it? I think there are probably significant savings that could be done with regard to how the money is spent.

It's not clear to me that the industry structure of rural carriers is the most efficient that it could be. It's also not clear that if you encourage consolidation and drove your USF funds for unserved or under-served high-cost areas as an incentive to drive performance, that you wouldn't end up with a significantly different structure of carriers that would be lower cost and more efficient.

There is also an inherent unfairness to the

current structure, which is that you can have a line that has the same high cost to it, but it gets the subsidy if it's one kind of carrier, and if it's a different kind of carrier it doesn't get a subsidy, which I find makes absolutely no sense. Subsidies should be related not to the carrier, but to the actual cost of providing service.

So, I think a few general thoughts, and then I want to talk a little bit about broadband in particular. I think there are some specific things that we could do.

One proposal would be that we should have states pay more of the cost of the program. There are many states that have high-cost areas within them and then low-cost areas within them. It's not clear to me, when a big state doesn't have a much higher cost structure, why the federal government should be paying for all of that. Why can't states pick up more of the tab? I would argue that states need to be picking up more of the tab and you would reduce some of the distortions.

Another proposal would be to drive the system in a more performance-based way. If we are going to require the states to pick up more of the tab, we should have some of the funding contingent upon real

performance metrics. So, if states are making progress in getting more people on the telephone system or the broadband system, they should be getting rewarded for that. In other words, drive states to make the right decisions about how to make the system work, and don't just simply reward inefficiency, as we do all too often today.

Finally, I think users should pay more. It's clear that the reason for USF programs is because we don't want users to pay the full cost, because the full cost would be prohibitive and keep them off the network. But we certainly could have them pay more.

I remember when I did a universal service fund study a few years ago and I decided that I would do some research, which I would caveat as being very limited. But I did call up a bunch of rural phone companies, just to see. I said, "I'm thinking of moving there from Washington. What would I pay?" And in every single case, I would pay less than I paid in Bethesda, Maryland. It's not clear to me why their customers should get lower rates than I get in Bethesda, Maryland, when it costs more to provide service in those areas. So we should ask rural users or users in high-cost areas to foot a little bit more of the bill.

I want to talk about broadband. I think the time has come to include broadband in the universal service system. And when I say that, I mean we need to be thinking seriously about a national strategy of how we're going to get broadband to places that are simply high-cost, where the market is not going to be able to do that on its own.

We made a down payment in the stimulus. Although I have to say we need to put that in perspective and look at what the Swedes did when they had a recession in 2001. They invested \$32 billion, to put it on the same per-GDP basis, in their rural stimulus package out of general funds, mostly through tax credits that incumbents or new entrants could take.

The Irish government just committed \$23 billion to rural broadband, again, on a per-capita equivalency basis. So \$7.2 is a nice number, but we shouldn't kid ourselves. It's nowhere near the number that's going to need to do the job.

So, how do we do that? I think one way to do it would be to do it through some sort of reverse auction system. When we were preparing work for a transition team on some of this, it was pretty clear that if you think about an upward sloping cost curve,

the market will only provide service where the cost of providing the service intersects with that cost curve. And so there are all these other places that aren't provided with broadband service.

And if you just sort of pick a subsidy -- we're going to do 80 percent of the cost or 40 percent of the cost -- you will end up over-subsidizing the part of the cost curve already getting broadband and you still won't pick up some other places because they cost more than that subsidy.

I think the most efficient way to do that would be some sort of reverse auction where we let carriers bid on the particular geographic areas. The idea would be that they would bid on a one-time capital allocation, if you will. They would bid to get the capital subsidy to build the network and the operational costs would be borne by their own operating revenues. They may build that in and say, "We need to build those in to the initial auction."

The advantage is that we don't really know what technologies are going to be the least cost. As 4G rolls out, we have no idea if 4G may turn out to be this amazingly inexpensive technology to serve a lot of these areas. Or, it may be that other technologies could play

a really efficient role.

So, we should leave that up to the marketplace and what the policy should be is, "How do we get good service?" You'd have to have some definition of what good service is and essentially just let the marketplace figure out the best way and most efficient way to do that.

Two more points and then I'll stop. One is that I agree with John. I don't think we should fund competition. I certainly don't agree with funding competition in the stimulus package. It's very expensive to put a network in a high-cost area. Why you would want to put two in a high-cost area is beyond me.

