

Before the  
Federal Communications Commission  
Washington, D.C. 20554

APR 9 1996

In the Matter of )  
 )  
Federal-State Joint Board on )  
Universal Service )

CC Docket No. 96-45

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Comments of Citizens for a Sound Economy Foundation

Citizens for a Sound Economy Foundation (CSE Foundation) supports reform of the current policies designed to promote universal telephone service. Founded in 1985, CSE Foundation is a nonprofit research and educational organization with 250,000 members and supporters in every state in the country. We have been active in a broad range of telecommunications policy concerns since 1987, addressing such issues as universal service, price regulation, interconnection, and use of the electromagnetic spectrum.

At present, a number of mechanisms and support programs exist to further the goal of universal service, but they serve this purpose with limited effectiveness and significant cost. We believe that substantial reform is necessary to meet the requirements set out by the Telecommunications Act of 1996 regarding universal service, particularly to make the subsidies explicit and to reduce the adverse effects on competition.

CSE Foundation believes that the most effective way to meet the new legislation's requirements is to target subsidies to specific subscribers, and to finance such subsidies by way of an explicit, broad-based, and flat surcharge on access lines. Moving to a system of targeted subsidies financed by explicit and flat surcharges will help create a more efficient and less-distorted market. This would best allow the universal service mandates of the Telecommunications Act of 1996 to be met, while moving to an efficient market that would benefit all consumers.

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## **I. The Challenge of Universal Service and the Threat of Cross-Subsidies**

Title I of the Telecommunications Act of 1996 places considerable emphasis on two major goals: competition and universal service.<sup>1</sup> In fact, competition is an important recurring theme of the entire 1996 Act, and sections covering issues such as the regulation of the Bell carriers, regulation of broadcast ownership and use, regulation of video services, and forbearance from regulation all address the issue of competition in various markets.<sup>2</sup>

The changes imposed by this new legislation are dramatic. Local exchange carriers, long-distance carriers, and cable providers will soon be free -- under certain limits -- to compete against each other. While no one can predict the exact results of competition in every possible situation, this new market discipline will almost certainly benefit consumers. Carriers that overcharge or poorly serve customers will now find eager competitors ready to take their place. As more innovation and fewer barriers make competition easier, the end result of this rivalry will be that no provider can charge much above cost for any period of time. That is, prices well above cost would invite entry by others ready and able to provide their services at a lower price.

What does competition have to do with universal service? First, competition lowers prices and thus prompts more people to subscribe. In other words, competition is itself a universal service mechanism. Second, competition makes it hard to impose cross-subsidies from one set of subscribers to another. In a competitive market, those paying too much for a

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<sup>1</sup> Telecommunications Act of 1996 Sec. 253 and 254.

<sup>2</sup> Ibid. Title I, Part III; Title II; Title III; and Title IV.

service will soon find alternative providers ready and willing to serve them. In other words, competition is antithetical to cross-subsidization, the financing technique of choice for most current universal service programs. Thus, a universal service policy built on the practice of overcharging some customers to help others will quickly collapse, a point acknowledged by virtually all involved in this issue.<sup>3</sup>

## II. Goals and Principles of Universal Service Support Mechanisms

Both the Telecommunications Act of 1996<sup>4</sup> and the NPRM to which this reply is directed<sup>5</sup> offer a number of principles which must be considered in defining and developing a policy on universal service. These principles mandate a framework which includes a support mechanism for rural and high-cost customers, low-income customers, and educational and health-care institutions.<sup>6</sup> They also require that these support mechanisms be specific and predictable, and that the contributions generated to support this policy be both equitable and nondiscriminatory.<sup>7</sup>

Importantly, the legislation makes clear that this is not an exclusive list of principles,

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<sup>3</sup> See "Universal Service Tool Kit, Part 1: Getting From Here to There: Transitions for Restructuring Subsidies," Telecommunications Industries Analysis Project, Boston, MA, 1994. Participants in this organization include representatives from local and long-distance companies, as well as members of state public utility commissions.

