

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Review of Treasury Report)

Docket No. PI2008-2

REPLY COMMENTS OF ROBERT W. MITCHELL
(May 1, 2008)

I. Reply to Pitney Bowes Initial Comments

In its Initial Comments, Pitney Bowes (“PB”) (p. 7) “strongly agrees” with Treasury Recommendation 5, that “[t]he current USPS cost accounting system should be **modified** so that all of the costs of USPS’s two **lines of business** ... can be assigned” and that “[t]he remaining unassigned costs should be treated as institutional costs[.]” Treasury Report, p. 9 (emphasis added).

PB then restates this recommendation to be “that the Postal Service should modify its costing systems to capture ‘**group-specific**’ costs, i.e., costs that are incurred exclusively for either competitive products or market-dominant products[,] ... [and] notes that these **group-specific** costs, once assigned to competitive and market-dominant products, are no longer part of the institutional cost pools subject to the appropriate [minimum] share requirement.” (Emphasis added.) PB reasons that “these [group-specific] costs are ‘incremental’ and should be included when applying the incremental cost test to competitive products collectively[,]” which PB states should be done to “ensure” that cross-subsidies are avoided.

PB’s comments raise several problems. **First**, new cost concepts are discussed, but nowhere defined (e.g., line-of-business costs, group specific cost), and their relation to existing, well-understood cost concepts is not clear. **Second**, what is intended by references to

“modifying” the existing systems is unclear, specifically, whether PB’s comments envision some kind of new, multi-layer system that would redefine the notion of institutional costs and be used somehow for both pricing and incremental cost tests. **Third**, these comments have an unsettling relation to PAEA’s mandates that the revenues from the competitive products as a group satisfy two separate tests: (1) the revenues must exceed the incremental costs, and (2) the revenues must exceed the attributable costs plus a portion of institutional costs as determined by the Commission. These Reply Comments discuss these issues.

1. Line of Business Costs Need to be Defined

The portion of the Treasury Report cited by PB refers to “the costs of USPS’s two lines of business” and states that it “understands that ... the USPS is working to develop and implement cost system modifications whereby the costs of its two lines of business (LoBs), the Market-dominant and the Competitive, will be assigned using cost drivers that capture the causal relationship between these LoBs and their applicable business costs.” (Treasury Report, p. 8.) It is well established that **incremental costs** are the relevant costs to use in tests for cross-subsidies, and the recent PRC decision on prices for competitive products states that it intends to test for cross-subsidies in this way. The question arising immediately is whether LoB costs are to be defined and developed to be estimates of incremental costs. I believe they should be so defined. But, if they are defined in some other way, I believe the Postal Service should outline clearly the

meaning of its LoB costs, including their characteristics and the uses to which they are designed to be put,¹ and should, as a separate step, also provide any needed estimates of incremental costs.

2. Incremental Costs are Well-defined, but can be Difficult to Estimate

A. Estimating Incremental Costs. Estimating incremental cost is not as straightforward or simple as PB's comments suggest, especially when the operations being analyzed involve extensive economies of scale and scope. How incremental costs are estimated is a matter of study design. Regardless of the techniques used, however, incremental cost must be the result of a **separate cost study** that is designed to provide answers to the appropriate question.²

Under PAEA, specific interest centers on the incremental costs of the competitive products as a group, which account for a **small portion** of total volume. As discussed in section 2-B, the concept of incremental costs requires the Postal Service to consider that the entire volume of the competitive products has been removed and then to estimate the stand-alone cost of a system reconfigured to handle and deliver efficiently the volume of market-dominant products that remains. The incremental cost of the competitive products, then, is the total cost of the Postal Service minus this stand-alone cost of the market-dominant products. Where, as here,

¹ It is not known whether the sum of the two LoB costs (market-dominant and competitive) will be defined so as to be equal to total Postal Service costs. To any extent that it is, questions of the basis on which costs are to be split become important. To any extent that it is not, any cost splitting still needs to be explained and the meaning of the difference between total costs and the sum needs to be made clear.

