

**EXPOSING THE HOAX:**

**THE PHONY “CRISIS” OF THE  
UNIVERSAL SERVICE FUND (USF)**

**A Report by the  
Keep Universal Service Fund Fair Coalition**

**February 27, 2006**

## OVERVIEW

Proponents of killing or expanding the federal Universal Service Fund (USF) fee paid by consumers share one thing in common: the claim that the Fund contribution formula is “broken” and “needs to be repaired.” In particular, this sense of urgency has been cited by Federal Communications Commission (FCC) Chairman Kevin Martin and some in Congress as a rationale for an immediate switchover from the current pay-for-what-you-use system of funding USF to a controversial “numbers” system that would assess consumers with a per-line USF fee regardless of whether or not they make any long-distance phone calls at all. The stakes here for consumers are exceedingly high since the widely criticized “numbers” plan would cost 43 million U.S. households – most of them low-income seniors, rural residents and minorities making few or no long-distance calls – up to \$700 million in USF fees – what nearly all Americans outside of the D.C. Capitol Beltway would think of as a tax increase.

However, the facts suggest that the case for a change so radical as shifting USF to a numbers-based formula is the telecommunications equivalents of weapons of mass destruction (WMDs) in Iraq: The evidence of a problem isn't there. Based on publicly available records, the facts about USF funding are:

- ***The USF fee passed on to consumers has been stable – not rising quickly.*** In the first quarter of 2006, the contribution formula was set at 10.2 percent of long-distance charges, which was the level set by the FCC for the preceding two quarters and an actual ***decrease*** from the 11.1 percent set for the second quarter of 2005 and 10.7 percent in the first quarter of that year. With the current relatively stable contribution factor, consumers are making ***lower*** USF payments today than they were in 2002.
- ***The current USF revenue base is stable – not eroding.*** In 2003, the long-distance revenue base for the Universal Service Fund fee was \$76.6 billion, compared to an estimate of \$78.9 billion in 2006. In 2007, the projected revenues will be down slightly to \$76.8 billion, but that is still slightly higher than the 2003 level.
- ***The potentially enhanced USF revenue base is growing – not insufficient.*** The current USF contribution methodology could logically be extended on a technology-neutral basis to include advanced telecommunications and Voice over Internet Protocol (VoIP). The 2004 expanded revenue base for USF would have been \$95.3 billion, growing to \$104.5 billion in 2006 and \$105.9 billion in 2007.
- ***Under a technology-neutral approach to USF funding, all consumers using long distance would pay less than they do now – not an increase of 1,000 percent or more for many under a “numbers” approach.*** Under an expanded USF revenue base, the USF contribution would have dropped this year from the current 10.2 percent (the contribution factor set for the first quarter of 2006) to roughly 7 percent.

As the actual USF data reflect, there is no Universal Service Fund contribution “crisis” today. There is no evidence that the contribution system is “broken” or “needs repair.” If changes to the USF contribution formula are needed in the future, it is possible to make modest incremental adjustments falling far short of radical upheaval of the sort of that would harm tens of millions of the most vulnerable U.S. consumers.

## **THE USF “CRISIS”: SEPARATING FACT FROM FICTION**

*“I believe the Commission needs to revise the way in which it collects universal service monies. ... For some time now, I have advocated a mechanism based on telephone numbers. ... Critics of this approach argue that a telephone number-based approach would disproportionately increase the costs of telecommunications services to low volume users. ... These questions have been debated by various segments of the industry for a long time now and I haven’t heard of any recent breakthroughs. I am not sure, at this point, that there will ever be consensus. Although I am open to other approaches that would serve to increase the contributions into the fund, we cannot wait much longer before taking action. The industry needs certainty and the fund needs fixing. I look forward to working with my colleagues to figure out a solution in the near future.”<sup>1</sup>*

*”In addition, the bill addresses a crisis in the structure of the universal service fund which has threatened its long term viability. Currently, the burden of universal service fund contributions is placed on a limited class of carriers, causing inequities in the system and incentives to avoid contribution. As demands on the fund increase, contributors are being forced to pay more. This tension threatens to cripple the fund.”<sup>2</sup>*

It is accepted as an unquestioned article of faith by some in Washington that the Universal Service Fund<sup>3</sup> (USF) fee paid by long-distance phone service customers is “broken” and “needs to be repaired.” And it is this WMD-like “crisis” that is being used to justify an intervention to overhaul the USF funding mechanism. The supposed funding crisis is invoked over and over again by two groups of individuals: those who want to kill the USF program and those who want to switch its funding formula from the current pay-for-what-you-use system to a controversial “numbers” system that would assess consumers with a USF fee regardless of whether or not they make any long-distance phone calls at all.

Championed by Federal Communications Commission (FCC) Chairman Kevin Martin and some on Capitol Hill, the highly controversial “numbers” approach to funding USF has been criticized by leading consumer, senior, minority, rural and other groups as something that would be profoundly harmful in terms of its impact.