<sup>4</sup> Telecommunications Act of 1996, Sec. 254(b).

<sup>5</sup> Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking and Order Establishing Joint Board, CC Dkt. 96-45 (March 8, 1996) ("NPRM").

<sup>6</sup> Telecommunications Act of 1996, Sec. 254(b).

<sup>7</sup> Ibid.

and it invites the Commission and Joint Board to add additional principles that they may deem necessary.<sup>8</sup> In addition to those listed in the 1996 Act, Citizens for a Sound Economy Foundation recommends the following two principles be incorporated by the Joint Board in its efforts to develop a policy for universal service. We find them to be consistent with the legislation and important guideposts for following the principles mandated by Congress.

\* **All subsidies should be simple, direct, and explicit.**

Although not included in the list of principles outlined in Section 254(b), the Telecommunication Act of 1996 makes it clear "that any support mechanisms continued or created ... should be explicit, rather than implicit as many support mechanisms are today."<sup>9</sup> As this language implies, such a mandate requires a change in many of the current universal service policies.

For example, practices such as rate averaging are an indirect, implicit means of subsidization. Rate averaging is an implicit subsidy (from subscribers with below-average to those with above-average costs), yet it is difficult to aggregate and frequently overlooked. Because it punishes the low-cost at the expense of the high-cost customer, rate-averaging sends funds from more densely-populated urban communities to rural areas, regardless of the financial status of the residents in each. Financing mechanisms which artificially price some subscribers' services higher to lower prices elsewhere also create market distortions, which encourage over-consumption in one market, under-consumption in the other, and equally-misappropriated investment by industry.

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<sup>8</sup> Ibid.

<sup>9</sup> Ibid., Sec. 254(e).

In short, employing a subsidy mechanism that includes rate averaging would violate the requirements for only explicit subsidy mechanisms. Rate averaging is just a hidden tax. It is not costless, frequently regressive, almost always arbitrary, and certainly not the most effective way of subsidizing whichever particular group we may wish to assist.

**\* Subsidy contributions should be clearly specified and apparent to consumers.**

**Regulators should adhere to a "Truth-in-Taxing" policy for telecommunications.**

This principle should be relatively uncontroversial; it merely requires those who finance subsidies to be informed of the contribution. For example, if a flat surcharge of \$1 per month on all business and residential lines is sufficient to raise the level of funds necessary for a particular program, this amount should be clearly identified on each ratepayer's monthly statement. Significantly, deviation from this policy of "Truth-in-Taxing" is inconsistent with the 1996 Act's requirements for an explicit subsidy mechanism.

### **III. Support for Low-Income, Rural, Insular, and High-Cost Areas**

Promoting "affordable" telephone service is both a goal of the 1996 Act and a long-standing policy of telecommunications regulators such as the FCC and state public utility commissions. For subscribers with low-incomes and those living in high-cost areas, this "promotion" has generally come in the form of subsidized service. In order to reform these subsidies while keeping in mind the requirements of the new legislation, any new universal service policy must attempt to meet the distinct (though sometimes conflicting) goals of promoting universal service and promoting competition.

Regarding low-income subscribers and those in high-cost areas, the Commission specifically requests comments on what services to support, who should be eligible for support, and how to calculate and distribute subsidies to these recipients.<sup>10</sup>

### **What services should be supported?**

Citizens for a Sound Economy Foundation recommends that the definition of services to be subsidized for low-income as well as high-cost subscribers be interpreted narrowly, focusing on access to basic switched service. The addition of supplemental services should be predicated on their ability to add to the health, safety, or personal security of subscribers, or in some other way earn the label of "necessity" in a strict sense. We would therefore be concerned by an extension of subsidized services beyond emergency 911 service or, perhaps, touch-tone service.

Focusing on a more broad definition of subsidized services is a mistake for at least two reasons. First, the use of a broad definition of "essential" services to be subsidized unfairly burdens the many remaining customers who must pay this subsidy. Second, the choice of which services will receive a subsidy involves a type of industrial policy inimical to a competitive market.

