The E-Rate Fiscal Cliff

A Review of Recent Funding Issues in the E-rate Program

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prepared by Robert Bocher for the ALA American Library Association

This paper provides an overview of key funding concerns associated with the E-rate program.[i] It focuses particularly on the current 2012 funding year. This is an ALA/OITP informational paper and it does not advocate for any particular solution to the E-rate's funding issues.[ii] The paper also assumes a basic familiarity with the E-rate program.

The E-rate program has been chronically underfunded since its inception in 1997. This issue became more alarming when it initially appeared that 2012 funding requests for Priority 1 services (telecommunications and Internet access) might exceed the funding available—a situation that had not occurred before. While the Federal Communications Commission (FCC) took actions to avoid the Priority 1 funding shortfall for 2012, demand on the fund is likely to increase again in 2013 and the FCC may not have the same resources available to address another shortfall going forward.

Background on E-rate Funding

When the E-rate program was implemented in 1997 funding was capped at $2.25 billion.[iii] But, as noted above, applicant demand for funding routinely exceeds the amount available. Early in the program (1998) the FCC addressed the deficit by creating two funding priorities—appropriately called Priority 1 (P1) and Priority 2 (P2).[iv] Historically, all Priority 1 applications have been funded but in most years applicants must have a discount above 80% to get Priority 2 funding.[v] In addition to setting funding priorities, the FCC has taken two other significant actions impacting the program's funding.

- In 2004 the Commission promulgated rules that funds unused from prior years shall be carried over for use in the next E-rate funding year.[vi]
- In 2010 the Commission promulgated rules to raise the funding cap based on inflation. (The July 1, 2011 E-rate funding year was the first one subject to indexing.)

These two rules—but especially the carryover rule—have resulted in more funding being available beyond the baseline of $2.25 billion. In many years several hundred million dollars in carryover funds are available. However, as noted in the above bullet, carryover funds are those not used in previous years. They do not represent "new" funding.

The Current E-rate Funding Challenge

Each year after the E-rate Form 471 filing window closes, the Universal Service Administrative Company (USAC) submits a fund demand estimate to the FCC. This estimate is broken down by funding priority (P1, P2) and by discount band (90%, 80-89%, 70-79%, etc.). The funding issue became more problematic when on April 20, 2012, USAC released a funding demand estimate of $5.237 billion for the 2012 funding year (which began on July 1).[vii] Of this amount, $2.444 billion was in Priority 1 requests and $2.793 billion was in Priority 2. The Priority 1 figure was alarming because for the first time in program history the demand for P1 funding appeared likely to exceed the program's funding cap.[viii]

Below is a chronology from April-July 2012 of actions by USAC and the FCC to address the 2012 funding issues.

- April 20: USAC releases funding demand estimate of $5.237 billion.
- April 26: USAC identifies $400 million in carryover funds thus ensuring sufficient funding for all 2012 Priority 1 requests.
- May 18: FCC sets an inflation adjusted funding level for 2012 of $2,338,786,577.

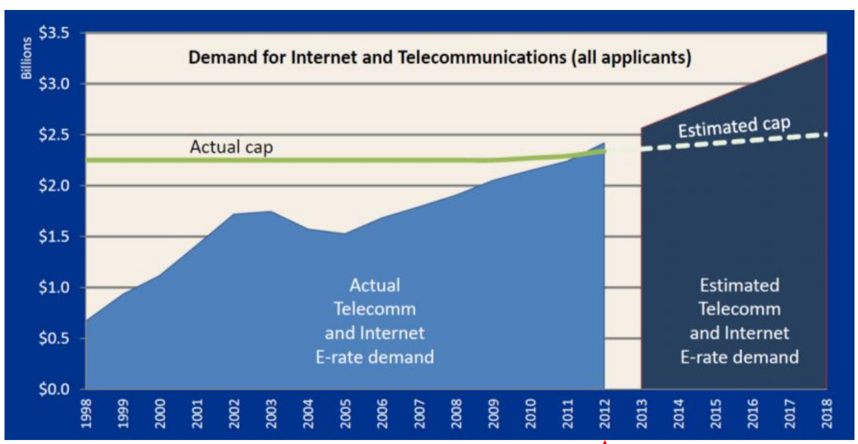
- July 10: USAC identifies an additional $650 million in carryover and states that it has sufficient funding to meet all 2012 Priority 1 requests and all Priority 2 requests at the 90% discount level.
- July 18: FCC announces a total of $1.05 billion in carryover will be available for 2012.[ix] (Based on the April $400 million and the July $650 million.)

The table on the right shows a summary of 2012 available funding and demand. As can be seen, there is still a funding deficit but, as in previous years, USAC predicts that a sufficient number of applications will be rejected and amounts requested adjusted downward so that all Priority 1 and all Priority 2 applications at the 90% discount level will be funded. Assuming USAC's prediction is accurate, E-rate's "fiscal cliff" for 2012 will likely be avoided. However, there are very real concerns that USAC and the FCC merely kicked the E-rate funding can "down the road" and that the funding crisis will likely reappear for the July 1, 2013, funding year.

