

Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Report on Universal Postal
Service and the Postal Monopoly

Docket No. PI2008-3

PUBLIC REPRESENTATIVE COMMENTS
IN RESPONSE TO ORDER NO. 71
June 24, 2008

On April 18, 2008, the Commission issued Order No. 71, in which it sought comments on the report to Congress required by section 702 of the Postal Accountability and Enhancement Act of 2006 ("PAEA").¹ The Commission identified 11 specific issues concerning which it sought comment. The Commission also invited comments on any other issues that parties might wish to raise.

These comments address the need to retain the postal monopolies as the means for funding any financial burden of a USO. The best advice the Commission has been offered came from a rural letter carrier in New Mexico. She said, "I urge extreme caution in applying academic theories to change the best system in the world."²

SOCIAL VALUE OF THE POST

Part of the social value of the postal monopolies consists of those activities (if any) currently undertaken by the Postal Service that would not be undertaken by

¹ "Notice and Order Providing an Opportunity to Comment," Docket No. PI2008-3, issued April 18, 2008.

² "Flagstaff Field Hearing on Universal Postal Service and the Postal Monopoly," May 21, 2008, Transcript at 22, lines 11-13.

anyone if the monopolies did not exist. The foregone value of such activities needs to be included in any evaluation of the costs and benefits of liberalization. The Postal Service provides governmental and social services that a private firm might not be willing to perform. "As a steady presence on America's streets, carriers are often in the right place at the right time to help their fellow citizens. . . . Having more than 200,000 letter carriers on the streets every day is an invaluable way to keep watch on America's neighborhoods and communities."³ The Postal Service ensures a communications link between government agencies and citizens. The Postal Service stands ready to distribute antibiotics in the event of a bio-terror attack.⁴ The Postal Service is the most trusted government agency in the United States. It serves as a lifeline, hard-copy communications service for those who do not use or do not trust the internet.⁵

UNIFORM RATES

A profit-maximizing firm will engage in price discrimination to the maximum extent legally permitted and economically practical. In the nineteenth century, economic practicality served to mitigate price discrimination in the delivery of letters. The uniform rate reduced transaction costs.⁶ Today, the uniform rate serves to subsidize unprofitable delivery points. Without its monopolies, the Postal Service would not be able to finance equal service to profitable and unprofitable delivery points. The profitability of a delivery point is not determined by its geographic location (*e.g.*, rural

³ Testimony of Richard Moses, United States Postal Service City Letter Carrier, "Portsmouth Field Hearing on Universal Postal Service and the Postal Monopoly," June 19, 2008, at 3.

⁴ *Id.*

⁵ "Flagstaff Field Hearing on Universal Postal Service and the Postal Monopoly," May 21, 2008, Transcript at 75-76.

⁶ *E.g.*, MA Crew & PR Kleindorfer, "Rowland Hill's Contribution as an Economist," *Competition & Postal Services* 1-11 (1991).

versus urban). Profitability occurs if the revenue from the mail delivered to an address exceeds the cost of delivery.⁷ Profitability is correlated with volume, which in turn is correlated with household income.⁸ Without its monopolies (or some other source of funding) the Postal Service would need to reduce the number of delivery days for unprofitable delivery points.

Is *free* delivery part of universal service? If so, the current monopolies are essential. Mail delivery is a network industry. A private delivery service that visited every delivery point six days per week would surely adopt a subscription charge.⁹ Electric, gas, and telephone companies do exactly that. If such a subscription charge were unregulated, it would vary inversely with the value of a delivery point. That is, delivery points that received high volumes of high-revenue mail would be charged lower subscription rates so as to encourage such delivery points to remain on the network. Low-value delivery points would be offered low frequency of delivery or high subscription charges for six-day delivery. Mail to the bottom of the Grand Canyon? Once a month, maybe.

⁷ See R Cohen *et al.*, "The Cost of Universal Service in the U.S. and Its Impact on Competition" 3 (2002); http://www.prc.gov/prc-docs/library/refdesk/techpapers/prcstaff/cost_of_universal_service.pdf (as viewed June 23, 2008). These authors discuss profitable routes, but the same concept applies to delivery points.

⁸ R Cohen *et al.*, "A Comparison of the Burden of Universal Service in Italy and the United States" 12 (2001); <http://www.prc.gov/prc-docs/library/refdesk/techpapers/prcstaff/comparison.pdf> (as viewed June 23, 2008).

⁹ Subscription charges on recipients of mail are at the essence of the testimony of the vice president of Earth Class Mail, who advocates new, premium services for mail recipients: "revenues previously not dreamed of." "Flagstaff Field Hearing on Universal Postal Service and the Postal Monopoly," May 21, 2008, Transcript at 57, lines 7-8. Without a monopoly to cross-subsidize high-cost delivery points, most mail recipients will pay a premium to receive the service that is now free.

