

**Before the  
Postal Regulatory Commission  
Washington, DC 20268-0001**

REPORT ON UNIVERSAL POSTAL SERVICE )  
AND THE POSTAL MONOPOLY )

Docket No.  
PI-2008-3

Response to Order No. 71

Testimony

of

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Good morning, Mr. Chairman, Commissioners, Ladies and Gentlemen.

My name is Leonard Merewitz, of 3210 Brooklawn Terrace STE 108; Chevy Chase MD 20815-3940. I offer these comments to the study made by the contractor on Universal Service Obligation which will lead on the report of the Postal Regulatory Commission to Congress. I'm testifying this morning on behalf of myself.

I began a dissertation on the economies of scale in the U.S. Postal Service in 1966. During 1969 through 1971 I served on a team that considered postal issues at the Institute for Defense Analyses. I participated in seven rate cases giving testimony two times for USPS ; two times for National Association of Presort Mailers, once for Florida Gift Fruit Shippers Association. Over the years I have consulted to ADVO, Pitney-Bowes, TNT-TPG, National Economic Research Associates, the Logistics Management Inst. , Deutschepost, USPS, the Nonprofit Mailers Federation and several law firms on postal issues.

I have successfully operated LAMA Consulting for 14 years practicing in Postal Electricity and Transportation.

I worked for the USPS' from 1979 and 1993 serving mainly as General Manager of the Rate Research Division in the Office Of Rates. I was also Special Assistant to the Executive Vice President For Finance and also to a Presidential Appointee at the Postal Regulatory Commission. I was a member of the Postal Career Executive Service for seven years.

Recently first class mail volume has been decreasing at rates approaching 3 per cent. I expect the decreases to continue at a reduced rate. The PS now more than ever must pay attention to economy and efficiency.

Those volume trends suggest that the postal service will need to cut some of its costs in order to continue to break even as Congress has directed. These cost savings can come as savings in the **processing function**. They can also come as savings in **factor prices**, i.e., wages.

Economies are to be gained by rightsizing the processing network. Efforts to centralize and pare down have fallen prey to political expressions of strength for local benefits to the detriment of national considerations. Lessons could be learned from the Base Alignment and Closures (BRAC) concepts. In those lessons, on a phenomenon which has run over nearly 10 years and is continuing, some local prerogatives have been limited for the national good. That continuing process should be watched carefully and we should learn from its successes and failures.

The story on wages is restraint in the last few years. The Postal Service (PS) and its unions have been able to negotiate fairly long-term contracts without extensive interests arbitrations. Job security has been a major consideration as has relative wage constraint. Both parties understand their common interests. Progress may have been made on issues of wage equity referred to by Professor Wachter and his colleagues over the years in testimony.

As the Postal Service looks for possible economies it must confront delivery services which represent about 30-35 % of postal costs. Many of these costs are fixed with respect to output or mail volume but some are variable.

There is nothing constant but change. Increasing fuel costs make transportation costs inevitably move upward. This fact of life makes PS dominance of the last mile of transportation to the receiver of more value. Many household trips for shopping may be satisfied by postal, i.e., reasonably- priced delivery, instead.

In confronting delivery costs several issues must be kept in mind.

**EQUITY** low-volume routes tend to occur in two places: rural low-income areas and urban low-income areas. The small-town CPA has Express Mail available to her just as the big-city CPA has Express Mail, UPS, FedEx, and DHL expedited mail,

**Use for GOVERNMENT** The law courts depend on first-class mail for reasonably-priced service to parties to cases. Federal, and especially state and local taxes depend on mail billing and payment. Voting is more and more done by mail including distribution of ballots.

**MEDICINES** Many insured and non-insured patrons receive their prescription medicines by mail and these have a high time value. Warehousing and logistics have distinct

economies of scale so that central depositories play a key role in efficient distribution. The lead time for drug ordering, fulfillment, mailing and transit are large so an additional day will cause short-run outages necessitating physician involvement and extra trips to retail pharmacies and back.

These uses of the mail remind us that mail has *public good* aspects. Willingness to pay exists beyond what is paid in the marketplace. There is value in its being there when we need it. Economists have called this concept “option demand.”<sup>1</sup> Because of this option demand a newer technique of the economics profession may be relevant. That has been called **contingent valuation** and has been used to evaluate the recreational values lost as a result of the Exxon Valdez oil spill in Alaska.

