

Issue Brief

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Universal Service Fund Reform Requires a Direct Overhaul

The COVID-19 pandemic drove significant adjustments to online work and learning options for tens of millions of Americans, highlighting the gap between Americans with access to reliable internet and those who lack the resource. Telecommunications access has become increasingly important as digitalization expands in the United States. However, the digital divide is still prevalent and persistent despite attempts to close this gap through legislation.

The Universal Service Fund (USF) is a well established initiative meant to address these barriers by funding equal access to communications services. Although the program has strong intentions, it requires reform in order to efficiently finance assistance to those who need it, and to protect the consumers paying higher fees to support it. Recently, the Federal Communications Commission (FCC) has recommended changing how the USF is funded by passing fees onto online content delivery services that people connect to over the internet, also known as edge providers. However, these proposals will likely do little to advocate for consumers that are seeing increased costs on their monthly telecommunication bills. The USF requires a more comprehensive overhaul to actually implement long-term and lasting solutions for effectively addressing the digital divide.

History

The Communications Act of 1934 [established](#) the FCC, which oversees the USF. The legislation stated, “all people in the United States shall have access to rapid, efficient, nationwide communications service with adequate facilities at reasonable charges.” Under this legislation, the USF eventually subsidized telephone service for low-income families in costly areas. The Telecommunications Act of 1996 elaborated on the definition of universal access to communications services to include facilities such as schools and libraries.

Currently, the [Universal Service Administrative Company](#) (USAC) collects contributions from telecommunications companies and manages the disbursement of financing through four USF programs. These are called: High-Cost, Rural Health Care, E-Rate,, and Lifeline.

The “Accessibility Gap” refers to the divide between those with access to online services and those without it – most of which reside in isolated, rural, or tribal areas. The High-Cost funding supports qualifying telephone companies that operate in high-cost areas to make the service more affordable for these customers. For example, rural areas are likely to be difficult to reach and less populous, making telephone costs higher for residents in these regions. Carriers will make less profit, and have less reason to invest in these areas. The High-Cost Fund works to bridge this divide to encourage investment similar to urban areas.

The Rural Healthcare Support Mechanism works similarly to support rural health care providers by presenting rates similar to those given to their urban counterparts. The USF provides funding for telecommunications and broadband systems that are essential to providing quality health care services.

The “Homework Gap” is characterized by the barriers students without dependable internet access face when completing classroom work or related activities. E-Rate helps deliver services such as internet access and connection to qualifying schools and libraries. The goal is for these public institutions to receive affordable broadband services. Discounts are given for telecommunications services based on assessments of poverty levels.

The “Affordability Gap” refers to the obstacles faced by those who cannot afford access to communications services. Lifeline works to support low-income consumers by subsidizing monthly bills for phone and internet. These subsidies are distributed through providers, who then pass the assistance onto qualifying customers.

The USF was designed with a goal to increase access to telephone service, so most of the companies that fund the program are traditional telephone carriers. However, with modernization and increased digitalization, the Telecommunications Act of 1996 could be seen as too [narrow](#) in scope. The legislation does not focus on addressing broadband costs, which have become more relevant for most Americans.

Funding

The USF relies on financial contributions from telecommunications providers based on assessments of interstate and international end-user revenues. These companies are required by law to pay a percentage of these earnings to the USF. Each quarter, this contribution factor changes based on the projections given by the USAC.

In the second quarter of 2022, the USF [contribution factor](#) was historically high at 33.4 percent. In comparison, the contribution factor was just 6.8 percent in the second quarter of 2001. Currently, the percentage is set at 28.9 percent for the fourth quarter of 2022. These steep jumps indicate inefficiencies in how funding is collected. Due to shifts away from traditional telecommunications providers, revenue has sharply decreased even though the services that the USF provides have expanded. FCC Commissioner Brendan Carr [predicts](#) that without reform, the contribution factor could reach a staggering 75 percent within four years.

Consumers are directly impacted by these costs because telecommunication companies often pass the burden of these fees onto customers. Many people are switching to Internet Protocol based alternatives, further decreasing revenue sources for telecommunication companies and increasing the rates that they charge their customer base. Although telecommunication companies benefit from the USF, consumers ultimately bear the burden of increased fees.