² Estimates of **volume variable** costs have been developed regularly in the Postal Service since 1970, while experience in estimating **incremental costs** has been much more limited. However, many of the tools and techniques needed to develop incremental costs are used regularly by practitioners of Activity Based Costing. See Kaplan, Robert S. and Robin Cooper, *Cost & Effect: Using Integrated Cost Systems to Drive Profitability and Performance*, Harvard Business School Press, Boston, 1998.

the volume removed is small, it may be that the reconfiguration needed to handle and deliver the market-dominant products efficiently is minimal and that the incremental costs of the competitive products can be estimated by adding: (1) the costs of any dedicated equipment and personnel withdrawn; (2) any remaining product- or group-specific costs; and (3) the increments of variable costs implied by some assumed shape for the marginal cost curves, drawing on results of the volume variability analysis in the current CRA.³ But where the volume being removed is large, the situation becomes more complex.

To see these issues more clearly, consider the incremental costs of the market-dominant products, which account for a **large portion** of total volume. This time, the Postal Service must consider that all volume of all market-dominant products has been removed and must estimate the stand-alone cost of a system reconfigured to handle and deliver efficiently the remaining volume of competitive products. Total cost minus this stand-alone cost of the competitive products would be the incremental cost of the market-dominant products. Here, since the volume of market-dominant products is very large, and of the competitive products it is very small,

³ Using marginal costs to help develop an estimate of incremental costs must be done with care. Consider the case of **one product**. The incremental cost would be the marginal cost of removing one unit + the additional savings from removing a second unit + ... + the additional savings from removing the (n-1)th unit + the additional savings from removing the nth unit, where n is the starting volume. As one moves from the full-volume position back to a volume of zero, the cost increments could decrease and then increase, remain constant, or have some other pattern. There is no way to know *a priori* what the pattern would be. Some evidence should be presented to support any assumptions made. In some cases, it might be easier to do the analysis in one step — what is the savings from removing all of the volume? — than to determine what the pattern of additional savings might be as one backs out the volume, one piece at a time. In addition, when the last piece is removed, or before, the Postal Service needs to ask about the savings available from reconfiguring its operations to handle the remaining volume efficiently.

When **several** different products are being removed, the complexity of the process grows substantially. In some cases, it might be better not to think of the marginal cost as being useful for estimating the incremental cost, particularly for large volume changes and numerous products.

substantial reconfiguration would be required, and estimating this stand-alone cost would be a formidable task. In such a situation, any estimate prepared would have to be viewed as very rough, and there would probably be substantial disagreement about whether a usable estimate had been obtained.⁴

In light of the difficulty of the analysis required, the need for an estimate of the incremental cost of the market-dominant products must be questioned. As I see it, a test of whether competitive products are subsidizing the market dominant products is not necessary. If competitive products were able to contribute billions of dollars to the market-dominant products, allowing rates for the latter to be kept low, no one would complain. Further, no estimate is needed of the extent of the economies of producing the two groups of products jointly, an issue discussed further in section 2-B. Accordingly, no need exists to impose substantial burdens on the Postal Service to develop an estimate of the incremental costs of the market-dominant products.

B. Basic Definitions and Relationships. Assuming the incremental costs of the competitive products are to be estimated, several basic definitions need to be recognized and honored. The incremental cost of a **group of products** is the reduction in the total cost of the Postal Service allowed by the complete removal of 100 percent of the volume of the products in the group, under the conditions that the remaining Postal Service **adjusts fully to this removal**, to arrive at a new, efficient operating position. Whatever adjustments the Postal Service would

⁴ On the question of estimating the stand-alone costs of the competitive products as a group, “Treasury assumes that the competitive products would share the economies of scale and scope with the market-dominant products and that the USPS costs would be assigned to the theoretical USPS Competitive enterprise without any attempt to determine the costs of a true stand-alone competitive products entity.” (Treasury Report, p. 7.)

make under such circumstances are not reflected in the current accounting records, hence the reference above to the need for a separate cost study.

Were **all market-dominant products** to be removed, only the competitive products would remain. The Postal Service cost to handle and deliver efficiently only the competitive products, after being reconfigured, is, by definition, the **stand-alone** costs of the competitive products.⁵ Thus, the total cost of the Postal Service minus the stand-alone cost of the competitive products is the incremental cost of the **market-dominant products**.

Similarly, the total cost of the Postal Service minus the stand-alone cost of the market-dominant products is the incremental cost of the **competitive products**. Assuming economies of joint production exist, the sum of the stand-alone costs of the two product groups minus the total cost of the Postal Service is a measure of the economies obtainable from the joint production of the two product groups. And, by rearranging these relationships, it can be shown that the total cost of the Postal Service minus the sum of the two incremental costs equals the same measure of the **economies of joint production**. It follows that if the two incremental costs were somehow assigned to the two product groups and subtracted from total costs, the remainder would be a measure of the economies of joint production. It would **not** be a **measure of fixed costs**. These are fundamental relationships, well accepted in the literature.⁶ They are not empirical.