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<sup>1</sup> Remarks of FCC Chairman Kevin J. Martin, before the TELECOM 05 Conference, United States Telecom Association, Las Vegas, NV, October 26, 2005, page 3.  
[http://hraunfoss.fcc.gov/edocs\\_public/attachmatch/DOC-261868A1.pdf](http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-261868A1.pdf)

<sup>2</sup> Statement of Senator Gordon Smith, Congressional Record, Senate, Page S9505, July 29, 2005.

<sup>3</sup> The Universal Service Fund (USF) is intended to ensure that low income and rural consumers have access to affordable phone services. It also provides Internet at discounted rates to schools, libraries and rural healthcare providers. Today, USF monies are collected on a “pay-for-what-you-use” system. Consumers pay a percentage of their monthly phone bill to the Universal Service Fund based on how much long distance they actually use. Under this arrangement, if a consumer uses less, he or she pays less.

On November 17, 2005, the Keep USF Fair Coalition released its report entitled “*Losing Numbers: How America’s Most Vulnerable Consumers Could Suffer Under Universal Service Fund (USF) ‘Reform’*”. The KUSFF report concluded: “The currently consumer-friendly ‘pay for what you use’ approach to funding the Universal Service Fund would be replaced under the Martin plan with a regressive, flat-fee arrangement of \$1-\$2 or more per phone line – regardless of whether or not consumers even make a long-distance call. For a consumer who now dials only a handful of long-distance calls per year and pays correspondingly low USF taxes, the effective tax rate under the Martin plan would soar by more than 1,000 percent on an annual basis! With low-income and elderly consumers already socked with high gas prices, the prospect of soaring winter heating bills and continued inflation in medical prescriptions, the wide range of diverse groups in the Keep USF Fair Coalition are opposing the Martin ‘numbers’ based plan. These groups caution against balancing USF finances on the backs of the very consumers who use long-distance the least and are unable to afford phone bills that would rise under ‘numbers’ simply in order to subsidize high-income/high-volume callers.”<sup>4</sup>

The KUSFF Coalition report estimates that the Martin “numbers” plan could result in a shift of more than \$700 million onto 43 million U.S. households – including a particularly vulnerable 16 million low-income seniors, rural residents, and minorities who currently pay little or nothing to USF since they can afford to make few or no long-distance phone calls.<sup>5</sup> Despite repeated calls by consumer groups and others<sup>6</sup> for Chairman Martin and other proponents of “numbers” for USF funding to calculate the impact on consumers of their plan, no such calculations have yet been made public.

But the fact that the numbers on “numbers” have not yet been provided is only part of the problem here. Also missing in action is the “smoking gun” that proves that there actually is an USF funding “crisis.” Not only have proponents of overhauling USF funding failed to reckon with the burden they would impose on consumers, they have not yet demonstrated that the current USF contribution method is – to use their oft-repeated talking point phrases -- “broken” and in “need of repair.”

The decision to try to stampede the reform process appears to be guided, in large part, by the consideration that the facts do not support the claim that there is a USF funding crisis. Based on publicly available records, the facts here are as follows:

- ***The USF fee passed on to consumers has been stable – not rising quickly.*** In the first quarter of 2006, the contribution formula was set at 10.2 percent of long-distance charges, which was the level set by the FCC for the preceding two quarters and an actual ***decrease*** from the 11.1 percent set for the second quarter of 2005 and 10.7 percent in the first quarter of that year. In December 2002, the FCC adopted a rule prohibiting long-distance firms from “marking up” USF pass through charges on consumer bills. Prior to that rule going into effect, long distance

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<sup>4</sup> “Losing Numbers: How America’s Most Vulnerable Consumers Could Suffer Under USF Reform,” November, 17, 2005, page 1. [http://keepusffair.org/img/gv2/nonstandard\\_files/keepusffair/Losing-numbers-report.pdf](http://keepusffair.org/img/gv2/nonstandard_files/keepusffair/Losing-numbers-report.pdf).

<sup>5</sup> Ibid, page 6.

<sup>6</sup> Linda Sherry, Consumer Action. See November 17, 2005 Keep USF Fair Coalition news release, <http://keepusffair.org/KeepUSFFair/news-losing-numbers.html>.

carrier USF pass throughs to consumers often where in the 12-13 percent range or even higher. Thus, with the current relatively stable contribution factor, consumers are making **lower** USF payments today than they were in 2002.