There are so many places in this country that don't have connectivity. We can't afford to over-build in a few places or under-build, or build nothing, in other places. Some people say, "Well, gee, if you don't do that, you won't get price competition." The last I looked, carriers have regional plans.

So, we did a little study asking, "Is there broadband in the District of Columbia and Baltimore?" by looking at the poorest census tracts. What we found is that 100 percent of the houses that we looked at -- I think about 100 houses -- all had broadband. I don't

know if they subscribed. But every one of them could subscribe and they all paid the same price that I pay.

I think we have to recognize that putting two carriers in a rural area is not going to lower the price. The prices are set based on regional price plans. I think this whole notion that somehow competition is the Holy Grail here is simply misguided.

Lastly, I would ask if we even need to think about some sort of program to target people who are low income and who don't get on broadband. I think we simply don't know enough right now as to what that's all about. There have been some very interesting studies, like one out of LaGrange, Georgia, where they gave people free broadband and a lot of low-income people didn't take it.

We don't know enough yet, but we really need to spend time thinking that through. Clearly, technical assistance, digital literacy, and a lot of those other sort of social technologies have got to be a key part. We can't just assume that it's a money issue. It may be and probably is more complicated than that. So, thank you very much.

MS. TATE: Thank you. Just a footnote: we don't just fund 2 competitors; in some places we fund 15

or 20. I just wanted to make sure that we're all on the same page.

Jeff Campbell is the director, technology and communications policy, of worldwide government affairs for Cisco. I am excited because maybe he can bring a little light on the fact that we are also talking about educating our kids for the jobs of tomorrow and to keep our global competitiveness. So, I look forward to hearing your remarks.

MR. CAMPBELL: Great. Thank you, Commissioner. Instead of going through a mind-numbing discussion of intercarrier compensation and the insanity that reigns there, and the intricacies of universal service and the insanity that reigns there, I thought I would tell a story, or a story-and-a-half, and then try to draw a couple of conclusions.

Really, the story is just what I was doing Tuesday night. Now that I am entering middle age, I have to pay somebody to exercise my body, because it won't happen on its own.

(Laughter.)

MR. CAMPBELL: I was at my trainer's Tuesday night, and my trainer is a very earnest, nice young man. He's 22, he just graduated from the University of

Maryland, and he is both very fit and into the science of being fit. He looks at me and sort of shrugs and says, "Well, we'll do the best we can."

I've been working out with him for quite a while, so we chat about what I do a lot. So he's like, "What are you doing this week," and I mentioned a few things and I said I was coming to this conference to speak.

And he said, "Oh, are you going to come and destroy net neutrality like you usually do?" I said, "No, actually, I'm not on that panel." Because, like most 22-year-olds, he's a fervent believer in net neutrality, even though he doesn't know what it means.

(Laughter.)

MR. CAMPBELL: But I said, "No, I'm going to be talking about the universal service system," and he said, "The what?" And I said, "You know, the telephone subsidy system." He said, "Telephones are subsidized?" I said, "Yes, all the rural telephones are subsidized by all these items you pay on your phone bill." And he looks at me and he says, "Oh, no, I don't subsidize that." And I said, "Oh, yes, you do." And he said, "I don't have a phone."

I said, "Well, I hate to tell you but it's not

just on the landline phones. It's also on your cell phone, and you have a cell phone." And he says, "Yes, I've got this cell phone and maybe I guess I pay a little bit on it, but I really don't use it. I only use it to talk to my older clients, like you."

(Laughter.)

MR. CAMPBELL: So, at this point I am thoroughly dejected. And I said, "Well, surely you text." He said, "Yes, I text some, but basically, I talk to all of my friends on the Internet." And of course when he says "talk," he doesn't mean voice all the time, although some of it is voice and some of it is video. But a lot of it is typing, texting, and stuff like that.

This is the wave of the future. This is the way people are living today and are going to continue to live today. When we look at a universal service system that is all about having a black rotary phone in my grandparents' farm house in rural Pennsylvania, there is already a disconnect, and it's just going to get bigger and bigger and bigger.

Maybe we don't design the system for the 22-year-olds; we design them for the 78-year-olds, or" -- now I have to figure out how old my father is -- "the

73-year-olds." I have a little half-story to add. I get an e-mail from my Dad recently on where they're going and things like this. They're stopping at my brother's and they're ending up in Florida, where they spend the winter. And he ends with, "Oh, by the way, call on the cell. I've terminated the phone." So they are cutting loose their landlines as well, because Dad knows how to squeeze a penny. He's going to pay for the cell phone anyway and he's not going to pay for another phone at the same time.