⁵ Since competitive products are processed and delivered jointly with a large volume of market-dominant products, the degree of reconfiguration required likely would not be minimal. It is easy to see that parcel routes (with no fixed path) might be substituted for the current letter routes (which take the same path every day), and trucks designed especially for parcels might be used. Also, the managerial pyramid might be adjusted.

⁶ See Rebuttal Testimony of Robert D. Willig on Behalf of the United States Postal Service, USPS-RT-5, Docket No. R83-1, who discusses the relation between incremental costs and stand-alone costs, based in part on his own work, and Rebuttal Testimony of Janusz A. K. Ordovery on Behalf

3. Product-specific and Group-specific Costs Are Not a Link Between Incremental Costs and Volume Variable Costs

PB's comments (at 7) shift the focus from LoB costs to **group-specific costs** and emphasize that these costs should be "included" in any incremental costs. In the sense that the incremental costs should account for the removal of any group-specific costs, PB is correct. As discussed below, however, it needs to be recognized that the difference between incremental costs and volume variable costs is not generally equal to group-specific costs.⁷

If the terms product-specific costs and group-specific costs are to be used to in discussing cost development, it is important to be clear about what they mean. Historically, the term "product-specific costs" has been used by the Postal Service and the Commission to refer to identifiable categories of accrued costs **that do not vary with volume** but that are caused by a specific product. By extension, it would seem that "group-specific costs" would be identifiable categories of accrued costs **that do not vary with volume** but that are caused by a specific group of products. If these are the definitions, the only difference between a product-specific cost and a group-specific cost is the number of products in the group, product-specific relating to a group with one product. Being consistent and non-arbitrary, then, would seem to require that they be treated similarly. Both cost categories have the same character of being fixed; the only difference is the number of products involved. If these are not the definitions that PB has in mind, then it needs to so state, and some agreement should be reached on what the definitions are.

of the United States Postal Service, USPS-RT-9, Docket No. R84-1. *See also* Gerald R. Faulhaber, "Cross-Subsidization: Pricing in Public Enterprises," *American Economic Review*, Vol. 65, No. 5 (December 1975), pp. 966-977.

⁷ Indeed, were the Postal Service to be operating at a high point on its marginal cost curve, the volume variable costs could be larger than the incremental costs or the accrued costs.

As defined in section 2 above, an incremental cost is the difference between the initial total cost and the stand-alone cost of the group of remaining products. If the volume removed is a small proportion of total volume, the reconfiguration needed to handle and deliver the remaining products may be minimal, in which case the incremental costs might be estimated by examining the costs of activities associated with the volume removed, including product specific costs. But the costs of these activities could include other fixed costs as well.

As an example, consider that a reference to product-specific costs or group-specific costs would be exclusive of any category of accrued costs that varies with volume, including such categories that are only partly variable. To make this clear, consider a category of accrued costs that is found to be 80 percent variable with volume, in the sense of the CRA cost model, which has been used in prior Commission ratemaking proceedings. This means that 20 percent of the costs in this particular category are viewed as fixed. An example could be a mechanized sorting operation for bulk parcels of various product categories. This 20 percent of costs, although considered to be fixed, traditionally is neither defined nor categorized as either product-specific or group-specific. However, some, or even all, of this 20 percent could easily be part of the incremental cost. The vast majority of the Postal Service's fixed costs are of this type. Therefore, including all categories of product-specific or group-specific costs in an estimate of incremental costs, as PB advocates, would not include any fixed costs like the 20-percent in this example. Also, of course, any assumption that the degree of reconfiguration is minimal needs to be supported.

4. Assigning of Costs Should be Restricted to Development of Incremental Costs

The Treasury Report recommends that the **LoB costs** be “assigned,” and PB recommends that the **group-specific costs** be “assigned,” in each case, as appropriate, to either the market-dominant or the competitive products. Each party then explains that once assigned, these costs would no longer be part of the institutional cost pool. The purpose of this assignment needs to be made clear. If LoB costs are defined as (or are a euphemism for) incremental costs, or somehow differ from but are included as an element of incremental costs, then the statement by Treasury could be interpreted to mean to assign the LoB costs of competitive products to those products for purposes of an incremental cost test. Similarly, PB could be interpreted to mean that any group-specific costs (a notion discussed in section 3 above) of any competitive products should be a part of their incremental costs. And, although assigning categories of costs that are considered to be incremental, to the overall measure of incremental costs, for purposes of an incremental cost test, might seem trivial, this interpretation comports fully with the cross-subsidy test mandated by PAEA, and presents no problems.

