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It's the Consumer, Stupid

by

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To borrow a famous line from a political campaign, modified here only slightly, "It's the consumer, stupid!"

I am put in mind of this line by something FCC Chairman Julius Genachowski said last week. Responding to a reporter's query concerning the likely timing of the FCC's action to reform the woefully outdated "USF" (Universal Service Fund) subsidy regime, Mr. Genachowski said: "I hope we will be able to deliver reform for the American consumer very soon."

Aha! The American consumer.

Those who follow the USF reform debate might be forgiven for forgetting — amidst all the daily back-and-forth parries and skirmishing by the various subsidy or would-be subsidy recipients, the ILECs, CLECs, RLECs, cable, satellite, and wireless operators - — that the main focus ought to be on the consumer.

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So, Chairman Genachowski deserves credit for using the “C” word.

But what he doesn’t say explicitly, but should, is that American consumers currently pay a 15% tax on all interstate and international calls to fund the subsidy regime, even though, by common agreement, it is wasteful, inefficient, and anti-competitive.

The 15% tax, which the government insists on calling a “fee,” is collected from American consumers to fund subsidies that, together, amount to over \$8.5 billion *per year*. Some of the subsidies are provided to support communications services for schools, libraries, health care facilities, and low-income persons. But over half of the \$8.5 billion per year goes to a so-called “high-cost” fund that distributes subsidies to rural telephone companies in areas with above-average per-line costs.

This high-cost fund that distributes over \$4 billion per year is in need of dire reform. That’s *billion*, not million. And that’s *per year*, not just a one-time disbursement.

If Mr. Genachowski wants to achieve meaningful reform of the USF regime, he should not continue to shy away from explaining to American consumers that they are paying a 15% tax on all long distance calls to fund the subsidy regime. Rather, he should trumpet the size of the tax as an integral part of a reform battle cry.

That the current universal service regime has remained unreformed for so long represents a major communications policy failure, one spanning several FCC administrations.

It was obvious many years ago that the emergence of competition in the telecommunications marketplace, spurred by the advent of new digital technologies substantially diminished the need for continuing payment of indiscriminate subsidies. The subsidies originated in a much earlier monopolistic era and were intended to support the widespread availability of voice telephone service. For all practical purposes, voice telephone service penetration, at 96% of American households, has been nearly “universal” for well over a decade.

Continuing the payment of excessive and wasteful subsidies to high-cost telecom providers has the undesirable effect of retarding the development of more robust competition by low-cost providers using more efficient technologies. And it has the concomitant effect of rewarding carriers for maintaining outdated infrastructure rather than implementing new, low-cost technologies. As the FCC put it in initiating its latest reform effort, the “current rules actually *disincentivize* something necessary for our global competitiveness: the transition from analog circuit-switched to IP [Internet Protocol] networks.”

In late July, six incumbent telephone companies – AT&T, CenturyLink, FairPoint, Frontier, Verizon, and Windstream – submitted a USF reform proposal they call the “American Broadband Connectivity” plan. The ABC plan, commendably, has many

positive elements, and it represents a good starting point as the FCC works to fashion final rules.

But if the main objective is to protect the American consumer, and not American telecom providers, the FCC can improve the ABC plan by incorporating certain market-oriented measures.

Here are some key ways to improve the plan.

First, the high-cost fund should be capped at the current level of \$4.5 billion, without any loopholes for exceeding that amount. And high-cost subsidies should be phased out over time, say, in ten years. In the competitive telecom environment that now exists, with the implementation of increasingly efficient, low-cost technologies by new market entrants, it doesn't make sense to adopt a plan that contemplates the payment of interminable "forever" subsidies

Second, no high-cost fund subsidies should be awarded in areas that are served by unsubsidized providers.

Third, while it may be reasonable to afford incumbent telephone companies some form of right-of-first refusal in certain areas to allow them additional opportunities to recover sunk investment, there should be a fairly prompt transition to the award of subsidies through a competitive bidding ("reverse auction") process.

A reform plan that incorporates these market-oriented elements will protect the interests of consumers, rather than the interests of any particular class of service providers.

And, most significantly, with the steady reduction in the amount of subsidies distributed, over time there would be a meaningful reduction in the current 15% tax on phone calls.

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