Postal Regulatory Commission
Submitted 2/25/2022 3:28:01 PM
Filing ID: 121002
Accepted 2/25/2022

Before the
Postal Regulatory Commission
Washington, D.C. 20268–0001

Institutional Cost Contribution Requirement for Competitive Products

Docket No. RM2022-2

Comments of the Lexington Institute
(February 25, 2022)

The Lexington Institute appreciates the opportunity to offer the following comments for the above referenced docket.

For several fundamental reasons, including dramatic changes in recent years with the U.S. Postal Service's revenue composition, product, and service mix, it is essential that the Postal Regulatory Commission (PRC or the Commission) fundamentally change its approach to, and methodology for determining, institutional cost contributions/attributions and the calculation of appropriate share pertaining to competitive products.

Respectfully, it is also important to be mindful of the strong language that the U.S. Court of Appeals for the District of Columbia Circuit used in urging a fundamentally new approach to identifying and determining competitive products' costs.

The Court said:

> "The Commission's interpretation and application of 3633(a)(3) and (b) are incomprehensible, and thus, unreasonable. No deference is due to the Commission's current position because the disputed order fails to apply the relevant terms of the statute, and it offers no basis for this failure."

It continued:

> "The Commission thus reasons that none of the Postal Service's institutional costs … are uniquely or disproportionately associated with its competitive products in the sense intended in 3633(b). This leads the Commission to conclude there are no costs for it to consider under 3633(b). The Commission's analysis defies reasoned decision making."

General Observations

Order No. 6043, pertaining to the preceding referenced dockets, often repeats the difficulties the Commission finds in identifying costs that should be attributed to competitive products. Based on this, there is reason to be concerned the Commission will not fully appreciate or take into account the large amount of total costs that should be applied to competitive products.

At the times the Commission seems solely concerned with protecting the Postal Service's competitive position, even if that will lead to financial losses, which are ultimately born by both taxpayers and Americans who use market dominant mail service.

For example, on page 6 the Commission says, "[T]he purpose of the appropriate share provision is to ensure fair competition in the market for competitive postal services by protecting against any possibility that prices for the Postal Service's Competitive products (despite covering their attributable costs) might nevertheless be anticompetitively priced as a result of the Postal Service's institutional costs being jointly incurred by Market Dominant and Competitive products."

This raises several troubling issues. Protecting the competitive position of the U.S. Postal Service (USPS) should be secondary to having the most accurate and reliable cost information. It is important to ensure that USPS can price all its services appropriately to best fulfill its historic public mission to deliver letter and other mail, which only it can do on a nationwide, affordable basis.

If USPS knows, or even thinks, it can obtain pricing assistance from the Commission to stay competitive, it will be less inclined to make the rigorous changes and improvements necessary for cost effectiveness. Furthermore, if the purpose of the appropriate share provision is "protecting against any possibility" of the products becoming uncompetitive, why allocate any costs to competitive products at all?

On page 96 the Commission says, “With respect to institutional costs, under the Commission’s current cost attribution principles, there are no costs classified as institutional that can be identified as ‘uniquely or disproportionately associated’ with competitive products.”

A review of USPS’s use of delivery vehicles and its planned purchase of 50,000-148,000 new vehicles demonstrate why this is not correct.

Postmaster General Louis DeJoy provided revealing testimony related to these matters on March 11, 2021 to the U.S. House of Representatives Appropriations Committee’s Subcommittee on Financial Services and General Government. He testified that a tractor trailer can hold 500,000 letters but only 5,000 packages. In other words, the average package is 100 times the size of the average letter.

USPS still delivers many more pieces of mail than packages. Based on figures from the Fiscal Year 2021 USPS 10-K, the Postal Service delivered 15 times the volume of mail (120.6 billion pieces) compared to packages (8.0 billion pieces).

Because USPS does not deliver 100 times as many letters as packages, packages take up disproportionately more space and incur higher delivery, storage, and processing costs. Indeed, USPS needs 6.6 times as much space for packages, as it does for mail, using the Postmaster General’s 5,000/500,000 ratio.

Dividing the 120.6 billion Fiscal Year 2021 mail volume by 500,000, the number of tractor trailers required to hold USPS’s mail volume is 241,200.

Dividing the 8.0 billion Fiscal Year 2021 package volume by 5,000 shows that 1,600,000 tractor trailers would be needed to store all packages, 6.6 times more space (1,600,000 vs. 241,200) than is needed for letters.

Based on the Postmaster General’s testimony and USPS’s preceding figures, approximately 87 percent of vehicle space is used for competitive products. Given this disproportionate use of vehicle space by competitive products/packages, the overwhelming majority of vehicle costs should be applied to competitive products as well as other costs involved in processing and delivering competitive products.

Additional factors supporting this change are the labor-intense nature of package delivery; packages intermittent delivery schedule (i.e., not to every address on every day); their higher injury rates and disability claims than mail; and their seven-day-a-week delivery window compared to mail's six-day window.

Additional Macro Operational Factors

The Postal Service's focus and heavy emphasis on expanding its package business has detracted from its historic and pre-eminent mission to deliver mail in a timely manner, thus imposing both short-term costs and a decline in the long-term value of USPS.

This is evidenced by the historic delays in mail delivery from December 2020-January 2021; the decision to slow delivery of 40 percent of first-class mail starting October 1, 2021; and the issuance of the 10-year strategic plan on March 23, 2021, wherein USPS aims to place even greater emphasis on competitive package services at the expense of mail.

In addition to financial impacts, these actions reduce the goodwill, or the intangible value, of USPS's mail service. The PRC should gauge these costs as well and systematically examine them in the future.

Improving Measurement Systems

Throughout Order No. 6043, the Commission states it is difficult to measure specific product costs. For example, on page 84 it says, "A multi-product firm with economies of scale and scope, like the Postal Service, will inherently accrue costs that cannot reasonably be apportioned between products based on any discernible relationships."

USPS, however, has not taken basic steps that would improve understanding of its costs on a per product basis, which would enable the Commission to make more informed decisions.

This includes USPS's failure to implement the recommendations of USPS's Office of Inspector General 2014 report, *Greenfield Costing Methodology, an Opportunity to Deliver Transformative Change*. Based on interviews with more than two dozen executives at USPS, it recommended that steps be taken to have more rigorous analysis of granular delivery costs and knowing the cost of every delivered item so that better decisions could be made.

A 2019 report by the USPS Office of Inspector General, *Costing Best Practices*, reiterated the need for such actions. That report, too, has been ignored.

The Commission should advise USPS to implement these provisions and to also work with its auditor, Ernst & Young, to obtain more comprehensive and informative cost data, which would also be shared with the Commission. This includes recommendations of software and data analytics financial measurement solutions, areas which have grown significantly in recent years and which are widely used by large businesses with diverse products.

Thank you for your consideration and attention to these matters.

Respectfully,

/s/ Paul F. Steidler
Paul F. Steidler
Senior Fellow -- Lexington Institute
steidler@lexingtoninstitute.org
703-522-5828 (office)
703-217-9452 (mobile)