Any choice of a subsidized technology or service consequently diminishes the chances that other technologies or services have to compete. For example, extremely large subsidies for wireline service in insular, high-cost areas may have unnecessarily hampered the ability of wireless carriers to compete in these markets, despite the technological superiority and

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<sup>10</sup> NPRM, Para. 10-70.

lower cost of wireless technology.<sup>11</sup>

The legislation's requirement that a "substantial majority"<sup>12</sup> of residential subscribers receive a service before it is subsidized for others offers a partial step in insuring against such industrial policy, though we stress this is only a partial protection. The fact that a service is subscribed to by a large percentage -- even a "substantial majority" -- of the customers in a given market does not in and of itself make it a necessity. A large percentage of households in this country have color televisions and VCR, though few would argue that ownership of these goods should be subsidized. CSE Foundation therefore recommends that the Joint Board instead give greatest attention to whether a particular service is "essential to education, public health, or public safety."<sup>13</sup>

#### **Who should be eligible for subsidies?**

We note that mechanisms employed by state public utility commissions (such as requirements that those receiving low-income subsidies also be eligible for Food Stamps or Medicaid) may provide a useful criteria for determining eligibility for universal service subsidies. Alternatively, a requirement that subsidy recipients be under the federal poverty line may be the most appropriate approach. Less stringent eligibility criteria may allow some subscribers to receive subsidized service at the same time that they are deemed too wealthy

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<sup>11</sup> Gilder, George, "From Wires to Waves," Forbes ASAP, June 5, 1995.

<sup>12</sup> Telecommunications Act of 1996, Sec. 254 (c)(1)(B).

<sup>13</sup> Ibid., Sec. 254 (c)(1)(A).

to receive "necessities" such as food and medical care from other social service agencies.

### **What should be the size of the subsidies?**

The expense associated with subsidizing low-income and high-cost, insular and rural areas needs to be recognized early on by all participants in this process. To a great degree, the calculation of the subsidy for these subscribers will be a social policy question, not one of technical feasibility. For instance, it would be "feasible" for telecommunications carriers to provide every poor household in the country with basic switched access service at no cost whatsoever. Such a policy would also be inherently unfair to the remaining ratepayers, who ultimately pay for any subsidy.

Citizens for a Sound Economy Foundation does not have specific recommendations for the appropriate size of subsidies.<sup>14</sup> We reiterate, however, that policymakers should grant subsidies sparingly, in light of their potential costs. Moreover, by keeping subsidy mechanisms simple and well-focused, an effective assistance program may be funded at a lower cost than the current universal system arrangement.

Consider, for example, the burden imposed by current policies designed to promote universal service. These policies result in higher prices in some markets, which help finance lower prices elsewhere.<sup>15</sup> Overall estimates of the cost of pursuing these policies range from

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<sup>14</sup> For rural, insular, and high-cost area subsidies, we specifically caution that the value of this subsidy should not be so great that the subsidized subscribers in high-cost areas pay less than the subsidized customers who support them. For example, while the Joint Board may decide to grant a rural customer with monthly service costs of \$50 sufficient subsidy to lower his or her bill to \$18 a month (i.e. the national average), there is no reason to price below this average rate, apart from low-income considerations.

<sup>15</sup> For an excellent discussion of the theory and method of telecommunications subsidies, see Kaserman, David, and John Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More

\$15 billion to over \$30 billion annually.<sup>16</sup>

In contrast, a simple and well-defined subsidy to both low-income subscribers and rural, insular, and high-cost subscribers could be had for no more than \$6 billion. The Joint Board and the Commission could pursue a universal service policy for these groups with the same level of support as (if not more than) the current program, but at a lower price. The support would be allocated as follows:

For low-income consumers, about eight million families in this country live at or below the poverty level.<sup>17</sup> A subsidy of as little as \$5 per month (which is more than 25 percent of the average cost of basic service) could be given to every one of these families for approximately \$500 million per year. At twice the subsidy (over half the cost of basic service), the total costs would be about \$1 billion.

