



# CIRF

## **Converging Industries Research Foundation**

*Practical Solutions for Communications Policy*

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### **Apples and Oranges: Differences between Various Subsidy Studies**

*Executive Summary*

**October 10, 1994; Revised July 19, 1995**

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

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## **Telecommunications Industries Analysis Project**

**Carol Weinhaus**

Telecommunications  
Industries Analysis Project

**Teresa Pitts**

Washington Utilities and  
Transportation Commission

**Mark Jamison**

Sprint

**Dan Harris**

Bell Atlantic

**Sanford Berg**

University of Florida

**Jim Dunbar**

Sprint Local Telecom

**David Charlton**

Corning

**Peter Copeland**

U S West

**Harry Albright**

Ameritech Services

**John Bosley**

NYNEX

**Linda Garbanati**

Bellcore

**John Monfils**

Anchorage Telephone Utility

**Pete Martin**

BellSouth

**Sandra Makeeff**

Iowa Utilities Board

**Terry Monroe**

New York Public Service Commission

**Agenia Clark**

NorTel

**Glen Sims**

Southwestern Bell

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# Apples and Oranges: Differences between Various Subsidy Studies

## *Executive Summary*

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### Various Estimates for Subsidies

Traditional policies for universal telephone service have concentrated on keeping prices for basic telephone service affordable for residential customers and for customers in high-cost areas, such as rural areas. Regulators and the telephone industry have tried to keep prices affordable by developing a system of subsidies that increase prices for other customers - primarily business, urban, and long distance customers - in order to cover the costs of serving the subsidized residential and rural customers.

Competition and changes in technology are making this traditional subsidy system unworkable for the future. As a result, numerous policy makers, companies, and industry analysts have developed proposals for developing a new subsidy system for universal service.

One of the key issues in developing a new subsidy system is, "How large is the subsidy?" Several recent studies have attempted to answer this question.<sup>1</sup> The answers have varied widely, from \$1.1 billion to \$20 billion. The purpose of this paper is to explain some differences between these estimates, indicated in **Figure 1**.

### Why are all of these estimates different?

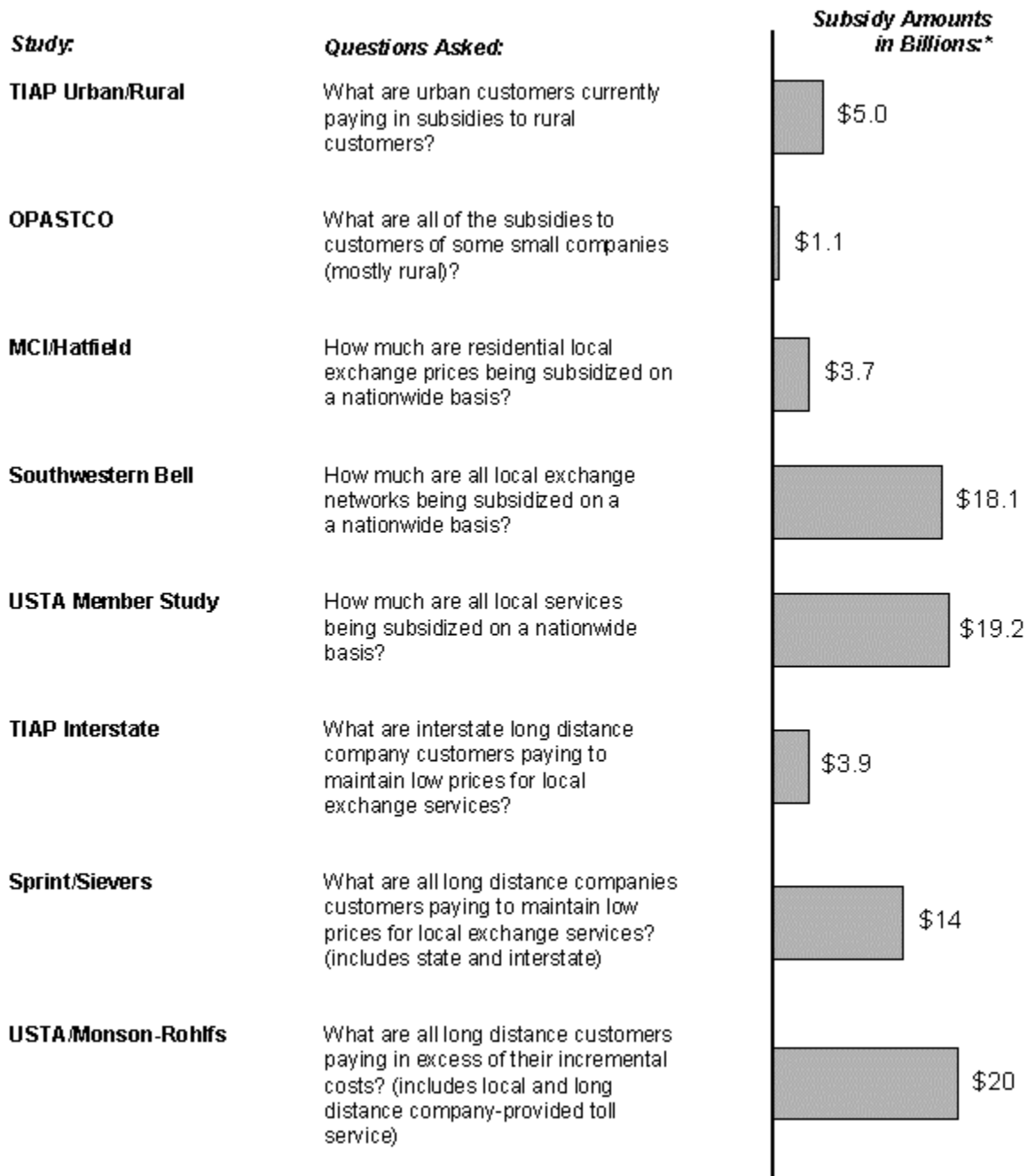
Each study answers different questions, as indicated in **Figure 1**. The studies examine different types of subsidies and markets, and they use dissimilar methods and data. In addition, there are varying views as to what constitutes incremental cost. For example, the MCI/Hatfield and the USTA/Monson-Rohlf's studies each use different definitions. There is a temptation to add or subtract these different study results; however, without detailed knowledge of each study, the resulting calculations are meaningless.

