

Before the
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WASHINGTON, DC 20268-0001

Report on Universal Postal
Service and the Postal Monopoly

Docket No. PI2008-3

PUBLIC REPRESENTATIVE REPLY COMMENTS
CONCERNING AUCTIONS OF THE USO
August 1, 2008

These comments address the suggestion that universal service can be provided through a mechanism of taxpayer subsidies and reverse auctions—a form of competitive bidding where the low bidder wins.¹ A familiar example is a road construction contract.²

Auctions have become well-known through the success of online services such as eBay. However, a reverse auction for universal service would be much more complex than an eBay auction. Indeed, a universal service auction would probably be

¹ RR Geddes, Oral Statement, July 10, 2008, at 3; <http://www.prc.gov/Docs/60/60458/Richard%20Geddes%20Oral%20%20Statement.pdf> as viewed July 28, 2008.

² See S Wallsten, "Reverse Auctions and Universal Telecommunications Service: Lessons from Global Experience" 3; http://techpolicyinstitute.org/files/wallsten_global_reverse_auctions-1.pdf as viewed August 1, 2008.

more complex than the recent FCC auction for wireless spectrum, which took years to design and two months to execute.³

Auctions for single items or well-defined lots, as conducted on eBay, tend to operate with low transactions costs. However, putting universal service out to bid raises several questions, including the following.

- What is being auctioned?
- Who designs the auction?
- Who conducts the auction?
- Who pays the subsidy?

In answering these questions one needs to be aware that auction designers have two competing goals in mind: getting the most for a seller while allocating resources efficiently.⁴ The answers to the above questions demonstrate the likelihood that auctioning a universal service obligation is more trouble than it is worth.

WHAT EXACTLY IS TO BE AUCTIONED?

There are at least two separate services performed by the Postal Service in "unprofitable areas." One service is retail sales; the other is delivery. On rural routes, these services are combined; for city routes, they are separate. Should these services be auctioned separately or as a bundle? Speaking of bundles, how does one define an "unprofitable area"? One's initial response might be to rely on the existing structure of

³ The auction opened on January 24, 2008, and closed on March 18, 2008. See FCC, "Auction of 700 MHz Band Licenses Closes," March 20, 2008; http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-08-595A1.pdf as viewed July 28, 2008. A sense of the complexity involved in designing the FCC auction can be found in JK Goeree & CA Holt, "Comparing the FCC's Combinatorial and Non-Combinatorial Simultaneous Multiple Round Auctions: Experimental Design Report," April 27, 2005; http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-05-1267A2.pdf as viewed July 28, 2008. In fact, the title alone conveys the complexity involved.

⁴ HR Varian, *Intermediate Microeconomics* 306 (5th ed. 1999). Congress, however, likes to add more conflicting objectives. FCC auctions must "promote rapid deployment of new technologies and promote economic opportunity and competition by dissemination of licenses to a wide variety of applicants." RP McAfee, J McMillan, & S Wilkie, "The Greatest Auction Ever," 2, http://www.aeaweb.org/annual_mtg_papers/2008/2008_92.pdf as viewed August 1, 2008.

routes or delivery units that fail to cover costs. However, it would be the rare route or delivery unit that had *no* profitable delivery points. Is it good public policy to pay someone to serve a profitable delivery point?⁵ Does one list unprofitable customers and auction each one separately, as New England towns in colonial times auctioned aid for the poor?⁶ Does one create groups of customers to be auctioned based on some vague idea of what bidders want? Or does one allow bidders to create their own "routes" or "delivery units" from a list of unprofitable customers?

These questions are not facetious. Each alternative described here entails a different trade-off between efficiency and transactions costs. And any reverse auction requires the drafting of a contract describing precisely what the winning bidder is supposed to do. Potential bidders have been known to lobby contract drafters to include or exclude terms in a contract.⁷ Performance of the contract must be monitored, and disputes over performance must be litigated.

Auctioning the entire universal service obligation as a single item would keep the costs of conducting the auction low. However, such an auction would significantly reduce the number of bidders and result in a higher bid. This is because potential bidders would have to assemble a nationwide network of retail and delivery services. It is difficult to imagine more than one entity with accurate information about the cost of

⁵ This may not be an issue. In a no-monopoly world, private firms would likely cherry-pick all profitable areas, no matter how defined.

⁶ RW Herndon, "Poor Relief in Eighteenth-Century Rhode Island" in BG Smith, *Down and Out in Early America* 151 (2003)

⁷ J McCollum, "Google Attacks Verizon Over Secret FCC Lobbying," October 8, 2007, <http://www.marketingpilgrim.com/2007/10/google-attacks-verizon-over-secret-fcc-lobbying.html> as viewed July 28, 2008; S Wallsten, "The FCC Does the Hustle," July 2007 at 2, <http://techpolicyinstitute.org/files/s3.pdf> as viewed August 1, 2008.

such a network. If there is only one bidder, and the source of funds to pay a subsidy is "taxpayers," the sky is the limit.