For rural, insular, and high-cost customers, the total cost of providing basic service at a price roughly equal to the national average (about \$18 per month) would be approximately equal to \$5 billion per year. This estimate comes from findings in two different studies. The Telecommunications Industry Analysis Project estimated an annual subsidy to rural subscribers of over \$5 billion, financed by urban subscribers.<sup>18</sup> Another study performed by

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Intelligent Telephone Pricing," Yale Journal on Regulation, Vol. 11, No. 1, 1994.

<sup>16</sup> For an estimation of the funds generated for cross-subsidies and other purposes, see Leighton, Wayne, "Consumers and Cross-Subsidies: An Interest Group Theory of Telecommunications Regulation," doctoral dissertation, George Mason University, 1996; and Monson, Calvin, and Jeffrey Rohlf, "The \$20 Billion Impact of Local Competition in Telecommunications," Strategic Policy Research, Inc., 1994. See also the discussion in Section VII of these comments.

<sup>17</sup> Department of Commerce, Bureau of the Census, 1994 estimates.

<sup>18</sup> Telecommunications Industries Analysis Project, "What is the Price of Universal Service? Impact of Deaveraging Nationwide Urban/Rural Rates," TIAP, Cambridge, MA (1995).

Dale Hatfield Associates found that more than \$6 billion per year would be needed to provide the least-populous regions of the country with basic switched service at a price equal to the national average.<sup>19</sup> However, Hatfield also noted that this subsidy could be reduced by about \$1.5 billion annually if more efficient technologies such as wireless systems were employed in high-cost areas,<sup>20</sup> a measure of flexibility that Citizens for a Sound Economy Foundation would support.

Adding the sum of support for both low-income subscribers (\$1 billion) and high-cost subscribers (approximately \$5 billion) gives a total of \$6 billion, considerably more than that which is currently expended in the telecommunications industry to promote universal service. We reiterate that the \$6 billion is an estimate for a very generous subsidy, not necessarily that which we would recommend for adoption. Rather, this illustration serves to show the enormous benefits that may be had by adopting a more simple and well-defined approach to universal service.

#### How should these subsidies be calculated?

We recognize that a number of proposals for calculating a universal service subsidy have been offered by both industry and consumer groups. The Commission has requested

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<sup>19</sup> Dale Hatfield Associates, "The Cost of Basic Universal Service," Dale Hatfield Associates, Denver, CO, prepared for MCI Corporation, July 1994. For a population density of 0-10 or 10-100 per square kilometer, Hatfield found the necessary subsidy to finance a \$18 average bill was \$2.8 billion and \$3.7 billion, respectively.

<sup>20</sup> *Ibid.* The price for service in the least-populated regions, with 0-10 persons per square kilometer, falls over \$25 per month, from \$65.63 to \$40.34. The change in price for regions with 10-100 per square kilometer is about \$1, with the price per subscriber falling from \$36.39 to \$35.36. The total savings amounts to about \$1.5 billion over a model in which new (wireless) technologies are not employed.

comments on one detailed proposal, the Benchmark Cost Model.<sup>21</sup> This approach offers the advantage of more specifically targeting subsidies to designated recipients, and is widely supported by many in the telecommunications industry.<sup>22</sup> In short, the Benchmark Cost Model employs Census Block Groups to separate subscribers into geographically distinct segments, which at about 400 households are sufficiently small to eliminate most problems with cross-subsidies. The model then calculates a subsidy for each market based on the best available technology in that particular area.

While potentially quite useful, the Benchmark Cost Model does not offer a complete solution to the problems associated with serving high-cost carriers. Specifically, this model places too much emphasis on the lowest possible cost that can be obtained from applying the best possible technology. This may or may not be the most relevant information. The most relevant information is, in fact, the costs which private actors would be willing to incur in order to serve a market.