On the other hand, if “assignment” means to link the fixed costs in question to specific **products** for use in calculating cost coverages and, after summing these products costs, in calculating institutional costs, as seems to be suggested by Treasury and PB references to reducing the size of the institutional cost pool, then serious questions arise. Specifically, except for any portions of the incremental cost that are viewed as volume variable (which would be attributed already), there is no non-arbitrary basis or reason for assigning incremental costs of competitive (or market-dominant) products to specific products. In the PB case of assigning group-specific costs, the absence of a non-arbitrary basis applies to the entire cost. In addition,

whenever any non-volume-variable costs are added to volume variable costs, regardless of whether they be part of the incremental costs, the new cost becomes a **mixture** that cannot be interpreted,⁸ and, from the point of view of resource allocation and economic efficiency, loses its value as a reference point for markup purposes. That is, it loses its tie to marginal costs. Accordingly, except in the trivial sense suggested in the previous paragraph, no attempt should be made to assign any incremental or group-specific costs.

A question relating to the terms product-specific and group-specific costs concerns their roll in attribution, in the sense of being added to volume variable costs and marked up (to arrive at cost coverages). In the past, the Commission has attributed product-specific costs, but it has not attributed any group-specific costs, reasoning in the case of the latter that no non-arbitrary, meaningful way exists to link the costs with specific products. **Now that the Commission plans to require incremental cost tests as part of its annual review, I believe it is appropriate to rethink the attribution of product specific fixed costs, and restrict the potential assignment of fixed costs to the incremental costs pools, and not calculate markups on any category of fixed costs when setting or reviewing rates.** Two reasons support this position.

First, when anything is added to volume variable costs, the resulting costs lose their marginal-cost meaning and thus lose their value as a reference point for questions of resource allocation and economic efficiency.

⁸ As an example of the difficulty of interpreting figures that are mixtures, consider how to interpret an average daily-high temperature figure when it is known that the temperature on some days was measured in degrees Fahrenheit and on other days was measured in degrees Centigrade. If some costs in a total are variable and some are fixed, and no compass guides the compilation, no interpretation is possible.

Second, if product-specific costs are attributed and group-specific costs are not, as the Commission has done in the past, questions of fairness arise, as seen in the following example. Suppose three products exist, Product A, Product B, and Product C. Assume it is clear that the costs in account 12467 are not volume variable, but are caused by Product A, and are thus labeled specific to Product A. Assume it is also clear that the costs in account 32864 are not volume variable, but are caused by Products B and C jointly, and are thus labeled specific to Products B and C (i.e., group-specific), but that there is no non-arbitrary way to decide how the costs in account 32864 should be split between Products B and C. If in addition to all volume variable costs for the three products, the costs in account 12467 are attributed to Product A but no costs from account 32864 are attributed to either Product B or Product C, it is clear that the reference cost for pricing Product A will be elevated and that the reference cost for pricing products B and C will not. Nothing is fair about such costing. It does not relate to a costing concept and it cannot be interpreted. It clearly is skewed.

One possible response to skewed costs like those just described is to adjust the cost coverage of Product A downward, to make up for the fact that its attributed costs (which included some fixed costs) go beyond those attributed to Products B and C. But doing this makes a mockery out of the costing process and removes meaning from the cost coverage. It also begins to draw on the kinds of methods that are part-and-parcel of fully-distributed costing schemes. Such schemes should be avoided. It is much better to do the costing right in the first place.

5. References to Modification of the Costing Systems Need Clarification

The Treasury Report refers to the Postal Service modifying its “cost accounting system,” and PB refers to the Postal Service modifying its “costing systems.”⁹ Some clarification is needed concerning what is to be modified.

Postal Service Handbook F-8 is titled “General Classification of Accounts.” It contains five-digit and eight-digit account numbers and is a key component of the Postal Service’s accounting system.¹⁰ The CRA system draws heavily from the F-8 HANDBOOK, often aggregating data contained in various accounts, then performing analyses to determine variability. It may well be that a study to estimate incremental costs would draw from the same accounts. In addition, it seems possible that an analyst estimating incremental costs could request that the accounting department collect some additional information in the F-8 accounts or disaggregate some accounts. However, I do not at this point see any reason for an interest in incremental costs to lead to any changes in the F-8 Handbook and do not interpret the Treasury Report as recommending that it be changed.

