CONSUMERGRAM

JUNE 2024

Universal Service Fund: The Bad, Good, and Optimal

AMERICAN CONSUMER INSTITUTE

Introduction

A divided and distracted Congress has paid little attention to reforming the waste, fraud, abuse, and looming insolvency of the Universal Service Fund (USF), a little-known bundle of programs overseen by the Federal Communication Commission (FCC) that is tasked with advancing the affordability and availability of telecommunications services throughout the nation.

FCC enforcement of the Telecommunications Act of 1996 requires that telecommunication providers collect fees on their interstate and international services to fund these programs in the name of "public interest." But as the USF has evolved to provide broadband services and fewer Americans rely on telephony, there are growing concerns that the fund may soon become unstable due to a shrinking contribution base. This has been predictably followed by clamoring for more money and changes to the underlying model structure.

Legislation has already been introduced in the U.S. Senate, and other proposals are in the ideas phase. With concerns and legislation mounting, this explainer details the current structure of the USF and its many shortcomings. It then analyzes existing ideas to reform the fund, suggesting improvements to existing ideas, and better alternatives for reform.

What is USF?

Achieving "universal service," where all Americans have access to communications services, has been an important government objective since Congress passed the Communications Act of 1934. This Act established the FCC and tasked it with regulating interstate and international communications. However, it wasn't until 1996 that Congress amended the Act, which created the USF to provide all Americans access to advanced telecommunications and information services, including most recently high-speed internet.

To advance this goal, the FCC operates the following four federal subsidy programs:

- High-Cost Program: The High-Cost program, also known as the Connect America Fund, provides financial assistance to qualifying telecom and broadband carriers that serve areas that have supposedly been too expensive to deploy network infrastructure. This support is intended to make phone service more affordable for Americans living in these (often rural) areas, though there is no supporting data that payments going to carriers ultimately flow through to consumers or that carrier support was needed.
    - Annual budget: $4.5 billion.
- Lifeline Program: Provides low-income customers a discount on phone and broadband service.
    - Annual budget: $2.7 billion
- Rural Health Care Program: The Rural Health Care program is designed to make telecommunication service rates more affordable for rural healthcare providers.
    - Annual budget: $706.9 million
- Schools and Libraries "E-Rate" Program: Subsidizes internet, telecommunications services, approved equipment, and system maintenance at schools and libraries.
    - Annual budget: $4.9 billion

These programs play an important role in connecting rural areas and underserved Americans in theory only. Unfortunately, they fall short of these lofty goals in practice.

Altogether, the four USF programs fail to deliver on their promise to equip underserved communities with telecommunications and broadband services. The FCC should learn the lessons of better-performing programs that more effectively accomplish the program's stated goals.

The Bad

Unlike other federal programs, which are subject to the congressional appropriations process, the USF is funded by taxing a percentage of telecommunication companies' interstate and international revenue at a fixed rate, known as the “contribution factor.” Between 2004 and 2024, the rate has more than tripled from less than 10 percent to 35 percent today – increasing the financial burden on ratepayers and consumers, some of whom the fund is supposed to help.

The USF’s contribution base is shrinking since it relies on declining interstate telecommunication services (largely voice services) revenue and newer fee-exempt forms of communication technology displace legacy systems. This has put the fund’s long-term financial viability in jeopardy. It has also led to calls to expand the contribution base to include large tech companies and edge providers, each of which is thought to benefit from USF now that the fund supports more than legacy telecommunications services. Costs from expanding the contribution factor to include broadband providers and edge providers would be passed down the business chain to consumers in the form of higher prices on websites, apps, and other online services. By the same logic, should hospitals, health providers, and government entities pay into the fund for the USF support they receive from the Schools and Libraries program?

The FCC estimates that most USF contributors pass these costs to end-users through higher landline prices and more expensive wireless phone bills. Lower-income and older Americans living on fixed incomes shoulder a disproportionate burden as these costs are passed down to consumers. FCC Chairwoman Jessica Rosenworcel has warned lawmakers that requiring contributions from “mass market broadband providers” would increase monthly average household broadband bills by anywhere from $5.25 to $17.96.

Companies that do not pass those costs along to customers – or whose customers are unwilling to pay higher prices – will need to scale down future investments and disrupt the pattern in “network enhancement, consumer happiness, and financial rewards… [that has] guided internet economies for almost four-plus decades,” as former FCC Commissioner O’Reilly recently observed. One way or another, the consumer always pays in higher prices or foregone access to new and better technologies.