So, I think that this is a multi-generational and a large shift in where the world is going. We can get the brilliant academics and the economists and stuff to tell us why this all matters. But I think, as someone on the prior panel said, we don't need to make the case anymore for why the world is now about broadband and how this is our future.

I want to pause at three notions about what we need to change about universal service. I recognize that going from where we are to what I'm about to suggest is not easily done and probably can never be done in a flash cut. But I think that if we don't start moving in that direction, we're never going to get there at the time when we need to be there.

The first thing that I would suggest is to make universal service be about broadband. It can no longer be about narrowband. Broadband is capable of delivering all the things that narrowband currently provides, but it provides so much more, not to mention it's what people want for the future. It is our economic future. It is our social future. And it's going to be everything else.

We should not focus and fixate what's happening in this dying narrowband world. We need to immediately transition part of the fund towards broadband. Then, we need a rational plan to migrate the entire thing off of narrowband and towards broadband. It's easy to say and it's extremely difficult to do, but if we don't start doing it, we will never do it.

The second point that I would make is that we have to fund infrastructure, rather than services. The universal service system is all focused on the cost of providing services and operates on an assumption of subsidies in perpetuity. Part of the reason why we're in the problem that we're in right now is that we have created an entire class of companies that are receiving these monies as an annuity, almost as a birthright, rather than saying, "We're providing you these monies to

provide an important public service and a particular way to do things."

That's how it started, but over time it has morphed into what it is today. And when there is an annuity out there, what happens? More people come to seek the annuity. Why not? People are giving out money. I want my fair share. I'm sure the people dealing with the stimulus package are going to have the exact same issue and challenge with this.

So, I think we have to switch from subsidizing services to subsidizing infrastructure. This matters on a couple of levels. The first is, serendipitously, as part of the stimulus package, we have \$7-odd billion going into broadband infrastructure right now, and it's going to be a great jumpstart for a change in our infrastructure, particularly in rural areas. We actually have some of what I would call "free money" that we can use to deal with this change.

Secondly, the bulk of the cost differential, along with the difficulty in providing these services in rural areas, is the cost of building the infrastructure. It's the size of the geography that you're dealing with and all the other challenges around there. If you take that out of the equation, the cost of operating a rural

broadband network is relatively close to being the same as urban or suburban areas.

The reason that it's so expensive or not economically efficient to do provide service in many rural areas is the construction costs and the deployment costs. If we find a subsidy system that provides the infrastructure, we have to think about infrastructure broadly. It can be telco fiber, cable, wireless, and in different areas, different technologies will be the most effective and efficient ways of providing the services.

But if we build the infrastructure at some level of subsidy without a future subsidy, we create a method by which we end this constant dependence on long-term service subsidies. And I think there are huge economic benefits to getting to that point if we can do it. As we transition to broadband, it's the perfect opportunity to do it.

My third point, and last idea, is that we have to get off the bugaboo that service has got to cost the same everywhere in the country. The irony is that, as Rob pointed out, it's often cheaper in rural areas, because of the subsidies, than it is in urban areas that aren't receiving the subsidies.

I think we have to recognize that it is not

unreasonable public policy to have more expensive broadband in rural areas than we might have in urban and suburban areas. We do not seem to have a huge problem with the fact that housing is dramatically more expensive in urban areas than rural areas. We don't have a problem with the fact that food in the grocery stores is a little more expensive in urban areas than it is in rural areas. I don't even know what the exact number is but it's probably on the order of 10, maybe 15 percent.

That kind of differential is just the cost of doing business in that location. There are huge numbers of markets where this is true. There are also huge numbers of other markets where it is more expensive in rural areas than urban areas and we don't run out to immediately subsidize it to make it the exact same cost. Telecommunications should be no different on this.

Now, we don't want to price it so high that nobody wants to come there. But if we're subsidizing the construction of the infrastructure, we ought to be able to ask the consumers of that service afterwards to bear the cost of operating the network that has been created with subsidized money. We have to recognize and get over the fact that, in many cases, this means that

broadband prices are going to be 10, 20, or 25 percent higher in rural areas than in other areas.

If there is an issue with people being able to afford service, that is better addressed through a lifeline/link-up type program that is targeted only at people who have the need, rather than just as a generic subsidy that's out there.