This understanding of the relevant information for private actors is critical. That is, the most important information is conveyed by the telecommunications service providers who will incur costs to provide a service. They will not agree to incur long-run losses, yet they will not be able to earn long-run monopoly profits if faced with competition in the market they serve. Because of the importance of understanding the true costs of providing service, CSE Foundation believes that the appropriate level of support for high-cost areas should be determined wherever possible through a process of competitive bidding for a specific

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<sup>21</sup> NPRM, Para. 28.

<sup>22</sup> "Benchmark Cost Model: A Joint Submission by MCI Communications, Inc., NYNEX Corporation, Sprint Corporation, U S West, Inc." Copyright 1995.

geographical area.<sup>23</sup> The Commission has specifically invited comment on this approach, which we support.<sup>24</sup> We envision that this process would work as follows:

For any given market, a competitive bidding process would be employed to identify all providers interested in serving as a carrier of last resort (COLR) for that market. Each bidder would agree to assume the COLR responsibilities. The Commission (or relevant authority) would use the estimate of the lowest bidder to form a subsidy, and this low bidder would be contractually obligated to serve the market for a specified period of time.

In calculating the amount paid, the value of the subsidy would equal the difference between the low bidder's price of service and the price which was determined above. For example, if the price was \$18 (i.e. the approximate national average for basic service) and the lowest bid was for \$40, then the guaranteed subsidy would be \$22.

Importantly, this subsidy would not be limited to the low-bidding provider. Thus, a carrier with slightly higher costs (say, \$50) could still receive the \$22 subsidy for each line served, even though the price of \$18 would result in a net loss per customer. The bottom line is that no potential provider is kept out of the market, the necessary subsidy paid out is minimized, and a universal service program is financed.

Regardless of how the size of subsidies are determined, CSE Foundation recommends a program of vouchers or "Phone Stamps" for all recipients. These vouchers may be sent in with the monthly telephone bill, or the recipient may agree to designate a particular carrier as

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<sup>23</sup> Borrowing a recommendation of the Benchmark Cost Model's advocates, this model may employ Census Block Groups to separate customers. Among all proposals put forth thus far, this type of market segmentation appears to be the most efficient for avoiding the incentive to rate average.

<sup>24</sup> NPRM, Para. 35-37.

his or her provider for a limited period of time.

Because the customer would have the right to use phone stamps with whichever carrier he or she chooses, this arrangement would encourage potential carriers to compete for the business of subsidy recipients. This competition should help to improve the quality of service offered to these subscribers as well as lower the total cost of the subsidy other ratepayers must support.

In summary, the most important considerations for subsidization are to maintain an explicit subsidy directly aimed at well-defined subscribers, to have a nondiscriminatory approach to choosing eligible providers, and to allow recipient flexibility in applying this assistance to the carrier of his or her choice.

## **V. Support for Schools, Libraries, and Health Care Providers**

The Commission seeks comment on how best to provide support to schools, libraries, and health care providers.<sup>25</sup> Similar to our financing proposal for other subsidies, CSE Foundation stresses that financing should be explicit and transparent. As with subsidies for high-cost and low-income subscribers, institutional subsidies must ultimately come from the ratepayers, and these ratepayers should know exactly to what extent they finance different policies.

## **VI. Comments on Other Universal Service Support Mechanisms**

The Commission also seeks comments as to whether the current carrier common line

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<sup>25</sup> NPRM, Para. 71.

rate (CCLR) may be inconsistent with the 1996 Act's mandate of explicit subsidies to be applied on a nondiscriminatory basis.<sup>26</sup> The Commission rightly notes that, if this current subsidy mechanism is inconsistent with the current legislation, then "recovery of the full interstate allocation of common line costs directly from end-users might cause flat monthly rates paid by certain subscribers to exceed acceptable levels, and could have an adverse impact on telephone subscribership."<sup>27</sup>

This observation by the Commission is likely to be accurate, but only to an extent. Specifically, the assignment of a set fee for fixed or non-traffic-sensitive (NTS) costs entails an increase in the flat fee for basic local service, but this does not necessarily imply that the average telecommunications consumer will see an increase in total expenses. Rather, the opposite may be true, as for many customers a significantly larger portion of their telephone bills reflect toll charges. There is thus very good reason to believe that subscribership will not fall should such a policy be adopted.

