Postal Regulatory Commission
Submitted 12/23/2009 12:04:59 P
Filing ID: 66151
Accepted 12/23/2009

Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Annual Compliance Report, 2009 Docket No. ACR2009

REPLY OF THE GREETING CARD ASSOCIATION TO MOTION OF THE PUBLIC REPRESENTATIVE FOR PRODUCTION OF ESTIMATES OF RATE ADJUSTMENTS

The Greeting Card Association (GCA) herein responds to the Motion filed by the Public Representative requesting that the Commission order the Postal Service to file estimates of the rate level adjustments "sufficient to insure financial stability of the Postal Service by the end of FY 2011."[1] From a theoretical viewpoint, it may be that such estimates, if they exist or could be constructed (and if, in either case, they did not rest on assumptions likely to be controversial in themselves), would be of interest to most postal stakeholders. It is much more questionable whether they would be of any practical use in this proceeding. In what follows, we explain the reasons for our skepticism on that point and our related conclusion that the Motion should be denied.

I. The Public Representative's theory

Reduced to essentials, the theory underlying the Motion appears to be that –

[1] Public Representative Motion Requesting Commission to Direct United States Postal Service to Provide Estimates of Rate Adjustments Necessary to Maintain Financial Stability (December 17, 2009), p. 1. In the alternative, the Public Representative asks the Commission to issue an Information Request in this or a followup docket to obtain such estimates.

- In an Annual Compliance Review the Commission may order changes to rates it finds unlawful;

- The dominant objective of the Postal Accountability and Enhancement Act (PAEA) is to maintain the financial stability of the Postal Service;

- It has been apparent for some time that Postal Service deficits were, and would be, a persistent problem;

- The Postal Service has not filed an "exigency" rate case under 39 U.S.C. § 3622(d)(1)(E); and

- Accordingly, the present rates – which, unaltered, will not cover Postal Service costs – are, or at least may be, unlawful.

In order to evaluate what, if anything, should be done pursuant to this theory, the Public Representative argues that the Commission needs

> . . . specific estimates, together with documentation, of rate level adjustments for every rate in its market dominant product categories designed to equate overall Postal Service revenue with overall estimated costs that would be sufficient to insure financial stability of the Postal Service by the end of FY2011.[[2]]

II. Critique of the theory

A. <u>What are the factors influencing the Postal Service's financial crisis</u>? The Public Representative's proposal rests on a number of assumptions, not all of them explained in the Motion. The most pervasive of these assumptions, never explicitly stated, is that the *only* route to financial stability is through rate

[2] Motion, p. 1 (fn. omitted). The Public Representative further specifies that the estimates should use the "best available elasticities (recognizing recession and volume trends due to the internet), current service levels, and estimated volumes" for FY 2010 and FY 2011 rate changes. Id., p. 13.

changes. To appreciate how vital this assumption is to the practical usefulness of the Public Representative's theory, it will be helpful to review the external factors[3] that have combined to place the Service in its present financial predicament. These are mentioned in the Motion, but the appropriate conclusion is never drawn. In what follows, we describe one example in detail and simply list the others that seem most relevant.

Retiree health benefits. PAEA requires the Postal Service to prefund retiree health benefit costs, and sets out a schedule of payments for the fiscal years 2007 through 2016; the required payments range from $5.4 billion to $5.8 billion.[4] The FY 2009 payment was legislatively restructured so that $4 billion would not count as a current charge to the Postal Service. As regards this obligation, which substantially exceeds anything found in the private sector[5], the Postal Service has stated that

> The requirement to prefund retiree health benefits is so burdensome that it is the driving factor behind the Postal Service's current losses. As can be seen by Table B-9, the Postal Service would have realized a profit in 2007 and 2008, and had an overall profit of almost $4 billion over the 2007-2009 timeframe, had there been no prefunding requirement.[[6]]

This obligation, clearly, is one that only Congress can change. The Motion recognizes only the possibility that it might again be postponed, as in FY 2009, but not that (for example) the payment schedule might be legislatively extended to

[3] By "external" factors we mean those not directly related to usage of the mails or to inescapable changes in the Service's delivery network. Thus the (largely Internet-driven) secular decline in First Class volume, the recession-induced volume losses in many categories, and the addition of more than a million delivery points a year are internal, not external, factors.

[4] 5 U.S.C. § 8909a(d)(3)(A).

[5] U.S. Postal Service, *Assessment of U.S. Postal Service Future Business Model* (November 2009), p. 14 ("Future Business Model Assessment").