**Figure 2** provides a detailed checklist of differences. Some of the items on the checklist cover the flow of subsidies by market segment. The market segments for subsidies are: services, geography, and customers. The paper also gives a brief overview of each study. Each one-page description presents the approach used in the study, the definition of "subsidy," a description of the data set, a chart indicating the subsidy flows within the context of the total local exchange carrier and long distance carrier markets (\$127.6 billion in revenues in 1992), and the resulting subsidy.

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<sup>1</sup> The term "subsidy" is chosen for this paper because it is the term most commonly used to describe the public policies that have been used to keep local exchange prices affordable.

**Figure 1: Questions Asked by Each Subsidy Study and Resulting Subsidies**



\*There is a temptation to add or subtract these different study results; however, without detailed knowledge of each study, the resulting calculations are meaningless.

**Figure 2: Checklist of Items Covered by Each Subsidy Study**

Questions covered by study	Study							
	TIAP Urban/ Rural	OPAS- TCO	MCI/ Hatfield	South- western Bell	USTA Member Study	TIAP Interstate	Sprint/ Sievers	USTA/ Monson- Rohlf's
<b>Who gets subsidized?</b>								
<i>Geography</i>								
Rural Customers								
OPASTCO areas	XXXXX	XXXXX						
All other areas	XXXXX							
<i>Customer Types:</i>								
Large/small								
Business/residential			XXXXX					
Income level								
<i>Services:</i>								
Local exchange	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
<b>Who pays the subsidy?</b>								
Long distance customers						XXXXX	XXXXX	XXXXX
Urban customers	XXXXX							
<b>What are the Methods and Assumptions?</b>								
Base year	1992	1992	1992- 1993	1993	1993	1992	1994	1991
<i>Costing Basis for the Subsidy:</i>								
Traditional accounting costs:								
Measures explicit subsidy mechanisms		XXXXX				XXXXX	XXXXX	
Maintains local exchange company revenues the same	XXXXX	XXXXX		XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
Incremental costs:			XXXXX					
<i>Regulatory Jurisdictions Covered:</i>								
Interstate	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX
State	XXXXX	XXXXX	XXXXX	XXXXX	XXXXX		XXXXX	XXXXX