Contingent valuation has been defined as

- “ - A detailed description of the good(s) being valued and the hypothetical circumstance under which is made available to the respondent. A market model is constructed in great detail which is communicated in the form of a scenario that is read by the interviewer during the course of the interview. The market is designed as plausible as possible: it describes the good to be valued, the baseline level of provision, the structure under which the good is to be provided, the range of available substitutes, and the method of payment. Respondents are usually asked to value several levels of provision.
- 2 - Questions which bring out the willingness to pay for the good to be provided.
- 3 - Questions about the respondent characteristics (for example: age, income), their preference relevant to the good(s) being valued, and their use of the good(s). This information is then generalized for a representative group of people.”

From *Surveys to Value Public Goods: The Contingent Valuation Method*. Mitchell, Robert Cameron, and Carson, Richard T. 1989. Resources for the Future, Washington, D.C.

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<sup>1</sup> **Burton A. Weisbrod**, "Collective-Consumption Services of Individual- Consumption Goods" Quarterly Journal of Economics, LXXVIII (Aug. 1964), 471-77.

Because I believe that is a promising method I offer the following example from the same book. It is helpful to be concrete. The survey involves valuation of a recreational amenity but I believe that useful information could be used to help evaluate the worth of reliable frequent postal service and service in small communities.

“This research is designed to more closely examine some of the trade-offs between industrial development, recreation, and the environment in the Lake Powell area. In connection with these objectives, I would like to ask you a few questions to see how you feel about environmental quality and its future in this area.

There are plans to construct a large electric generating plant north of Lake Powell. This plant is expected to be at least as large as the Navajo Plant on the south side of the lake.

Have you noticed the Navajo Plant or its smokestacks? \_\_\_\_\_ Yes \_\_\_\_\_ No

Depending on exactly where and how a new plant is constructed, it could have a significant effect on the quality of the environment. If the plant is built near the lake, it could be visible for many miles up and down the lake. If air pollution is not strictly controlled, visibility in the area may be significantly affected. These photographs (interviewer shows photographs) are designed to show how a new powerplant on the north side of the lake might appear. Situation A shows a possible plant site but assumes that the power plant would be built at some distant location, not visible from the lake area. In situation B the power plant is easily seen from the lake, but emits very little smoke; visibility is virtually unaffected. Situation C is intended to show the situation with the greatest impact on the environment of recreationists in the area. It is easily seen from the lake, and the smoke substantially reduces visibility.

Vacationers, of course, spend considerable amounts of money and time and effort to equip themselves with vehicles, boats, camping, and fishing gear, and for traveling to the destination of their choice. It is reasonable to assume that the amount of money you are willing to spend for a recreational experience depends, among other things, on the quality of the experience you expect. An improved experience would be expected to be of greater value to you than a degraded one. Since it does cost money to improve the environment, we would like to get an estimate of how much a better environment is worth to you.

First, let's assume that visitors to the Glen Canyon National Recreation Area are to finance environmental improvements by paying an entrance fee to be admitted into the recreation area. This will be the only way to finance such improvements in the area. Let's also assume that all visitors to the area will pay the same daily fee as you, and all the

money collected will be used to finance the environmental improvements shown in the photos.

Would you be willing to pay a \$1.00 per day fee to prevent Situation C from occurring, thus preserving Situation A? \$2.00 per day? (increment by \$1.00 per day until a negative response is obtained, then decrease the bid by 25 cents per day until a positive response is obtained, and record the amount.) \_\_\_\_\_\$/day

Would you be willing to pay a \$1.00 per day fee to prevent Situation B from occurring, thus preserving Situation A? (repeat bidding procedure)

(Answer only if a zero bid was recorded for either question above.) Did you bid zero because you believe that:

\_\_\_\_\_ the damage is not significant

\_\_\_\_\_ it is unfair or immoral to expect the victim of the damage to have to pay the costs of preventing the damage

\_\_\_\_\_ other”

It is easy to spend someone else’s money. Attention must be given to putting that the survey in a context that includes a budget constraint. Economists have paid attention to that also. Several recreational amenities were offered and the respondent was given a budget to allocate among them. In the postal context to respond in can be made to allocate of budget among healthcare, river basin development and reliable postal services to learn more about relative valuations of these services. Tradeoffs could be studied between types of postal expenditure or postal expenditure and other public expenditure.

Cost savings are not the only palliative. The postal service is hit now by a perfect storm. There is a secular decline in mail volume because of electronic realities. There is also the reaction to recession or near recession in that mail volume is highly correlated with the rate of capacity utilization in the economy. Furthermore, factor prices are increasing. When GDP begins growing again at 3% (or more) in real terms one of these problems will be mitigated. There have been inventive and encouraging efforts at Negotiated Service Agreements to the extent that these continue the PS financial situation will improve.

Thank you for your time today and for providing this opportunity. I would be happy to answer any questions that you may have.