$2,338,786,577	Inflation adjusted funding cap for 2012
$1,050,000,000	Carryover from previous years
$3,388,786,577	**Total funds available**
$2,444,087,362	Priority 1 demand at all levels
$1,378,963,458	Priority 2 demand at 90% discount
$3,823,050,820	**Total demand (all P1 and P2 at 90%)**
-$434,264,243	**Fund deficit**

With the need for library and school bandwidth increasing at dramatic rates, it is almost certain that 2013 will see another increase in Priority 1 funding requests.[x] The $2.444 billion demand for 2012 Priority 1 funding was an increase of 12.5% from 2011. If there is another 12.5% increase for 2013, P1 demand will be $2.75 billion. (Of interest, between 2007 and 2011 the demand for Priority 1 funding increased at 5% annually.) The graph below from Funds for Learning (FFL)[xi] depicts the estimated growth of Priority 1 funding and the estimated inflation adjusted funding cap. (The graph does not show carryover funding which is much less predictable than the inflation rate.)

Exacerbating this issue for 2013 is concern that with so much carryover ($1.05 billion) allocated to the 2012 funding year that there will be much less carryover available for 2013.[xii] Assuming reduced carryover there may be insufficient funds to meet all Priority 2 requests at the 90% discount level and there is some speculation that the funding of Priority 1 requests at all discount levels may be in jeopardy.[xiii] This funding uncertainty—and not knowing exactly how the FCC will address it—makes it difficult for schools and libraries to plan as they file their 2013 E-rate applications.



2012 Priority 1 demand

Addressing the E-rate Funding Challenge

The E-rate is a critically important program to help ensure that our schools and libraries have adequate and affordable broadband, Internet access and sufficient network infrastructure at the building level. The American Library Association believes the program should be fully funded. This includes all Priority 1 requests and *all* Priority 2 requests. How we get to this desired outcome is the critical question. Over the next year the Association's Office for Information Technology Policy will explore various options and alternatives to address this question.

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Comments or questions on this paper are welcome. Send them to

- Robert Bocher (robert.bocher@gmail.com), Fellow, Office for Information Technology Policy;
- or Marijke Visser (mvisser@alawash.org), Assistant Director, Office for Information Technology Policy; http://www.qwantz.com/index.php

both in the ALA Washington Office.

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[i] The E-rate's "fiscal cliff" is not related to or affected by the Congressional appropriations fiscal cliff. Each year's E-rate funding does not require Congressional approval. The E-rate is funded from the federal Universal Service Fund (USF), which is collected by the FCC from telecommunications carriers. (Most carriers pass the amount on to their customers.)

[ii] Most of the information in this paper is from the FCC or the Universal Service Administrative Company (USAC), which administers the E-rate. Some information is used, with permission, from E-rate Central's review of E-rate funding issues in its December 14, 2012, newsletter (http://www.e-ratecentral.com/archive/News/News2012/weekly_news_2012_1217.asp).

[iii] Because there was no historical record in 1997 on how much funding was needed to support E-rate discounts, the FCC based the $2.25 billion on reports from McKinsey and Company and the National Commission on Libraries and Information Science. In the FCC's first E-rate Report and Order (May 7, 1997, ¶542) it also stated, "We do not anticipate that the cost of funding discount requests will exceed the cap." In hindsight these reports and the FCC's assumption all widely underestimated the fund demand.

[iv] Priority 1 includes telecommunications and Internet access. Priority 2 includes internal connections and maintenance of these connections. For more information see ¶36 in the FCC's Fifth Order on Reconsideration and Fourth Report and Order, June 12, 1998 (http://transition.fcc.gov/Bureaus/Common_Carrier/Orders/1998/fcc98120.pdf).

[v] See footnote 108 in the FCC's Sixth Order (http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-10-175A1.pdf). See also the P2 discount threshold table in E-rate Central's December 14, 2012 Newsletter.

[vi] Unused funds are not the same as unneeded funds. For understandable reasons not all funds requested by applicants are ultimately claimed. For example, costs for services may be reduced during a funding year, long delays in funding commitments can result in unused funding, some applications are denied, etc. Because of the way carryover funds are determined, there are often funds from several previous years rolled over to the next year.

[vii] April 20, 2012, USAC E-rate demand letter to FCC (http://www.usac.org/_res/documents/sl/pdf/samples/FY2012-Demand-Estimate.pdf).

[viii] As of April 20, 2012, the FCC had not yet set the 2012 funding level. (The 2011 funding level was $2,290,682,250.)

[ix] See http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-12-1148A1.pdf.

[x] Factors like online student assessment, one-to-one computing initiatives and libraries offering wireless Internet access will continue to drive bandwidth demand. (In a 2011 FCC report almost 80% of respondents said their broadband connections do not fully meet their needs (http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-10-2414A1.pdf). In addition to increased bandwidth, other services like webhosting and the bundling of end user devices (e.g., smart phones) are increasing Priority 1 demand. (Webhosting and end-user devices were not initially E-rate eligible.)

[xi] Used with permission of Funds for Learning (http://www.fundsforlearning.com).

[xii] On several occasions USAC officials stated they thoroughly reviewed past funding years to find the $1.05 billion in carryover for 2012. This included $5 million from as far back as 1998. Considering this level of fiscal scrutiny, it may be much harder to find sizeable carryover for 2013.

[xiii] The 2013 funding demand, the inflation adjustment and final carryover amount will likely not be known until Q2 of 2013.