PB’s reference to the Postal Service modifying its “costing systems to capture ‘group-specific’ costs, i.e., costs that are incurred exclusively for either competitive or market-dominant products” may be read as a reference to the costing system that generates the CRA. Basically, the CRA system has been developed to provide estimates of volume variable costs, which are understood to be relevant to pricing decisions and pricing analysis.

⁹ The Public Representative appears to support modifying the existing costing systems, saying that it “offers considerable advantages.” Public Representative Initial Comments, p. 8.

¹⁰ See USPS-LR-I-183, Docket No. R2000-1, and Response of Postal Service Witness Tayman to POIR No. 10, Question 1, Docket No. R2005-1.

Presently, it is widely understood that the Postal Service is making some changes in the CRA cost system to focus the results directly on products instead of subclasses. Other than that, however, I do not see that an interest in incremental costs should lead to changes in this system. If the Postal Service does a study of incremental costs and wishes to draw from results of the CRA system, no difficulties would be caused. Also, if the Postal Service wishes to make an incremental costing system a new component (as in a tangent) in what might still be called the CRA system, this might be acceptable as well. But neither of these steps require any changes to the existing CRA system or its outputs, and none should be made.

6. Institutional Costs are Residual, Non-Volume-Variable Costs — NOT Residual Non-Incremental Costs

The Treasury Report speaks of removing the “costs of USPS’s two lines of business” from the costs now treated as institutional, and PB speaks of removing “group-specific costs ... [from] the institutional cost pool[]” to which the Commission-determined minimum contribution share is applied. Both Treasury and PB see the removal of such costs to be a reason for the Commission to reconsider that share, which currently is set at 5.5 percent. As explained below, I see important difficulties associated with these recommendations.

Institutional costs are the difference between total costs and attributable costs. The recommendation of PB would reduce the sized of the institutional cost pool by some process of assigning group-specific costs. This recommendation would remove fixed costs from the institutional cost pool, thus changing its meaning, and is ill-advised. Note specifically that

adding group-specific costs to volume variable costs would not result in a measure that could be meaningfully subtracted from total costs.

If LoB costs are defined as incremental costs,¹¹ attributing them, as Treasury appears to recommend, would leave a residual pool equal to the economies of producing the two groups of products jointly. Moreover, unless a non-arbitrary scheme were available for attributing incremental costs to specific products (and no such scheme is available), the residual pool would have no relation to the markups needed on individual product costs to achieve breakeven or profitability. In short, no basis exists for attributing incremental costs and it should not be done.¹² Any attribution of such non-volume variable costs reduces the value of attributable costs for purposes of considering resource allocation and economic efficiency, both of which are identified as important in PAEA. Note that this reasoning provides additional support for the position taken above (in section 2-A) that no attempt need be made to estimate the incremental costs of the market-dominant products as a group.

In general, it would not be unreasonable to expect incremental costs to exceed attributable costs, perhaps by a substantial amount. Attributing them, then, would leave a residual pool (total cost minus the sum of the two incremental costs) with no relation at all to any concept of fixed

¹¹ The issue of how to define LoB costs was discussed *supra*. It should be noted that if, instead of defining them as incremental costs (for which a clear definition is available in the literature), LoB costs are developed by simply splitting all Postal Service costs according to some arbitrary allocation factors (like pieces, pounds, cubic feet, relative revenue, density, ton miles, or some other), the sum of the two LoB costs would exhaust entirely all Postal Service costs, leaving zero costs as a residual. At that point, whether they be called institutional or something else becomes somewhat academic.

¹² See Direct Testimony of John C. Panzar, USPS-T-11, Docket No. R97-1, who provides extensive discussion of the reasons for focusing on and restricting attributable costs to volume variable costs.

costs, joint costs, or overhead costs.¹³ Such a residual cost should not be described as, or equated to, those institutional costs that represent the difference between total costs and variable (attributable) costs.

Finally, the nature of the incremental cost test needs to be recognized. In effect, the revenues of the competitive products are to be compared with their incremental costs, and if the revenues are higher, the test is passed. Passing the test evidences the absence of a cross-subsidy to competitive products, but the incremental costs have no other use.