I think if we follow all three of these principles looking at reforming universal service, we can come to an end point which, admittedly, is going to be a number of years down the line, where we have universal availability of broadband in this country, as well as all the necessary forms of communications to people, that is conducted on a long-term financially stable method of dealing. Thank you.

MS. TATE: Thanks, Jeff. I am going to loan you and Rob my bullet-proof vest that I now no longer have to wear, in case you all go out to any rural telephone companies any time in the near future.

(Laughter.)

MS. TATE: Next is Steven Davis, the senior vice president of public policy at Qwest.

I want to take just a minute to thank Qwest, but thank many of you all in the audience, for the many

times that you came to our office -- and especially mine, when I challenged you to do so -- and didn't just come with, "Here is the problem," or, "Here is what we need from you," but you actually came with real world solutions. I think that's really important.

I hope that we might hear some of those solutions, whether they are pilot project ideas, or whatever. But I think that's important. Especially right now, I think you all have a historic opportunity to have a real impact on public policy, the new administration, the new FCC, with Congressman Boucher having his hearing -- I guess that's in the next week or so. So, I think that this is a great time to bring forward real world concepts and ideas. Thank you.

MR. DAVIS: Well, good, because that's kind of where I was going.

Good afternoon. A friend and colleague reminded me before this panel began that I have an unfortunate propensity on panels like this to begin by saying, "That's the silliest thing I have ever heard." She will be relieved to know I have no inclination to do that today, because actually I agree with basically everything that's been said.

The difficulty I have, as a carrier, is that

many of these ideas have the same likelihood of success as did SPF and SLU in 1962. If you laughed, I know your age.

(Laughter.)

MR. DAVIS: I am going to talk about how we do things that might have a more realistic likelihood of being implemented without violating the rule against perpetuities.

Qwest is the largest local telephone company in 14 western states, from Arizona to Minnesota to Washington. We also have a nationwide interexchange network, where we provide services to large business customers, including the federal government, across the U.S.

We are a significant collector of universal service funds. We are a very minimal recipient of universal service funds. At this time, our switched access expense is largely balanced out, but generally speaking, our switched access revenues are less than our switched access expenses. So that's kind of where we stand.

We have been a significant proponent of the reform of intercarrier compensation and universal service reform for a long time. I also agree that the

two are inextricably intertwined. It's very difficult, maybe impossible, to deal with one without the other.

We strongly support the recommendations of the Joint Board. We thought they did a very good job of identifying the issues and proposing some realistic solutions. Generally, we supported the FCC's proposals at the end of 2008 that were not adopted but were discussed.

The elimination of the identical support rule is correct. Reducing switched access, beginning with terminating switched access, is the right approach. We believe that the need for reducing or terminating switched access stems from the urgent need to reduce or eliminate arbitrage, and, in particular, traffic-pumping arbitrage, which has become a significant issue for Qwest, across our 14-state region.

That would be one of the areas where I think greater progress can and should be made in the very near future. Traffic pumping is, essentially, the artificial stimulation of switched access traffic to rural local telephone companies, with high switched access costs, through the use of free calling services.

These free calling services generally are adult chat lines, free conference services, free

international calling, pre-recorded business services, and things like that. But the sole purpose is to give the service away to stimulate switched access charges, which the local telephone company then splits with the provider of the free service. Of course, the recipient of the service gets to use the adult chat line for free and we pay significantly higher switched access charges to the two companies that are engaged in the practice.

Both independent telephone companies and CLECs engage in this traffic pumping practice and it's not uncommon to see the traffic volumes, the switched access volumes, of a telephone company go from tens of thousands of minutes a month to tens of millions of minutes a month, almost overnight. It costs the industry tens of millions of dollars a year to deal with this issue.

We recently had a hearing before the Iowa Utilities Board and some interesting facts came out of that. One is that the telephone companies do not charge the free calling service companies local exchange rates, universal service rates, or any other rates. They're not really customers of theirs.

None of the companies were residents of Iowa. None of them had any facilities or employees or

equipment in Iowa, with the exception of whatever electronic equipment they put in the central office. One of the rural CLECs had never had any outside plant and never provided any service to customers in Iowa. Indeed, there was one CLEC who collected USF support for several years -- more than \$3 million a year -- even though it had absolutely no customers whatsoever.