[6] Future Business Model Assessment, pp. 16-17.

one more consonant with private-sector practice[7], or the calculations revised to incorporate a realistic view of the Service's employee headcount.[8]

Other factors –

Network restructuring. The Service, with significant excess mail processing capacity, has every reason to close or consolidate redundant up-stream facilities, but is often faced with political opposition (informal or otherwise) to its doing so.[9] The possibility that Congress would forego such opposition to network realignment, allowing important cost savings, is not considered in the Motion.

Labor costs. Most of the Service's labor agreements are due for renegotiation in 2010. In other troubled industries, unions have agreed to contribute to restoring the organization's financial stability. This bargaining process, which could bring important benefits to the Service's financial condition, is not under Commission control, in this Docket or elsewhere.

[7] Private sector practice in this respect is of interest also because in many lines of business the Postal Service must compete with private firms which may have substantially less costly retirement obligations. We refer not just to express companies competing in the package business, but also to Internet-related firms offering a competitive substitute for First-Class Mail.

[8] Details can be found in reports by the Postal Service's Inspector General and by the Commission. See U.S. Postal Service, Office of the Inspector General, *Final Management Advisory Report – Estimates of Postal Service Liability for Retiree Health Benefits* (Report No. ESS-MA-09-001) (June 19, 2009); Postal Regulatory Commission, *Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General* (July 30, 2009). Consultants' reports are included in both documents

[9] Future Business Model Assessment, p. 31, and Appendix D, "The Future of the United States Postal Service" (Elaine C. Kamarck), p. 26. It should be noted as well that the decline in First-Class Letter mail, which has affected Presort along with Single-Piece, implies material excess processing capacity in the private sector (i.e., presort bureaus and large mailers which process mail in-house) as well as within the Postal Service. But the Service's concern is with its own excess capacity, and it should not be hampered in its attempts to slim down its network.

Borrowing authority. The Postal Service's statutory borrowing limits are $15 billion (total) and $3 billion per year[10], which "have been in place . . . for many years."[11] They too are subject to change by legislation, but not otherwise. The possibility of legislative change is not recognized in the Motion.

Service levels. Another prominent cost-reduction proposal is reduction of delivery days from six to five per week – a controversial measure, which GCA, among others, firmly opposes. Such a reduction has long been, and is now, barred by an annual appropriations rider, which only Congress can change. The Motion, however, explicitly assumes that it will not be changed.[12]

The significance of these cost-causing factors is that, together or severally, they are largely responsible for the Postal Service's persistent deficits. None of them can be affected, one way or the other, by any Commission action under 39 U.S.C. § 3653. Yet the Public Representative seems to assume that, except for postponing the retiree health payment, even the most limited legislative change is unthinkable. In specifying the information requested, the Public Representative calls for alternative estimated rate increases assuming "that Congress postpones and also maintains the current requirement to pay retiree health benefit payments in September 2010 and 2011" and, in both cases, that "current service levels" persist.[13] The estimates, then, would ignore the possibilities of (i) more thorough restructuring of retiree health benefit funding, (ii) any successes in collective bargaining or eliminating overcapacity, (iii) any change in the Service's borrowing powers, or (iv) permission to reduce delivery days. Their underlying thrust is that *only* a massive rate increase need be considered as a remedy for the Service's ailing finances. This argument neglects the Postal Service's own,

[10] 39 U.S.C. § 2005(a).

[11] Motion, p. 4.

[12] Id., p. 14.

[13] Id., p. 13.

quite reasonable, rationale for not raising rates: that an increase under present deeply recessionary conditions – which may have rendered customers far more price-sensitive than previous Postal Service elasticities would reflect – could well significantly depress volume and hence total revenue.[14]

B. <u>The existence of a deficit does not by itself make the rates under which it exists unlawful</u>. We saw above that Congress has required the Postal Service to operate under conditions which contribute at least as significantly as rate levels to the current and expected deficits. When an unsatisfactory state of affairs is caused by multiple factors, it is irrational to decide at the outset that (i) only one of those factors can be addressed as an avenue to correcting the situation, and (ii) that one factor must be exploited intensively enough to overcome the effects of all the other causes as well. Yet that is the fundamental assumption of the Motion; and it is only on that assumption that the Public Representative is able to argue that current rates are unlawful.

The only plausible[15] basis for the unlawfulness argument is 39 U.S.C. § 3622(b)(5):

> Such system [of rate regulation] shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

* * * *

[14] Brief mention should be made of the Public Representative's argument (id., p. 8) that because the Service has raised rates on competitive products "[t]he argument that rates should not be raised during a recession, when business is slow, lacks credibility[.]" There are several answers to this contention, one of them suggested by the Public Representative himself when he reports (id., p. 8, fn. 19) that UPS will raise 2010 rates by 4.9 percent. If one's competitors are raising their prices, market share will presumably not suffer through raising one's own. It should be borne in mind also that when a postal customer is lost to Internet diversion, the loss is likely to be permanent, regardless of how postage rates may change thereafter.