Proposed Reform

Commissioner Carr recently released a [statement](#) discussing possible USF reform titled “Report on the Future of the Universal Service Fund”. He stated “the FCC’s funding mechanism for this vital program is stuck in a death spiral”. His two main proposed solutions are expanding contributions to include Broadband Internet Access Services and edge providers such as Amazon or Microsoft. With this report, the FCC is essentially asking Congress to take the next steps on USF reform. The FCC analysis correctly identifies there are massive funding issues within the USF, but their recommendations simply push liability onto other digital players (and, eventually, consumers).

The report considers the idea of taxing broadband. However, the Commission believes this option would create higher end-user fees, the gross amount that is invoiced to customers. The FCC points more directly to streaming platforms that make up a large portion of network traffic in rural areas. The FCC argues some companies are heavily profiting from USF-funded support, but do not contribute to the Fund. The report states that if these companies contributed a percentage of digital advertising revenue to the USF, the contribution factor would be much lower and consumers would see decreased costs.

While the FCC correctly identifies problems with how the USF is funded, the solution it offers is unlikely to actually reform and improve the Fund. If the USF were to charge streaming providers, for example, it is likely that these companies would simply pass this burden onto customers. Consumers may see a decreased monthly bill from telecommunications companies, but the difference would likely show up in increased costs from streaming providers. These services are growing and changing because they are still relatively new, so it would be concerning for the USF to set a standard of simply demanding fees from the newest consumer innovations.

These edge providers also do more than just provide streaming services. They are often the host of online platforms that are beneficial to everyday Americans who go on the internet. Commissioner Carr [states](#), “to ensure we can assess a full range of services offered by large technology companies and do so on a truly fair and equitable basis, we will likely need Congress to grant the FCC additional authority.” While it may be worthwhile to further analyze the usage of edge providers and tech companies, it would be [troubling](#) if the FCC pushed more fee responsibility onto these companies simply because they are profitable.

The FCC report essentially calls for taxing the internet to pay for the USF. If the goal of the USF is to increase access to the internet, it seems counterintuitive to put fees on these very services. Taxing tech companies is a lazy solution to a [larger problem](#). Edge providers help create robust online ecosystems and should not be seen as a scapegoat for the USF to deflect its internal funding problems towards.

What Comes Next?

Online services are increasingly essential for everyday Americans to be active in society. The USF has historically helped close the digital divide and remains an important program. However, the funding model is outdated and requires modern changes instead of quick fixes.

Previous FCC Chairman Ajit Pai [proposed](#) moving the USF on-budget, providing funding for the program for the next five years. He stated, “The law authorizing this spending would call on Congress to come up with a solution to the eroding contribution base within five years. In the near term, this proposal would allow us to eliminate the USF contribution system—a system which is regressive, wasteful, and often arbitrated. In addition, consumers would get a tax cut in the form of lower phone bills.”

This proposal would allow legislators to carefully decide on a long term solution to address the digital divide, whether that is reforming the USF or changing it entirely. It will likely require time to sufficiently solve the issue at hand, but taxpayers do not deserve to bear the burden of skyrocketing

contribution costs while policymakers work to improve the USF. Any additional government spending from moving the USF on-budget could be offset with a number of spending offsets suggested recently by NTU and NTU Foundation; for just one robust example, see our 2020 [“Toward Common Ground” report](#) with the U.S. Public Interest Research Group Education Fund.

Many government programs are funded by direct appropriations, so it would not be out of the ordinary to include USF under this umbrella for several years. The program would be subject to direct Congressional oversight, which would likely identify and prevent issues such as fraud within funding distribution. By having a legislative watchdog to closely monitor the program with hearings and questioning, the USF would be under closer scrutiny and be on the Congressional agenda for urgently-needed reforms.

Instead of the current system of dynamic contribution factors, the USF would have a budgetary cap. The program would be forced to narrow spending inefficiencies and would ultimately be more accountable to Congress and taxpayers for the way it spends money. With the opportunity for a complete overhaul, the USF stands to truly accomplish its original mission of closing the digital divide and ensuring equal access to the internet.

Conclusion

Historically, the USF has been central to efforts to bridge the digital divide. Current reform proposals do not encourage a long term solution for solving the critical gaps in internet access across the United States. Instead, taxpayers and consumers are directly impacted by the increasing contribution factor and by proposals to expand USF fees to new types of digital service providers. By temporarily moving the USF on-cycle, Congress can provide Americans with some relief from mounting monthly telephone bills and the program as whole can be effectively changed for the better.

About the Author

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