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Converging Industries Research Foundation

Practical Solutions for Communications Policy

Universal Service Tool Kit, Part 2: Beyond Cost Allocation: Benchmark Subsidy Method

Executive Summary

October 10, 1994

*Presentation at the November 1994 NARUC Meeting,
Reno, Nevada*

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Description

This paper continues research on universal service done by the Telecommunications Industries Analysis Project (TIAP). The TIAP is writing a series of papers that can be seen as a *Universal Service Tool Kit*. Just as you need a variety of tools for different problems on your car, you also need various tools (mechanisms) to restructure universal service policies. This paper - *Universal Service Tool Kit, Part 2: Beyond Cost Allocations: Benchmark Subsidy Method* - presents one approach that combines several transition mechanisms with major restructuring for the long-term. Other approaches are possible.

Objective

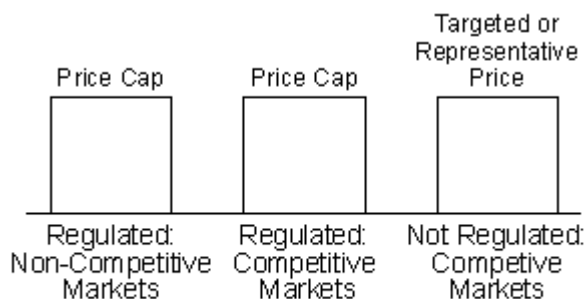
The objective of this paper is to illustrate a single mechanism for subsidies regardless of whether or not a market is competitive. This approach provides incentives for efficiency. It also preserves basic subsidies while shifting to a new regulatory mechanism.

Importance

Subsidies can be used to promote universal service even when there is competition. Also, subsidies can be constructed to work in both regulated and non-regulated markets. It is possible to shift to price regulation and eliminate rate of return regulation and allocations of accounting costs while still retaining subsidies for some definition of basic service.

Benchmark Subsidy Method

In the Benchmark Subsidy Method the subsidy is the difference between benchmark costs and benchmark prices. Benchmark costs are the incremental cost of basic services, plus a reasonable contribution to overhead costs.



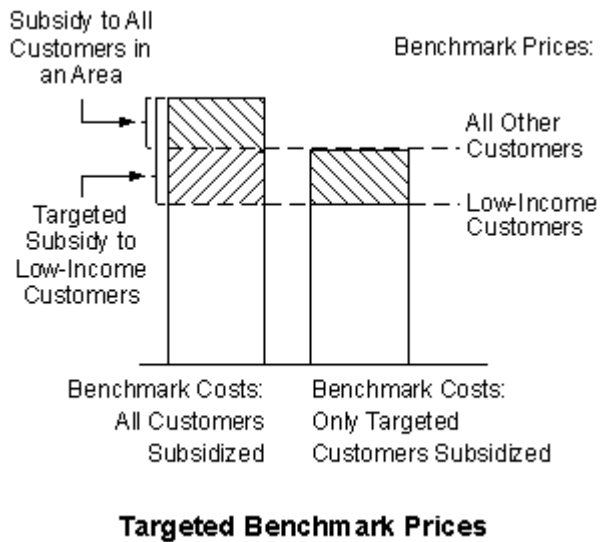
Benchmark prices are either price caps for basic service (if prices are regulated) or target prices (if prices are not regulated). Providers of basic services would receive revenues from customers in the form of prices, and from the Benchmark Subsidy Method in the form of subsidies. These revenues should be sufficient to allow a reasonably efficient service provider to be financially viable.

Benchmark Price per Line for Basic Service

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Benchmark Subsidy Method, cont.



The regulatory process would determine the new subsidy amount for an area by subtracting the benchmark prices from the benchmark costs. Subsidies would not be necessary when benchmark prices were equal to or above benchmark costs.

Subsidies could be general or specific, or both. An example of a general subsidy is one applied to all customers in an area. An example of a specific subsidy is one applied to low-income customers. The chart illustrates both of these examples. In the same area, it is possible to have both of these subsidies. The dashed lines indicate two different benchmark prices.