[15] The Motion cites several other § 3622(b) objectives as being "place[d] . . . at risk" by revenues inadequate to cover total costs, but it is clear that these supposed infringements have no existence independent of the § 3622(b)(5) issue. Moreover, it is hard to see how increases of the magnitude the Public Representative contemplates could be squared with § 3622(b)(2), calling for predictability and stability of rates.

> (5) To assure adequate revenues, including retained earnings, to maintain financial stability.

Perhaps tacitly recognizing this, the Public Representative claims that "[i]n the instant case, the most important objective of modern rate regulation is, "To assure adequate revenues, including retained earnings, to *maintain financial stability."*[16] There is no statutory warrant for asserting – in the instant case or any other – that this one objective of the new regulatory scheme is "most important," or "[o]f overarching importance" (as the Public Representative asserts elsewhere in the same paragraph). Section 3622(b) specifies that the objectives are to be applied in conjunction with one another. One is not to predominate over the rest. Indeed, there are important features of PAEA which indicate that the Service is to balance its books by achieving operational economies as well as by charging adequate rates. The most prominent of them is the simple fact that PAEA abandons cost-of-service ratemaking in favor of a price cap based on an extrinsic economic indicator. It should be noted that the price cap system set up by 39 U.S.C. § 3622(d)(1) is a "requirement" – not an "objective" – and that departures from it under § 3622(d)(1)(E) are permissible only in "extraordinary or exceptional circumstances." This is not a structure of which it is reasonable to say that adequacy of revenue trumps every other consideration.

In short, the Public Representative may believe, and quite justifiably, that restoration of financial stability is currently the most important *issue.* But that is a policy judgment, not a rule of law.

It may be objected that the quest for remedies for the external problems discussed above is unlikely to succeed, and in any case will take substantial time, whereas the Commission can act relatively quickly on rates found to be unlawful. That objection may have some plausibility, but it does not address the

[16] Motion, p. 7 (emphasis in original).

basic problem: that current rates are not *by themselves* responsible for the Service's inability to collect revenues adequate for financial stability.

Moreover, history shows that – given a substantial enough financial problem – legislative assistance is by no means an implausible goal. In the mid-1970s, the Postal Service was in dire financial condition. The legislative response was Pub. L. 94-421, the Postal Reorganization Act Amendments of 1976. Pub. L. 94-421, inter alia –

- provided, for FY 1976 and FY 1977, annual appropriations of $500 million to retire Postal Service indebtedness; and

- established the 10-month time limit for rate proceedings and authorized imposition of temporary rates by the Board of Governors if the limit were not met.[17]

Passage of this legislation, incidentally, took about 14 months from the introduction of H.R. 8603 in July 1975.

The present situation, then, is one in which various external problems, which could be dealt with through legislation (being actively sought by various postal stakeholders) and through meaningful changes in the Postal Service's wage and benefit obligations (particularly in view of the upcoming round of labor contract negotiations), have contributed at least as significantly as rate levels to the Service's financial difficulties. It is far from clear how, in these present circumstances, the Commission could securely or even plausibly conclude that the *rates* are unlawful, and unlawful *solely* because they do not produce sufficient

[17] One of the main problems facing the Service, as the situation was perceived in the mid-1970s, was the slow pace of rate cases. Docket R71-1 occupied the Commission for 17 months; Docket R74-1, for 23 months. See *Postal Reorganization Act Amendments of 1975,* H.R. Rep. 94-391, *in* 94th Cong., 2d Sess., *H.R. 8603, Postal Reorganization Act Amendments of 1976 – Legislative History,* p. 45 (where the Service's indebtedness incurred to cover operating losses is also quantified, at an estimated $1.5 billion by September 1975).

revenue to cover all costs. But that is precisely the premise for the Public Representative's Motion. It is for that reason that GCA doubts the practical usefulness in this Docket of the estimates the Public Representative asks for, and consequently opposes the Motion.

III. The Public Representative's Targeting of Single-Piece First-Class Letter Mail

At pp. 11-12 of the Motion, the Public Representative appears to argue that the First-Class letter stamp should be a particular target of rate increases. For example, the Motion states that

> . . . The estimates would likely include annual increases of several pennies for sing[l]e-piece First-Class rates amounting to five or ten percent, or more, to "save the service" currently enjoyed and demanded by many mailers and the public.[[18]]

Since the Public Representative, in specifying the relief requested, asks for rate estimates for *all* market-dominant products, it is not easy to see why the letter stamp should be singled out in this way. The Motion's treatment of the subject, however, does serve to illustrate the simplistic analysis characteristic of the entire document.

