

UNIVERSAL SERVICE: THE POVERTY OF POLICY

JAMES ALLEMAN*
PAUL N. RAPPOPORT**
DENNIS WELLER***

ABSTRACT

Competitive forces, technology, and the convergence of traditional industries such as telephony, broadcast media, publishing, and computers are transforming the world's economies. The long-anticipated global information infrastructure is here, although its structure is still evolving.

The convergence of the previously distinct industries has created new problems and issues for policy makers and analysts. The regulatory structure in each industry has been distinct, with different methods of social control, goals and objectives.¹

The traditional telephone monopolies are disappearing, although vestiges of their market power may continue for some time.² New regulatory tools of incentive regulation and competitive entry are replacing the traditional rate-based, rate-of-return regulation, and rate structure setting methodologies.³

Many issues arise because of this transition: Are the competing regulatory structures at odds with one another? What

* Associate Professor for the Interdisciplinary Telecommunications Program at the University of Colorado.

** Associate Professor of Economics at Temple University.

*** Chief Economist for GTE. The authors wish to thank Robert J. Herrington for excellent editorial assistance and Soontaraporn Techapalokul for research assistance. Substantial portions of this article are taken directly from Dennis Weller, *Auctions for Universal Service Obligations*, 23 (9) TELECOMS. POL'Y 645 (1999).

1. See ALFRED KAHN, *THE ECONOMICS OF REGULATION: PRINCIPLES AND INSTITUTIONS* (1970) (discussing pre-incentive regulation). For a review of the more recent incentive regulation, see JEAN-JACQUES LAFFONT & JEAN TIROLE, *COMPETITION IN TELECOMMUNICATIONS* 37-96 (2000).

2. See LAFFONT & TIROLE, *supra* note 1, at 4, 265-72, and the references cited therein, for most recent documentation of this convergence.

3. See *id.* at 16-17.

market structure will emerge? What market structure is desired? One element of traditional regulation, however, remains and still impedes the development of an effective competitive transition—the universal service obligation (“USO”).⁴

Until recently, the regulator had not needed to recognize the distinction between the aspects of traditional regulation intended to control the incumbent’s exercise of market power, and those designed to achieve socially desirable policy objectives, such as universal service. Indeed, to some extent it may have been useful for regulatory authorities to obscure the costs of certain social policies by embedding them within the pervasive regulation of an incumbent firm.

All this changes with the decision to promote a competitive telecommunications market. For the transition to competition to succeed, asymmetric measures to control market power should be phased out as the incumbent’s market power diminishes. However, if the regulator wishes to maintain some market interventions in the new competitive market in order to meet social policy goals, then a new method for this will have to be devised—one that does not rely on the market power of the incumbent, that will be sustainable in an environment with more than one firm, and that will be minimally distorting to the market outcome.⁵

4. Universal service is the social obligation imposed on the telecommunications industry to ensure that residential exchange rates are low and that rural telephone rates will not be higher than urban rates. In the United States, it is the principle that exchange service will be subsidized in order, it is alleged, to increase telephone penetration. A similar concept is applied to the National Information Infrastructure (“NII”). *See id.* at 16–17.

5. In terms of the taxonomy developed by Cherry and Wildman, the traditional pervasive regulation imposes a universal service obligation on the incumbent which is asymmetric and unilateral. *See* Barbara A. Cherry & Steven S. Wildman, *A Framework for Managing Telecommunications Deregulation while Meeting Universal Service Goals* (visited Mar. 22, 2000) <<http://www.benton.org/Policy/Uniserv/Conference/Frame/frame-exec.html>>. The challenge for the regulator is to develop a new approach in which the obligation is *symmetric* (in that it can be applied to firms other than the incumbent) and *multilateral* (it involves a transaction entered into voluntarily, in which the carrier takes on the obligation in return for compensation). *See id.*