If several different areas were offered for bid, local firms with specialized knowledge about a given area could enter the bidding. But who would define the different areas? There are at least two ways to do this, both with significant transactions costs. One approach is to allow a potential bidder to define a service area that it would like to bid on. That is, the potential bidder selects a subset of "unprofitable" customers that it would like to bid for.⁸ The creation of such a list from which bidders could select is a costly activity. And potential bidders have an incentive to design "unprofitable areas" that are uniquely suitable for them, reducing the number of bidders for their preferred area and causing winning bids to be higher. A second approach is called a "combinatorial auction." In such an auction, bidders create groups of customers as part of the bidding process itself, which involves several iterations or rounds of bidding. This is how the FCC recently auctioned spectrum for wireless telecommunications.⁹

WHO DESIGNS AND CONDUCTS THE AUCTION?

One would expect the person who owns an item being auctioned to design the auction—that is, create the rules for conducting the auction. In the case of universal service, however, it is "taxpayers" who are attempting to minimize the subsidy they must

⁸ See D. Weller, "Auctions for Universal Service Obligations," presented at the 12th biennial conference of the International Telecommunications Society, Stockholm, June 1998; http://faculty-gsb.stanford.edu/wilson/archive/E542/classfiles/gte_colr_auctions.pdf as viewed July 16, 2008.

⁹ See Denise Papalardo, "FCC wireless auction still open, but bidding is slowing down," <http://www.networkworld.com/news/2006/090806-fcc-auction.html> as viewed July 16, 2008 ("The FCC's Advanced Wireless Service (AWS) auction is still underway more than four weeks since bidding began."); DC Parkes, "Iterative Combinatorial Auctions" in *Combinatorial Auctions* (Cramton, Shoham, & Steinberg eds) 41-77 (2006).

pay. Who represents the interests of "taxpayers"? In the case of wireless spectrum, it was the FCC—an agency created by Congress—that was responsible for designing the auction.

The FCC solicited comments on auction design and hired contractors to run experiments on proposed designs.¹⁰ There is also an industry of firms that will set up electronic reverse auctions. However, these firms generally offer only auctions for single items or clearly defined lots,¹¹ just like eBay.

WHO PAYS THE SUBSIDY?

The short answer is "taxpayers." However, this ignores the process by which funds collected as taxes are allocated to specific uses. "Reverse auctions do not address the way in which universal service funds are collected, instead focusing on how those funds are distributed."¹² Prior to the PRA, the Post Office was subsidized by taxpayers. However, the annual appropriation and authorization process generally resulted in insufficient funds for the Post Office. Recent experience is no better. Although Congress has authorized a payment of \$29 million per year to the Postal Service, the money has not always been appropriated. Thus, even if Congress were to authorize "someone" to conduct a reverse auction, the funds to pay the winning bidders might not materialize. In order for auctions to succeed, there needs to be a reliable

¹⁰ McAfee, McMillan, & Wilkie, *supra* n.4 at 2-10; B Gardiner, "FAQ: Inside the High-Stakes 700-MHz-Spectrum Auction," WIREd, September 11, 2007, http://www.wired.com/techbiz/it/news/2007/09/auction_faq?currentPage=all as viewed August 1, 2008.

¹¹ *E.g.*, LS Crane, "Seven Questions to Ask Before Running Your Next Reverse Auction," March 13, 2008, <http://www.purchasing.com/article/CA6537987.html> as viewed August 1, 2008. ("LEE S. CRANE is contracting officer with the U.S. Postal Service. This column is taken from a longer article on www.purchasing.com. Also, Crane has developed an eRA Pre-Auction Decision Analysis Tool available free at <http://www.eratool.net>.)")

¹² S Wallsten, *supra*, n.2, at 8.

source of funds. In the case of universal postal service, the only likely source is mailers, just as the source of funds for the FCC's universal service fund is customers of telecommunications companies. Mailers, of course, are the *current* source of funds for unprofitable areas. If mailers are going to be responsible for subsidizing unprofitable areas, an auction is simply a roundabout (and expensive) way of accomplishing what the monopoly accomplishes now.

The financing of any public subsidy is a complex, political process. The PRA was enacted in part because the traditional appropriations process had broken down. The Postal Service became self-financing. The PAEA retains self-financing while creating new incentives for efficiency. The PAEA also allows for incremental change in the form of moving individual products away from coverage of the monopoly. 39 U.S.C. §3642(a). But elimination of the postal monopoly is hardly an incremental change. The risks of disruption to a basic means of communication outweigh the ephemeral benefits of complex and expensive auctions.

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