Universal Service: A Critique

James Alleman
Interdisciplinary Telecommunications Program
University of Colorado & PHB Hagler Bailly
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Agenda

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

Policy Goal: Universal Service

Universal Service:

Below-cost Prices for Exchange Service

Policy Goals

- Policy Instruments
  - Pricing Goal
  - Not Policy Goals

Policy Goals: Concerns

- Economic Efficiency
- Distributional Impact/Equity
- Externalities Addressed?
  - High Market Penetration of Exchange Service
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

Incidence

Efficiency Concerns

- Inefficient

Universal Service Obligation

- Inefficient
  - Not Marginal Subscribers

Service Subsidy
Universal Service Obligation

- **Inefficient**
  - Not Marginal Subscribers
  - Not Targeted

If Targeted
  - Externality Addressed
  - Comports with Efficient Pricing:
    - Closer to MC =>
      - High Access Charge &
      - Low Usage Charges
Universal Service Obligation

- Inefficient
  - Not Marginal Subscribers
  - Not Targeted
  - Not Desired
- Demand Relationships

Demand Relationships

- Subscriber Access is 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

Demand Relationships

- Access is Derived Demand
- Demand Cross-elasticities
- Expenditures Experience

Expenditure by Income


Expenditure by Income

Expenditure by Income


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Expenditure by Income


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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
- Anti-Competitive

Anti-competitive

Service Subsidy

Price \( P \)  
\[ A' \]
\[ (A' = A + B) \]
AC, MC

Q  Quantity

Price \( P' \)  
\[ A \]
\[ B \]
AC, MC

Q  Q'  Quantity
Anti-competitive

Efficient Entrant's MC

Efficient entrant excluded from the market

Price P

P'

AC, MC

Q Q'

Quantity

Subsides

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

Recommendations

Summary/Recommendations

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

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