A large part of this presentation consists of a comparison between the Postal Service's First-Class letter rate and those of other industrialized nations, expressed in U.S. dollars.[19] The Public Representative goes on to say that

[18] Motion, p. 11. We assume, as it seems we must in the absence of any further explanation from the Public Representative, that this estimate is meant to reflect an increase for Single-Piece Letters proportionate to increases on all other categories. A ten-percent increase in Single-Piece revenue (using RPW volumes for FY 2009 and assuming *no* volume effect from the increase) would produce about $1.3 billion, or about a sixth of the projected FY 2010 deficit of $7.8 billion. Single-Piece letters are, similarly, about a sixth of the total mailstream. This at least does help to make it clear that the Public Representative sees *no* solution to the deficit save increased rates. Whether such an across-the-board scaling up of rates without regard to the demand characteristics of the different mail types would produce the hoped-for improvement in financial stability is quite another question (also not discussed in the Motion).

[19] Specifically, the United Kingdom ($0.64), Germany ($0.77), France ($0.78), Japan ($0.83), Norway ($1.25), and Canada ($0.47).

> . . . Where Postal Service rates do not adequately reflect the total cost of service it is not apparent why, other than bragging rights, the U.S. postal rates should be much lower than in most, if not all, of the industrialized world.[[20]]

It is difficult to know how seriously the Public Representative intends this argument to be taken. In the first place, comparisons in dollar terms between U.S. and foreign postal rates depend largely on the value of the dollar in other currencies. Taking one major example, a recent[21] rate is $1.4343 to € 1.00; on December 3, it was $1.5120 to € 1.00. At the beginning of 2009, the rate was $1.3866 = € 1.00; at the beginning of 2003, $1.0361 = € 1.00; and at the beginning of 2001, $0.9465 = € 1.00.[22] Thus at the 2001 rate, the "78-cent" French letter stamp would cost 0.78 / (1.4343 / 0.9465) = 51.47 cents. The Public Representative, however, does not even attempt to justify using transnational rate relationships which necessarily fluctuate with fluctuations in the dollar as a criterion for domestic postal ratemaking – nor, we believe, could such an attempt succeed. Neither the Postal Service nor its customers are responsible for the weakness of the dollar in currency markets.

Secondly, comparisons between U.S. and foreign letter rates should take account of the varying efficiencies (as reflected particularly in per-piece costs) of the different postal systems. If U.S. letter rates are lower than those of France or Japan, a principal reason may be that U.S. unit letter costs are also lower. It is common knowledge that the extremely large size and diversity of the U.S. mail market create economies of scale and scope that exist nowhere else. The Public Representative ignores this factor as well.

IV. The (practical) question of volume effects

---

[20] Motion, p. 12.

[21] December 16, 2009.

[22] Historical rates adapted from data available on www.x-rates.com.

We noted above (fn. 18) that the Motion does not go into the question of how increases of the size apparently contemplated would affect demand for postal services. Among the generally acknowledged challenges the Service faces are increasing Internet diversion and the current economic slowdown. These, along with what may be thought more "permanent" characteristics of various mail classes, could be expected to affect significantly the revenue results of a drastic rate increase. The Motion does acknowledge this to some extent, in that the relief specifically requested includes the use of "best available elasticities (recognizing recession and volume trends due to the internet)" but this formulation might in practice raise as many problems as it seeks to resolve. Does the phrase "best available" mean the best available to the Service at this point in time? or the best that could be constructed (by the Service or any other party), perhaps using different econometric techniques and assumptions about Internet substitution and the general economic situation? How would the Commission decide what elasticities were the best? In particular, how would this decision be made within the 90-day limit[23] for an annual compliance review?

V. Conclusion

GCA's position, accordingly, may be expressed thus: If the Postal Service were in a position to furnish the estimates the Motion calls for – which it evidently is not[24] – GCA, while unconvinced of their usefulness for this Docket, would not object to their production. We do, however, believe that the premise on which the Public Representative asks for them is fundamentally erroneous, and that the outcome contemplated in the Motion – a finding that current rates are unlawful simply because of the current deficit – would be unjustified. For that reason, as

[23] 39 U.S.C. § 3653(b).

[24] Response of the United States Postal Service in Opposition to Motion of the Public Representative (December 18, 2009).

well as for the practical reasons expressed in the Postal Service's responsive pleading (with which we would agree), the Motion should be denied.

December 23, 2009

Respectfully submitted,

GREETING CARD ASSOCIATION

David F. Stover
2970 South Columbus St.. No. 1B
Arlington, VA 22206-1450
(703) 998-2568
(703) 998-2987 fax
E-mail: postamp@crosslink.net