BUNDLING PRODUCT ATTRIBUTES

Many Postal Service products are bundles of service features. For example, First-Class Mail includes forwarding service as well as delivery service. Bundling (or "tying") of products can be used to extract higher profits from consumers.¹⁰ Bundling allows the Postal Service to generate extra revenues to fund its USO, particularly the uniform rate requirement. Without its monopolies, the Postal Service would be vulnerable to cherry-picking. That is, a private firm could offer a no-frills First-Class service to customers who do not value attributes such as free forwarding. Here are some suggestions for unbundling.¹¹

- De-averaged First-Class – The idea is to allow businesses rather than the USPS to optimize their product by making the communications channel more efficient and to also increase demand for their product. The concept is to take apart some of the cost components of First-Class Mail and offer a la carte pricing that would be focused on the following: delivery timeframe; forwarding; UAA information; and PLANET Coding. The idea is to offer a no additional services discount, a step above Standard Mail and then allow the customer to choose among a la carte services.
- Radius Based Pricing – The idea of radius base pricing is to base pricing on distance transported from the origin versus a flat rate that allows for the industry to solve the USPS transportation costs. Today, for example, mail produced in Philadelphia costs the same whether it's going to Los Angeles or Chicago.
- First-Class Lite – Related to the de-averaging concept presented earlier is the idea presented of First-Class "Lite." This service would offer no forwarding, no return and just offer speed and a sealing against inspection. It would be part of a new First-Class Business Subclass or "Lite" service.
- Flexible Drop Services – Related to a new Business Subclass could be an electronic dropship service or an all dropship service.

¹⁰ E.g., WK Viscusi, JM Vernon, and JE Harrington, Jr., *Economics of Regulation & Antitrust* 241-53 (3d ed. 2000).

¹¹ Envelope Manufacturers Association, "First-Class Mail and the United States Postal Service" 5-6; http://www.emafoundation.org/file_depot/0-1000000/0-10000/2518/conman/First-Class+Mail+and+USPS.pdf (as viewed June 23, 2008).

- Modify the old standard parcel return services – Potentially a new rate could be created to make parcel returns a more cost effective service or a bulk parcel return service.
- A Bulk Business Reply Mail Service – Why not more aggressively price bulk rate return mail so that it provides an incentive to the mailer to use BRM. Most specifically, eliminate the singlepiece surcharge.

All of these suggestions would reduce revenue while simultaneously increasing volume and attributable costs. Replacing the lost revenue would come at the expense of low-volume mailers and unprofitable delivery points and could initiate a death spiral.

"BENEFITS" OF ALLOCATIVE EFFICIENCY

Some opponents of the postal monopolies cite the benefits of competition. Such benefits include innovation that enables firms "to become more efficient, improve their service quality, introduce new products and services, and become more responsive to consumers' preferences."¹² The introduction of competition in surface transportation "created massive social benefits."¹³ These social benefits are increases in consumers and producers surplus.¹⁴ Such increases are sometimes called movements toward "Pareto efficiency"¹⁵ or "allocative efficiency."¹⁶ An unfortunate consequence of movements toward Pareto efficiency is that they are not generally "Pareto

¹² Letter of R. Richard Geddes to Dan Blair, filed June 16, 2008, at 3 (quoting Clifford Winston); <http://www.prc.gov/Docs/60/60149/Geddes%20Response%20Order%20No%2071.pdf> (as viewed June 23, 2008).

¹³ *Id.*

¹⁴ SE Landsburg, *Price Theory & Applications* 241-49 (4th ed. 1999).

¹⁵ Pareto efficiency (or Pareto optimality) occurs when it is not possible to reallocate resources in a way that makes someone better off without making someone worse off. HA Varian, *Intermediate Microeconomics* 15 (5th ed. 1999).

¹⁶ See EJ Mishan, *Cost-Benefit Analysis* 307-15 (1971).

improvements." A Pareto improvement occurs when a reallocation of resources produces at least one winner and *no losers*.¹⁷

When a reallocation of resources, such as occurs when a monopoly industry is deregulated or liberalized, creates uncompensated losers, it cannot be considered an unambiguous "social benefit." Such a reallocation of resources also redistributes wealth. In the UK, the liberalization of the postal industry has created a massive redistribution of wealth—away from virtually every actor in the mail industry and to a few large mailers. "[L]arge businesses . . . have seen clear benefits from liberalisation: choice, lower prices and more assurance about the quality of the mail service. . . . There have been no significant benefits from liberalisation for smaller businesses and domestic consumers."¹⁸

Respectfully submitted,

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¹⁷ Landsburg, *supra* n.14, at 443-44.

¹⁸ "The challenges and opportunities facing UK postal services" 6 (May 2008); <http://www.berr.gov.uk/files/file46075.pdf> (as viewed June 23, 2008).