The other thing we found is that, in Iowa, none of the lines tested by Qwest restricted in any way access to adult porn or adult chat by minors. There were no credit card requirements, no pass codes, no scrambling or anything else that restricted access by minors to these lines. This is an area where we have urged the FCC and the states to take action and to prohibit this practice. We believe that this is something that could reasonably be done in our lifetime.

The second issue I want to talk about is the failure in the FCC's proposals at the end of 2008 to comply with, or to propose a solution that complies with, the 10th Circuit Court of Appeals decisions which invalidated the FCC's high-cost support rules for non-rural carriers.

Of the \$347 million in non-rural support today, about two-thirds or \$198.8 went to the state of

Mississippi, \$112 million went to wireless companies in Mississippi, and \$142 million went to AT&T in Mississippi. Don't blame AT&T, I'm just jealous.

By contrast, Qwest gets \$27 million annually, for all 14 states we serve, which includes some states which some people consider rural, like Montana, Wyoming, North Dakota, South Dakota, Idaho, and Utah. So something needs to be done about the non-rural high-cost fund.

Twice, in 2001 and 2005, the 10th Circuit Court of Appeals has rejected the FCC's rules and remanded the case to the FCC with direction to adopt rules that comport with the act. The FCC has yet to do anything to act on the 2005 decision.

The principal problem with the current rules is that they look at an entire state as a cost area. So they assume that over-cost rates, high rates, can be charged in urban areas to subsidize below-cost rates in rural areas. Regardless of the accuracy of that prediction 10 or 20 years ago, it just certainly can no longer be considered to be an accurate model for the disposition of universal service funds.

There have been a number of proposals to the FCC to solve this issue. Qwest has made one. Embarq

has made one. I think the ITTA made one. So we will continue to urge the FCC to deal with this issue and adopt rules that comply with the 10th Circuit's orders, as well as to deal with the traffic pumping issue.

Thank you.

MS. TATE: Thank you so much. We will have time for some questions in just a moment. I know you all want to get to lunch and the Blair Levin conversation, but I wanted to emphasize a couple of things that were said that we might want to explore further.

First, it was suggested that we should declare success and just move on. Second, in the stimulus package, there is still some priority for previous or present borrowers, which tend to be RLECs. Does this lessen their need for reliance on the USF so that we can move forward with reform? Finally, we currently have a myriad of broadband funding mechanisms from many different sources. We're suggesting that the universal service fund should now support broadband, but we already have millions of dollars going into multiple new broadband streams. I'm interested in discussing how the stimulus package is going to impact reform ideas.

I am really glad that Steve brought up that

whole list of consensus items. I would suggest that if any of you can get together on phantom traffic, traffic pumping, a reverse auction pilot project, using Lifeline and Link-up in a CETC cap, and eliminating the identical support rule, you might want to do that right now.

Chairman Copps has long pushed for reform and has said that he would like to look at reform for now and in the near future.

So, let's talk about the stimulus package, if you all would.

MR. MAYO: Let me begin with a precursor to the stimulus, because you spoke about the phrase of declaring victory and moving on.

Again, I will hearken back to what I said at the outset. Dollars, as much as they are being thrown around these days, are scarce. A dollar spent on one particular program cannot be spent on another particular program.

There really is no debate among students of this industry that there is telephone service available to the American population. As I said, 95 percent of American households have telephone service. We have 270 million lines at the very moment that our technology is enabling to move to broadband and consumers, especially

people younger than us, are moving in droves that way.

I don't think we need to spend \$7 billion on narrowband universal service. So, it seems to me to be not just prudent, but also affirmatively smart, to begin the process of sealing off and allowing a decrease in support to narrowband, and an increase in focus to broadband. I think that should be non-controversial.

With respect to the stimulus, I agree with Jeff's remarks, that as we move forward focused on broadband, there is a critical distinction that perhaps is enabled by the stimulus measure to avoid a perpetual annuity of support. That is the notion that broadband support in the stimulus should be timely, temporary, and targeted.

If that is the case, then we're going to get that infrastructure out there and then start allowing people to buy the service. To the extent that individual households are unable to afford the services carried over that broadband pipe, then I think a targeted system akin to Lifeline and Link-up can be enacted, which has been far more effective than the untargeted high-cost support mechanism.

MR. BROCK: I would like to make a brief additional comment. It's fairly obvious that there is

not enough money in the current stimulus package to start spreading fiber optic to all the rural homes and that would probably not be the most efficient way to bring broadband anyway.