The use of a set fee for NTS expenses may not only involve no negative consequences for subscribership, it is also likely to provide the most economically-efficient result. While not glamorous from a policy perspective, economic efficiency is necessary for the long-run competitiveness of the industry, which in turn impacts both the price and quality of the goods and services available to consumers in the future.

A substantial literature exists supporting the economic efficiency of realigning NTS expenses, both from the theoretical and empirical perspectives. From a theoretical approach,

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<sup>26</sup> NPRM, Para. 113.

<sup>27</sup> Ibid.

Alfred Kahn and many others have put forth the argument that the most efficient mechanism for covering this type of cost structure (with NTS costs allocated over many users) requires a two-part tariff, with a fixed fee allocated for NTS costs.<sup>28</sup> Deviation from this approach will leave open the possibility that one group of subscriber will pay an arbitrary (and inefficient) level of the NTS costs.

The empirical approaches to understanding NTS costs generally support the idea that increases in the flat rate for basic service need not result in decreased subscribership. For example, increases in subscribership accompanied a steady rise in the federal Subscriber Line Charge during the 1980s, and lower rates for interstate toll service have had a positive effect on the number of subscribers which significantly outweigh the negative impact of higher flat rates for basic service.<sup>29</sup> Taken together, these findings give considerable reason to conclude that the use of an excessively high carrier common line charge in lieu of a flat subscriber line charge should be reconsidered.

## VII. Administration of Support Mechanisms

The Commission also requests comment on the details of administering a universal

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<sup>28</sup> See Kahn, Alfred, "The Road to More Intelligent Telephone Pricing," Yale Journal on Regulation, Vol. 1, No. 139 (1984), Kahn, Alfred and William, "Current Issues in Telecommunications: Pricing," Yale Journal on Regulation, Vol. 4, No. 191 (1987), and Littlechild, Stephen, "Two-Part Tariffs and Consumption Externalities," The Bell Journal of Economics, Vol. 3, No. 2 (1973).

<sup>29</sup> See Crandall, Robert, After the Breakup, U.S. Telecommunications in a More Competitive Era, Brookings Institution, 1991; Mueller, Milton and Jorge Schemet, "Universal Service from the Bottom Up: A Profile of Telecommunications Access in Camden, New Jersey," Rutgers University Project on Information Policy, February 1995; Pitsch, Peter and David Teolis, "Updating Universal Telephone Service," Hudson Briefing Paper No. 167, The Hudson Institute, August 1994; and references cited therein, especially Belinfante, Alexander, "Telephone Subscribership in the United States," Industry Analysis Division, Common Carrier Bureau, FCC, March 1994.

service support mechanism, specifically addressing who should contribute and how such contributions should be assessed.

### **Who should contribute?**

Regarding contributions, the new bill states the "(a)ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service."<sup>30</sup> Because the telecommunications industry increases almost daily in the number of customers, service options, and service providers, one can easily extend the list of possible contributors at any point in time. Such a process could quickly become absurd. For example, should direct broadcast satellite (DBS) providers be required to contribute if they only engage in the transmission of a pre-arranged program, thus offering no ability for two-way communications? Should a local cable provider be required to contribute if it does not provide interactive services?

The Commission seeks comment as to which telecommunications providers should be labelled as interstate providers, which would in turn necessitate their contributing to any subsidy mechanism established. CSE Foundation recommends that the standard for determining required providers be the provision of access to the local exchange network, or the provision of any other type of service which ultimately allows the subscriber to access the switched local exchange networks across the states. This definition would include all access services provided by local exchange carriers, interexchange carriers operating local networks, resellers, competitive access providers, cellular and personal communication system (PCS)

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<sup>30</sup> Telecommunications Act of 1996, Sec. 254(b).

providers, and others. Cable television and other providers would also be incorporated into this pool of subsidy recipients if they offer voice-grade telecommunications services which could provide access to the local telephone network.