The USF’s unique funding model protects it from market fluctuations but also shields it from accountability in the appropriations process – risking abuse of consumer funds and insufficient oversight. In a 2017 Senate Committee on Commerce, Science, and Transportation hearing on the USF’s Lifeline program, economist Jeffrey A. Eisenach testified that “the FCC’s mismanagement of the Lifeline program is not an outlier,” and that the “universal service program has been rife with waste, fraud and abuse throughout its history.” A particularly egregious example of abuse occurred when the Gambino crime family swindled $22 million from the USF between 1996 and 2004 by “fraudulently creating” a rural telephone company.

The USF is also notoriously inefficient. Research has revealed that the USF spends "more than half as much on administrative expenses" as it does on its Rural Health Care and Lifeline programs combined. A 2012 American Consumer Institute (ACI) study that analyzed over 200 rural telephone companies receiving USF High-Cost program support found that these companies (collectively) were already the most profitable in the industry – even before receiving subsidies.

Summing up, the USF creates a tax by another name that shields the fund from accountability and then funnels public money to companies that may not need assistance. And it does all of this while duplicating the efforts of other programs that more effectively accomplish the admirable task of connecting Americans.

The Universal Service Fund has many problems – but lawmakers only have a limited number of proposed solutions. A report from the Congressional Research Service finds lawmakers have only introduced five bills this season that would impact USF programs – mostly to expand the fund's contribution base – but that number will likely grow as the fund's tax base becomes less reliable. The current proposals include:

- The FAIR Contributions Act (SB 856)
    - Requires the FCC to "conduct a study on the feasibility of collecting Universal Service Fund contributions from internet edge providers." Digital advertising and user fees are offered as new possible revenue sources.

- The Lowering Broadband Costs for Consumers Act (SB 3321)
    - Requires the FCC to ensure "equitable and nondiscriminatory" contributions to advance universal service and specifically mandates that the Commission complete a rulemaking to include broadband and edge providers in the contribution base.

- The Reforming Broadband Connectivity Act of 2023 (SB 975 and HB 1812)
    - Directs the Commission to initiate rulemaking to reform the contribution system. Designed to "strengthen funding mechanisms for the USF," and require the FCC to consider the "fairness" and "relative burden" of fees on consumers and businesses.

- The Promoting Affordability Connectivity Act (SB 4208)
    - Folds the Affordability Connectivity Program (ACP) into the USF to protect it from the uncertainty of the appropriations process. The Act requires broadband providers and tech companies to pay into the fund as a base expansion measure. It also contains a unique provision that enables the FCC to borrow money from the Treasury to be "used in the same manner as the amounts in the Affordable Connectivity Fund."

Rather than addressing the underlying reforms, each proposal expands the USF contribution factor to include broadband and edge providers, despite the fund's inherent inefficiencies and waste.

A draft bipartisan proposal from a working group of lawmakers from both chambers is expected soon, after nearly a year of work evaluating and proposing potential reforms to the USF. And while it's an open question what such a proposal will look like, it seems probable that it will needlessly expand the fee base to include broadband providers and potentially large tech companies. The Co-Chairs of the group, Senators Ben Ray Lujan (D-NM) and John Thune (R-SD), have each previously signed onto legislation that would examine expanding the USF tax contribution base.

Very few legislative proposals seek underlying reform, instead opting for a status-quo safety valve that would expand the base, keep budgets the same or increase them, and unintentionally encourage more future spending without reform. Such an unnecessary problem can be anticipated and averted by adopting less-discussed alternatives.

The Good

Proposals swirling through Congressional chambers are more bad than good – but there are some reasons for buoyant optimism, specifically legislation that would address the USF's structural issues instead of funding future problems. The Rural Broadband Protection Act of 2023 (SB 275), for example, is designed to "crack down on waste, fraud, and abuse in FCC rural broadband programs." It requires the Commission to establish a vetting process for the USF High-Cost program applicants to make sure money is well spent. That's commendable, but more ambitious reforms are needed.

The gold standard of reform was laid out by Sen. Ted Cruz (R-TX) in a March 2024 report that roadmaps how to restrain counterproductive spending, streamline programs, and crack down on the worst abuses of the High-Cost program. The plan is broken down into eight principles, each serving as a guide and useful goal for comprehensive reform. Several are worth highlighting, due to their important contribution to reform, and provide a possible roadmap for future legislation. These include:

- Put Congress Back in The Driver's Seat
    - Mission creep has driven demands for more program dollars and has renewed calls for contribution reform. Congress, not the FCC, should define universal service and decide where funding should go so that it is spent efficiently and not squandered.