Really, the question of how significant the stimulus package is for universal service depends upon what happens from here on out. The stimulus package provides an alternative vision of how to support the deployment of expensive infrastructure. Insofar as that is done, as the others have emphasized, then there should be no further need for separate subsidies for operating arrangements. If that becomes the policy structure, then it will need a lot more money put behind it than the existing amount.

Another possibility is that broadband deployment under the stimulus package will simply be incorporated into the existing universal service structures and we will miss an opportunity for reform. I don't think it's at all clear which of those approaches is going to develop.

MR. DAVIS: Commissioner Tate, as you know, Qwest has proposed some type of broadband support for some time before the stimulus package. We have suggested that we need to learn from the mistakes made

in the first universal service support system and not repeat them as we move forward.

First, we should only subsidize one provider, because we do not need to subsidize multiple providers. Second, we should subsidize the low-cost provider by deciding whatever the minimum terms of the service are and then subsidize the provider that can do that at the lowest possible cost. Third, the subsidy should be a one-time subsidy for the deployment of facilities.

I would just suggest, responding to John, that I don't believe individual subsidies to users are necessary. Quite frankly, we charge \$14.99 for 1.5 megabit service. I'm not sure an additional subsidy for that is needed or, to the extent it is, it should be a very defined program, such as Lifeline and Link-up that is really targeted to a very narrow cross-section of the public.

MR. CAMPBELL: One of the challenges for distributing the stimulus money is that we're either going to just shovel it out to whomever shows up at the door or we're going to attempt to have some sort of order to it and accomplish goals above and beyond just providing broadband.

The legislation does not provide for any

particular speed or service requirements. Implicit in that is that there are not going to be any ongoing operating subsidies. That's very clear.

It would probably be very useful to think about the long-term impact of the stimulus program on the entire communications system. While the money is being delivered and utilized, we need to make sure that we are improving that situation, rather than not simply making it more complex in the long run.

I concur with the things Steve talked about, but would also ask, "What kind of broadband do we want to have?" I don't mean "kind" as in type of technology, but rather the speeds and services that should be supported.

We could go with a hodge-podge of standards or we could say that since we're going to subsidize something, we need to at least get to certain minimum levels of service that are going to be able to provide the kind of services and applications that people need in the future.

MS. TATE: Just running down the panel, I am interested to see if anyone else has any thoughts about the utilization of Lifeline and Link-up, since it's tested, and low-income directed, very targeted? John?

MR. MAYO: I completely agree with Steve, though I didn't know that you could get broadband for \$14 in the Qwest area. There is just a rich history of empirical analysis that points to the effectiveness of targeted assistance programs relative to untargeted programs.

We could be considerably more generous to our most impoverished households if we would target those dollars, as opposed to spreading dollars out among the general population. As much as I appreciate any subsidy I might receive in Bethesda, Maryland, as Rob does, it's not going to affect my behavior. And in an economic sense, that's a dollar of pure waste. So, while I appreciate it, it ought to go to someone else who would change their behavior and perhaps would not subscribe to a broadband service without that subsidy.

MS. TATE: I think that it's important for us to note that there has been more investment in infrastructure by the private sector than in any other comparable industry. Just reeling off from the earlier panel: AT&T at \$20 billion, Verizon at \$24 billion, hundreds of millions of dollars by cable, and \$80 billion for schools and libraries in both public and private funding together. There has been huge

investment.

One problem is that we have never done a good job of figuring out what we're trying to solve. Who are the people we're trying to reach? Once they have access, what decision-making processes go into adoption?

We have some serious problems outside the ITC sector, but the sector has the ability to make a large positive impact on our economy. This impact ranges from creating more jobs to actually having the capacity to help us with our energy independence through telecommuting.

We have huge problems with our educational system. Yesterday, I attended a summit where we talked about the stimulus bill and how it could help with both education and telemedicine, especially in rural areas. So the impacts can be exponential. I sometimes worry that we haven't completely defined the problem before asking how to solve that problem.

So, with that, why don't we open it up for a couple of questions before Randy says that it's time for lunch? Anybody?

(No response.)

MS. TATE: I know it's a titillating, provocative topic.

(Laughter.)

MS. TATE: Well, thank you all again. I am thrilled to be here. I thank you all for being on the panel. And, Randy, do you have an announcement about lunch?

(Applause.)

MR. MAY: Deborah, thanks to you for moderating.