More broadly, several tests need to be made. First, as indicated above, there needs to be a test of whether the competitive products as a group cover their incremental costs. Second, there needs to be a test of whether revenues from competitive products are larger than the sum of the volume variable costs and the Commission-determined minimum contribution to institutional costs. Third, there also might be a test of whether the revenue from each competitive product covers **its** incremental costs, if such costs are available.¹⁴ If either or both of the first two tests are failed, then rates in general (and revenues) for the competitive products would need to be increased. If the third test is failed, the prices (and accordingly the revenues)¹⁵ for the products in question would need to be increased. But these tests do not build on each other. In other words,

¹³ Note also that, relative to institutional costs as currently derived, this “residual pool” could be rather small. Specifically, since the volume of competitive products is small, their stand-alone costs would be rather small. And, since the economies of joint production would have to be smaller than these stand-alone costs, the residual pool would have to be small.

¹⁴ The purpose of this test would be to avoid having individual competitive products subsidized by other products, whether these other products are competitive or not.

¹⁵ Note that an increase in revenue would be brought about by an increase in price *only* if the own-price elasticity of demand is less than 1.0. However, because the increase in price would still cause a decrease in volume and incremental cost, the price increase would help the product pass its incremental cost test.

no logic supports a fourth test, which might be whether the revenues cover the incremental costs plus some further contribution to some group of redefined institutional costs.

II. Reply to Parcel Shippers Association Initial Comments

The Parcel Shippers Association (“PSA”) asserts that “creating the ‘on paper only’ enterprise by **assigning** to it the **incremental cost** of competitive products plus an appropriate [minimum] **share of institutional costs** is consistent with the provisions of the PAEA that address cross subsidization.” (p. 3, emphasis added.) Actually, such an approach would be inconsistent with PAEA provisions on cross-subsidization and those on contributing to institutional costs as well.

No support exists in the literature or in standard practice for assigning incremental costs, adding some kind of institutional cost contribution, and then checking, in a test, to see whether the revenues of the products in question cover the new total. The revenues can be thought of as equal to: (a) the volume variable costs, (b) the required minimum contribution to institutional costs, and (c) whatever additional elevation in revenue is achieved by the Postal Service as it maximizes its profits from the competitive products. If the revenues from the competitive products are larger than their incremental cost, the cross-subsidy test is passed. If they are not, changes in rates need to be made. No support exists in theory or logic for layering the minimum institutional cost contribution onto the incremental costs. The cross-subsidy test and the minimum institutional cost requirement are separate requirements and should be kept separate. The revenues from the competitive products should, of course, satisfy both requirements.

Some confusion also may exist on the question of **USO costs**. “PSA believes that because USPS competitors are not subject to a USO and thus do not incur any USO costs, it would be inappropriate to charge USO costs to competitive products.” (p. 4.) It may well be that the competitive products should not carry any USO costs. This would be consistent with Creamer et al., who say: “An operator who can charge a price that is sufficiently large to cover costs has no reason to refuse the provision of service.”¹⁶ Since the Postal Service can charge any price it wishes for the competitive products, as well as, presumably, offer them any level of service it wishes, PSA’s conclusion may be correct. But if it is correct, it is not because of whether competitors bear any USO costs. Instead, it must be because the Postal Service incurs no USO costs in the provision of the competitive products.

Fortunately, the Commission has underway a study of USO costs. This study should identify the USO costs, including the products to which they belong, and it should quantify the extent to which they are already attributed.¹⁷ A determinant of the results should be the levels of prices and services **actually provided** to the competitive products, instead of the levels of prices and services that the Postal Service **could provide** to the competitive products. In effect, the logic that guides development of USO costs should be the logic that determines which products incur them and whether they already are attributed. To use a separate logic would be to introduce conflicting approaches. After the study of the USO is complete, questions relating to allocation of USO costs should be reviewed again.

¹⁶ Creamer, Helmuth, Philippe De Donder, Francois Boldron, Denis Joram, and Bernard Roy, “Social costs and benefits of the universal service obligation in the postal market,” presented at the 15th Conference on Postal and Delivery Economics, June 2, 2007, Semmering, Austria, p. 4.

¹⁷ The Postal Service Comments indicate that some USO costs may be attributed already. (p. 28.) As explained in the text, the USO study should provide guidance on this issue.

In the end, the outcome may not be to layer volume variable costs, USO costs, and a minimum level of institutional costs. That is, it may be sufficient to test whether revenues cover incremental costs plus any USO costs that are not part of incremental costs. When the Commission determines the incremental and USO costs, it should specify what portion of USO costs are to be included in incremental costs.

Respectfully submitted,

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