- ***The current USF revenue base is stable – not eroding.*** In 2003, the long-distance revenue base for the Universal Service Fund fee was \$76.6 billion, compared to an estimate of \$78.9 billion in 2006. In 2007, the projected revenues will be down slightly to \$76.8 billion, but that is still slightly higher than the 2003 level.<sup>7</sup>
- ***The potentially enhanced USF revenue base is growing – not insufficient.*** The current USF contribution methodology could logically be extended on a technology-neutral basis to include advanced telecommunications and Voice over Internet Protocol (VoIP). The 2004 expanded revenue base for USF would have been \$95.3 billion, growing to \$104.5 billion in 2006 and \$105.9 billion in 2007.<sup>8</sup>
- ***Under a technology-neutral approach to USF funding, all consumers using long distance would pay less than they do now – not an increase of 1,000 percent or more for many under a “numbers” approach.*** Under an expanded USF revenue base, the USF contribution would have dropped this year from the current 10.2 percent (the contribution factor set for the first quarter of 2006) to roughly 7 percent.<sup>9</sup>

As the actual USF data reflect, there is no Universal Service Fund “crisis” today. There is no evidence that the contribution system is “broken” or “needs repair.” If changes to the USF contribution formula are needed, it is possible to make modest incremental adjustments that fall far short of radical upheaval of the sort of that would harm millions of vulnerable consumers. That is why the Keep USF Fair Coalition members and other groups concerned are coalescing around the “Fair Share Plan,” which would eliminate the need for radical changes that would be injurious to vulnerable consumers.<sup>10</sup>

The Plan sets out the following, common-sense reforms to improve the USF contribution process to ensure sufficient funds:

- Expand the USF contribution base to include revenues derived from all telecommunications, including services provided using Voice over the Internet Protocol (VoIP) technology.
- Establish a contribution factor cap to be applied to the revenue-based approach, e.g., somewhere between 12 and 15 percent of revenues derived from interstate telecommunications (including VoIP).

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<sup>7</sup> Congressional Budget Office, “Financing Universal Telephone Service,” March 2005.

<sup>8</sup> Halpern Capital, “Voice over Internet Protocol (VoIP),” March 8, 2005 and UBS Investment Research, “Telephony and HSD Update for 4Q04,” March 10, 2005.

<sup>9</sup> Based on a contribution base of \$104.5 billion and a funding requirement of \$7.1 billion, as has been projected by the Congressional Budget Office, Universal Service Administrative Company and FCC staff projections.

<sup>10</sup> [http://keepusffair.org/img/gv2/nonstandard\\_files/keepusffair/JointExParteComments81505.pdf](http://keepusffair.org/img/gv2/nonstandard_files/keepusffair/JointExParteComments81505.pdf).

- Carriers would still be assessed based on revenues up to that cap amount, and would still have the right to charge their end users a USF recovery charge not to exceed the capped amount.

It is only after all of these steps have been taken under the Fair Share Plan that a numbers-based approach could be invoked strictly as a fallback funding approach, which is not expected to come into play. In order to minimize damage to consumers, the numbers component would only recover the amount of any revenue shortfall. The Plan would benefit those low-income users who make few interstate calls. They would be subject to flat assessments for their wireline and wireless telephone numbers, but the level of those assessments would be measured in cents, not the \$1-\$2 a line or more that should be anticipated under a “connection” or “numbers” based funding plan.

**SOURCES/  
RECOMMENDED READING**

Losing Numbers: How America's Most Vulnerable Consumers Could Suffer Under Universal Service Fund (USF) "Reform", Keep USF Fair Coalition, November 17, 2005  
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"Universal Service Fund Increases: What Every Consumer Should Know," Federal Communications Commission, <http://www.fcc.gov/cgb/consumerfacts/usfincrease.html>.

## **ABOUT THE COALITION**

The Keep USF Fair Coalition (<http://www.keepusffair.org>) is committed to keeping the Universal Service Fund collection method fair, and opposing proposals to move to a regressive, per-line flat fee. Now counting more than 115,000 members in its ranks, The Keep USF Fair Coalition was formed in April 2004. Current members include Alliance for Public Technology, Alliance For Retired Americans, American Association Of People With Disabilities, American Corn Growers Association, American Council of the Blind, Black Leadership Forum, Consumer Action, Deafness Research Foundation, Gray Panthers, Latino Issues Forum, League Of United Latin American Citizens, Maryland Consumer Rights Coalition, National Association Of The Deaf, National Consumers League, National Grange, National Hispanic Council on Aging, National Native American Chamber of Commerce, The Seniors Coalition, Virginia Citizen's Consumer Council and World Institute On Disability.

The NAACP is a supporter of the Keep USF Fair Coalition, and is among the many national organizations that have filed comments with the FCC in support of a non-regressive USF collection method. Keep USF Fair also has received support through a resolution passed in 2005 by the National Association of Consumer Agency Administrators (NACAA). The resolution recognizes that a "restructuring effort of the Universal Services Fee must find a fair method, competitively neutral, that takes into consideration new technologies," and says that a "flat fee or exclusively numbers-based plan would be unfair to millions of consumers, especially lower call volume users if they would now pay the same fee as high volume, business users."