- Move Social Welfare Spending On-Budget
    - Most importantly, a lack of direct Congressional oversight insulates USF programs from accountability by shielding them from the appropriations process. To encourage prudent budgeting, negotiations over program spending should be handled by Congress so that money always goes where it was intended.

- Eliminate Program Duplication
  - According to the Government Accountability Office (GAO), 15 agencies administer 133 federal broadband programs, sparking fragmentation, duplicative efforts, and poor coordination between agencies. This has even led to overbuilding, where broadband networks are unnecessarily built on top of existing networks, wasting precious resources. In addition, most states operate their own universal service funds, and the need for subsidies has decreased as real broadband prices have declined relative to the Consumer Price Index or when adjusted for hedonic quality.

- Stop Subsidizing Networks That Face Unsubsidized Competition
  - The USF was created by the Telecommunications Act of 1996, when dial-up services dominated the market and few competitive high-speed alternatives existed. With telecommunications, cable, satellite, and wireless internet service providers, subsidizing competitive markets is not a good use of fund dollars.

- Target Low-Income Subsidies To Those Who Truly Need Them
  - Program overlap is problematic because it results in program duplication and inefficiently uses scarce resources. For example, the ACP and Lifeline both subsidize internet access to low-income households by providing them with a one-time discount on the purchase of covered technology.
  - To avoid program duplication and save money, the USF's Lifeline program should be merged into the ACP, if not eliminated entirely. As ACI has previously written, the ACP has more effectively connected Americans to the internet and provided them with bigger discounts on one-time device purchases. Most Lifeline subscribers are already eligible for the ACP anyway, suggesting an easier path to merge the programs.

- Establish Better Controls To Stop Waste, Fraud, and Abuse
  - Senator Ted Cruz's report notes that all four USF programs have been "wracked by massive amounts of fraud and abuse," but that's not the only evidence. For example, a Government Accountability Office audit of the Lifeline program found the program mistakenly gave deceased individuals more than $1 million in phone subsidies – a massive waste of fund resources. Another GOA report on the Schools and Libraries "E-Rate" Program discovered several fraud risks that had persisted for several years.

The exact cost savings of reforms are hard to predict, if only because the program has little public transparency and accountability – but bringing the USF program under the umbrella of the appropriations process would improve both by reducing market distortion and the misallocation of resources. Elected officials accountable to voters and stakeholders could then play an active role in approving future program expenditures, as already occurs in ordinary budget debates. That process is not perfect, of course. Congress spends too much money in normal budget cycles already, but budgeting in full view is better than budgeting in the shadows. This procedural reform would help guard against excessive spending, dissuade mission creep, shield against unnecessary program expansion, and provide a counterweight to changes to the contribution rate.

The Optimal

Eliminating the Universal Service Fund would save ratepayers billions of dollars a year, save American consumers money, and free up time for the FCC to focus on more pressing initiatives. That would be a welcome improvement, but replacing the USF with the ACP is an even better alternative. Unlike the USF, the ACP is enormously popular and more effective at providing targeted assistance to disadvantaged Americans – but Congress allowed the program to lapse. Millions of Americans rely on the ACP for work and use it to access important services like education and healthcare. Resurrecting this program and replacing USF would solve two problems at once.

The ACP is better designed than the USF – but it is imperfect. The poverty threshold – currently 200 percent of the poverty line – should be lowered so funds are better targeted to those in need. That small tweak would also simplify a merger between the two programs by aligning participant qualifications in the ACP and the USF's Lifeline program. Even without such tweaks, the ACP is already more affordable on an annual basis. The USF runs on a nearly $10 billion annual budget. Most current requests to restore ACP funding, such as that proposed by the White House last October, are noticeably less – roughly $6 billion for a year-long extension. Congress should fund programs that work best – not double down on errors.

Conclusion

The Universal Service Fund has routinely proven unaccountable, unreliable, inefficient, duplicative, wasteful, and burdensome to consumers who must pay for its continued operation through higher monthly telecommunications bills. It should be refocused or scrapped entirely. As currently constructed, the program has outlived its usefulness, and it has been outcompeted by many other programs that more effectively accomplish this task. The Affordable Connectivity Program, for example, does a better job of providing broadband services to consumers at a more affordable cost.

Congress must examine the structural problems in the USF if it desires sustainable change. Absent more substantial reform, Congress should require USF programs to be subject to the appropriations process so future spending can be more closely monitored. Simply expanding the USF's contribution base only delays needed structural reform. Rather than de facto taxing telephone companies to subsidize broadband adoption, Congress should seek remedies that reduce the fees that businesses pass onto consumers through higher prices and reduced innovation.

If technology and broadband are important to the lives and well-being of consumers, we should not tax what we want to encourage.

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