Insight

Is The Lifeline Subsidy An Effective Program?

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Since the 1980s, the Lifeline program has acted as a subsidy for telephone service for low-income households. The Federal Communications Commission (FCC) administers the program and former FCC Chairman Tom Wheeler initiated and ordered to expand Lifeline to broadband service. However, the current Chairman, Ajit Pai, decided to halt the expansion of the program to broadband and take a second look at the order. Most reactions were negative and followed a similar narrative arc, namely, Lifeline increases broadband adoption and is the best method of getting people connected. But this widespread notion isn't factually grounded. While broadband expansion should be a goal, Lifeline is probably not the best method to achieve that end, as the Government Accountability Office, the FCC's own pilot programs, and economic analysis suggest.

Lifeline is a $9.25 per household subsidy program supported via the Universal Service Fund (USF), which gets its revenue from a mandatory tax on wireless and wired telephone services and is overseen by the FCC. The Lifeline program was created to help people get a phone line, but in recent years, the FCC has made changes to expand out the program first to wireless phones and now to broadband services. Because consumers have moved away from landlines, wireless services have increasingly shouldered the burden of the expanding program. Since 2006, the USF tax increased from 2.99 percent to 6.64 percent last year. Assuming that the contribution method doesn't change, wireless taxes will have to increase to support the expansion of the program.

Many think the program is needed because high-speed Internet is astronomically expensive. Yet, when you consult the official numbers from the Bureau of Labor Statistics via the Consumer Price Index (CPI), the price for Internet access has been basically flat, increasing from 76.2 in January of 2009 to 77.1 in January of this year, which results in a 1 percent increase over eight years. During that same time period, however, the entire CPI went up from 211.1 to 242.8, for a rise of 15 percent, while other household bills went up 7.5 percent.

One former FCC staff member suggested that Pai's "actions will make the market for Lifeline broadband services less competitive, limiting choice and keeping prices high." Another commentator suggested that "in any way limiting the Lifeline program, at this moment in time, exacerbates the digital divide. It doesn't address it in any positive way." Yet, there is very little data to support either of these claims.

Those that tout the Lifeline program see it as a means of increasing adoption by reducing the price. On the collection side of things, however, the increase in tax will have a similar, but negative, effect. Raising the price will likely kick off consumers from wireless services, and also nudge current wireless consumers to consume a little bit less of their monthly service. Given what we know about the marginal propensity to consume, we should expect the tax increase would negatively affect the poor and elderly the most. The net effect is thus hugely dependent on how sensitive each class of consumer is to price change. We cannot simply make bold claims about the effects of these price inducements without a proper study.

So what do we know about consumers being enticed by the price reduction? Well, the FCC conducted a study a couple of years back, testing a number of different pricing methods, and in the end counted 8634 new users.

Yet, when the pilot was first announced, the agency estimated 74,000 people would opt in. One of the participating companies, XChange, expected 5,000 people to subscribe, but only found 214 takers. Frontier expected 1,500 people to sign up for the offer but got 118 instead.

The companies aren't to blame. Official Census data and reports from Pew routinely cite price as a barrier to adoption, and it has become a widespread belief that a reduction in price will help everyone leap over this barrier. Yet, even with these price reductions, as the FCC reported, "the pilot programs show, however, that it is challenging to entice this group to connect."

Data from the FCC pilot project hint at the issue. In comparing pre and post project surveys, the agency found that even though the non-connected report that they did not subscribe because of price, when they do finally subscribe, for the most part it is not primarily because of price, but for other reasons like staying in touch with family. In other words, it isn't a reduction of price that induces the adoption of broadband, but an increase in value of the service.

This is one of the most of the most fundamental problems in economics: the relationship between value and price. While people might claim that price is the reason they didn't subscribe to broadband, price here is a proxy for value, and the service isn't valued very highly. A reduction in price doesn't go far in getting people online because it only marginally reduces the price of the service without doing much to pump up the perceived value.

These are hardly new criticisms of the Lifeline program. As pointed out in a GAO report, aptly titled "FCC Should Evaluate the Efficiency and Effectiveness of the Lifeline Program," the oversight agency pointed out that "the Lifeline program, as currently structured, may be a rather inefficient and costly mechanism to increase telephone subscribership among low-income households." These problems have not merely ended because the program was expanded to include broadband. Indeed, the GAO has 46 broad recommendations for the FCC and 9 of those are dedicated solely to the Universal Service Fund programs.

We should have a larger discussion about communication services and how people can get and stay connected. But most of the negative reaction to the temporary halt in the Lifeline expansion is just bluster without empirical grounds.