### **How should contributions be assessed?**

CSE Foundation believes that the funds raised to support any universal service program -- whether for high-cost, low-income, educational or health care institutions -- should be clearly identified as a type of tax. The 1996 Act essentially gives the Commission the power to tax, a power that should be judiciously employed. We believe that the best structure for such a tax would be a flat rate charge on every access line (say \$1 or \$3 per month), similar to the current federal Subscriber Line Charge. Such a flat Universal Service Support Tax ("USST") would be the least distortive of any potential tax, since it would not create disincentives to increase or decrease use of a particular service, which promotes efficiency in the market and serves the interest of consumers. For these reasons, a flat surcharge (or "flat tax") approach is preferable to other subsidy mechanisms, such as one based on a pro rata share of a carrier's gross interstate revenues.

In addition, because a gross interstate tax only affects interstate and other long distance services, the higher price which must be passed on to customers would only affect the market for these services. Customers would thus demand a smaller quantity of these interstate services, due only to the distortive effects of this market intervention. Providers would either not invest in the capital necessary to provide interstate services, or inefficiently invest in parallel (and perhaps duplicative) facilities that are not subject to this tax. Either of

these outcomes would be inefficient and discriminatory. Both would be inferior as compared to a flat surcharge.

Lastly, we believe that, to make this tax apparent to users, it should be listed separately on each customer's phone bill, much as is the current subscriber line charge. This would clearly identify to all ratepayers exactly how much they are contributing to this federal program.

### **VIII. Conclusion**

The Telecommunications Act of 1996 poses a serious challenge to the Federal-State Joint Board and policymakers at both federal and state levels: promoting universal service while simultaneously creating the opportunity for competition to emerge in this market. Indeed, many subsidy mechanisms are antithetical to competition. Subsidies that create artificially high prices in one market to finance artificially low prices in another market will promote excessive (and inefficient) investment by new competitors in the first case while virtually eliminating any investment in the latter. Not only is this in conflict with the new legislation, it is against the best interests of consumers.

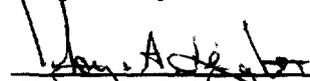
In determining the level of assistance subscribers will receive, the Commission and the Joint Board should employ a narrowly-targeted approach. For example, individuals who would not qualify for other types of social assistance such as Food Stamps or Medicaid should not qualify as low-income subscribers. Similarly, it would be a particularly egregious burden on ratepayers to require them to finance subsidies for subscribers in high-cost areas which result in lower prices than those charged in the lower-cost areas.

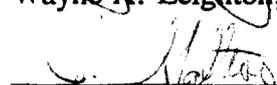
To determine who will provide subsidized service, a competitive bidding process should be employed. Despite the outcomes of the auction, no one provider should be given the exclusive right to provide service at a subsidized rate. Rather, all carriers should be free to compete, though the lowest bidder should be held by contract to provide service for a set period of time.

The financing for the universal service program should be as pro-competitive and non-distortive as possible. The best support mechanism would be a flat surcharge which is clearly posted on the ratepayer's bill, similar to the federal Subscriber Line Charge, and it should designate the programs subsidized by this tax.

In conclusion, the dictates of both the 1996 Telecommunications Act and economic efficiency require a universal service program with certain characteristics. These include the need to tailor well-defined subsidy mechanisms to a specific set of subscribers and to pay for these subsidies through explicit, predictable, and non-discriminatory charges that at the same time avoid placing limits on competition. We believe that these principles provide an important framework for reform in the current universal service arrangement.

Respectfully Submitted,

  
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Wayne A. Leighton, Ph.D.

  
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James L. Gattuso

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