Universal Service: The Poverty of Policy

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Agenda
- Overview
- Expenditure Observations
- Auctions
- Conclusions/Recommendations

Universal Service:
Below-cost Prices for Exchange Service

Policy Goal: Universal Service

Rural/Urban Rate Parity
Residential Subsidized
Business > Residential Rates

Policy Goals: Concerns
- Economic Efficiency
- Distributional Impact/Equity
- Externalities Addressed?
  - High market penetration of exchange service

Goal: Universal Service
Efficiency Concerns
Cross-Subsidies
Summary/Recommendations

Policy Goal: Universal Service

Economic Efficiency
Distributional Impact/Equity
Externalities Addressed?
High market penetration of exchange service

Universal Service:
Rural/Urban Rate Parity
Residential Subsidized
Business > Residential Rates
Policy Goals

- Not Addressed
  - Incidence
  - Penetration
  - Needs/Means Test
- What are the Social Goals?

Implicit Assumptions:
(but incorrect!)

Benefited Class (Poor?):
- Use only exchange service
- Do not use toll
- Live in the rural areas
- Low exchange rates achieved high market penetration

Policy Goals

Demand Patterns

User Subsidy

Service Subsidy

Inefficient
- Not marginal subscribers
- Not targeted
- If targeted
  - Externality addressed
  - Comports with efficient pricing:
    High access charge & usage charge
    Closer to Marginal Cost

Contributions by Service Category

Intrastate Access

Interstate Access

IntraLATA

Vertical Services

Business Exchange

Residence Exchange

Contribution Support

Universal Service Obligation

Rebalanced Contribution

$22.90/month

Contributions by Service Category

Service Subsidy Demand Patterns User Subsidy
Service Subsidy

Universal Service Obligation

- Inefficient
  - Not marginal subscribers
  - Not targeted
  - Not desired
  - Demand relationships

Demand Relationships

- Subscriber Access: Derived Demand
  - Exchange usage
  - Toll usage
  - Other services

Demand Relationships

- Access Is Derived Demand
- Demand Cross-elasticities
  - Access demand has a cross-elasticity with toll demand

Policy Goals: Concerns

- Economic Efficiency
- Distributional Impact/Equity
- Externalities Addressed?
  - High market penetration of exchange service

Demand Relationships

- Subscriber Access: Derived Demand
- Demand Cross-elasticities
- Expenditure Observations
Agenda

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Exchange Service by Income

<table>
<thead>
<tr>
<th>Income</th>
<th>Service/Monthly</th>
</tr>
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<tbody>
<tr>
<td>&lt; $15K</td>
<td>Internet</td>
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<tr>
<td>&lt; $25K</td>
<td>Wireless</td>
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<tr>
<td>&lt; $35K</td>
<td>Cable</td>
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<tr>
<td>&lt; $50K</td>
<td>Toll</td>
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<tr>
<td>&lt; $75K</td>
<td>Exchange</td>
</tr>
<tr>
<td>&gt; $100K</td>
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</tbody>
</table>

Source: PNR & Associates, Request™, 1999
Expenditures

Income versus Service/Monthly

Source: PNR & Associates, ReQuest™, 1999

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Efficiency Concerns

- Inefficient
  - Not marginal subscribers
  - Not targeted
  - Not desired
  - Demand relationships
- Companies Subsidized

Cross-Subsidies

- No Market Test
- Inefficient
- Avoids Competition
- Preemptive

Preemptive

Efficient Entrant's MC

Price

P, P'

AC, MC

Q, Q'

Quantity

Recommendations

Subsidies

- No Cross-Subsidies
- Targeted Subsidies, if any
- Government Financed
Recommendations

- Universal Service Inappropriate
- Social Obligation Defined
- Research on Incidence
- No Cross-Subsidies

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Auctions

Auctions:
- Assign Value
- Minimize Payments
- Voluntary Actions
- Discipline Regulator
- Efficient Entry & Investment

Assign Value

- Market Mechanism
- Not Cost-of-service Based
- Eliminates Cost Debates

Minimize Payments

- Market Determined
  - Self-determined market structure
  - Replaces exclusive franchise

Auctions

- Assign Value
- Minimize Payments
- Voluntary Actions
- Discipline Regulator
Discipline Regulator

- No Regulatory Gaming
- No Regulatory Determination:
  - Who is subsidized or
  - The size of the subsidy

Auctions

- Assign Value
- Minimize Payments
- Voluntary Actions
- Discipline Regulator
- Efficient Entry & Investment

Overview

Expenditure Observations

Auctions

Conclusions/Recommendations

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