FEDERAL TRADE COMMISSION

ACCOUNTING FOR LAWS THAT APPLY DIFFERENTLY TO THE UNITED STATES POSTAL SERVICE AND ITS PRIVATE COMPETITORS

A Report by the
Federal Trade Commission
December 2007

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INTRODUCTION AND EXECUTIVE SUMMARY

A. The Postal Accountability and Enhancement Act and the FTC Study

On December 20, 2006, President Bush signed The Postal Accountability and Enhancement Act (PAEA or the Act) into law.[1] The PAEA requires the Federal Trade Commission (FTC) to prepare and submit to the President, Congress, and the Postal Regulatory Commission (PRC) "a comprehensive report identifying the federal and State laws that apply differently to the United States Postal Service with respect to the competitive category of mail and to private companies providing similar products."[2] The PAEA also requires the report to include recommendations that the FTC considers appropriate: (1) "for bringing such legal differences to an end"; and (2) "in the interim," to account – under the PRC's regulations to prohibit subsidization of competitive products – "for the net economic effects provided by those laws."[3]

To fulfill the FTC's charge under the PAEA, this report first identifies, and quantifies to the extent possible, the United States Postal Service's (USPS or Postal Service) economic burdens and advantages that exist by virtue of its status as a federal government entity and its postal and mailbox monopolies. We emphasize that our efforts to quantify the USPS's burdens and advantages pursuant to the PAEA's directive yielded approximations of their amounts under various cost-allocation assumptions, utilizing the limited data we received. Second, the report also accounts for the "net economic effect" of the relevant laws by examining the compounded marketplace impacts, or "distortions," that they bring about. Finally, this report explores potential means for minimizing or eliminating these distortions. Ultimately, the PRC will need to determine the appropriate approach under its regulatory authority to require the USPS to account for the economic benefits it derives from differential legal treatment. Further, only Congressional action can eliminate the legal constraints that negatively impact the USPS's

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[1]The Postal Accountability and Enhancement Act, Pub. L. 109-435, 120 Stat. 3189 (Dec. 20, 2006), *codified* at 39 U.S.C. §§ 101 *et seq*.

[2]PAEA § 703(a). Competitive products accounted for 9 percent of USPS's total revenue in fiscal year 2006. *See infra* at note 39 and accompanying text.

[3]PAEA § 703(b). The PAEA also required other agencies to prepare reports on other aspects of postal reform. For example, the Act gives the PRC two years from enactment to conduct a major study on universal service and the postal monopoly. *Id.* at § 702. Further, the PAEA requires the Governmental Accountability Office (GAO) to conduct an in-depth study of "various options and strategies for the long-term structural and operational reforms" of the USPS, within five years of its enactment. *Id.* at § 710. Further, the Secretary of the Treasury is required to submit a report developing recommendations regarding accounting practices and principles to be used to value USPS's competitive products assets and rules to be used to determine the federal income tax on competitive products revenue. 39 U.S.C. § 2011(h)(1)(A).

competitive products operations. Thus, as in prior studies, the Commission itself is not making any recommendations, but is submitting this report as required by the PAEA for whatever guidance needed by the President, Congress, and the PRC in consideration of further legislation or regulation.

The PAEA represents a dramatic change to the manner in which the USPS sets rates for its products. The Act divides the USPS's products into "market-dominant" and "competitive" categories. The Act defines the market-dominant category as:

> each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products.[4]

The competitive products category simply is defined as consisting of "all other products."[5] The Act lists market-dominant and competitive products,[6] but allows the newly formed PRC to change these lists, based on the definitions just stated, "by adding new products to the lists, removing products from the lists, or transferring products between the lists."[7] The PAEA, however, explicitly forbids the PRC from transferring products covered by the postal monopoly to the competitive products list.[8]

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[4]39 U.S.C. § 3642(b)(1).

[5]*Id*.

[6]The Act lists as market-dominant products: first-class mail letters and sealed parcels; first-class mail cards; periodicals; standard mail; single-piece parcel post; media mail; bound printed matter; library mail; special services; and single-piece international mail. 39 U.S.C. § 3621(a)(1)-(10). The Act lists as competitive products: priority mail; expedited mail; bulk parcel post; bulk international mail; and mailgrams. 39 U.S.C. § 3631(a)(1)-(5).

[7]39 U.S.C. § 3642(a). When the PRC issued its final rule to establish a system of ratemaking, it adopted an initial list of the USPS's competitive and market-dominant products. *See* Postal Regulatory Commission, Order No. 43, *Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products*, PRC Docket No. RM2007-1, 72 FED. REG. 63,622 (Nov. 9, 2007) [hereinafter "PRC, Order No. 43"]. We provide a more detailed discussion of competitive products *infra* at Chapter I.B.

[8]39 U.S.C. § 3642(b)(2) ("A product covered by the postal monopoly shall not be subject to transfer under this section from the market-dominant category of mail."). The Act defines a product covered by the postal monopoly as one reserved to the USPS under 18 U.S.C. § 1696, subject to exceptions to the postal monopoly codified at 39 U.S.C. § 601. *Id.* We provide a more detailed discussion of the postal monopoly *infra* at Chapter I.A.

The Act requires the PRC to establish "a modern system for regulating rates and classes for market-dominant products."[9] This modern rate regulation system must satisfy a variety of objectives, including providing incentives to reduce costs, increasing efficiency, increasing predictability and stability of rates, and maintaining financial stability.[10] The PRC will regulate the USPS's rates for market-dominant services, and any increase will be capped at the rate of inflation.[11] The Act also creates a separate revolving fund for revenues from the sale of competitive products,[12] permits the USPS to borrow on the fund,[13] and subjects income from the sale of competitive products to the equivalent of federal corporate income taxes.[14]

The Act gives the USPS authority to set its own prices for competitive products,[15] including entering into negotiated service agreements (NSAs),[16] which are agreements with mailers providing for rates different from the published rates for competitive products. It also instructs the PRC to promulgate regulations to prohibit cross-subsidization of competitive products (which include NSAs) with revenue from market-dominant products, to ensure that each competitive product covers it attributable costs, and to ensure that all competitive products "collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service."[17]

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[9] 39 U.S.C. § 3622(a).

[10] *See* 39 U.S.C. § 3622(b).

[11] 39 U.S.C. § 3622(d). Notwithstanding this limitation, Section 3622(d)(1)(E) sets out a procedure to raise rates on an "expedited basis due to either extraordinary or exceptional circumstances." The PRC already has promulgated rules under this provision. *See* PRC, Order No. 43, *supra* note 7.

[12] 39 U.S.C. § 2011.

[13] *Id*.

[14] 39 U.S.C. § 3634.

[15] 39 U.S.C. § 3632 (b)(2).

[16] 39 U.S.C. § 3632(b)(3).

[17] 39 U.S.C. § 3633(a).

On October 29, 2007, the PRC adopted final rules to implement the new ratemaking system,[18] and these rules became effective on December 10, 2007.[19] These new regulations require that prices for competitive products satisfy three conditions to comply with the PAEA: (1) competitive products must cover their incremental costs, defined as each product's attributable costs plus causally related group-specific costs; (2) each competitive product must recover its attributable costs; and (3) competitive products collectively must cover at least 5.5 percent of the USPS's institutional costs.[20] The PRC's regulations require the USPS to publish a notice providing an "explanation and justification" in the *Federal Register* 30 days in advance for changes to rates for competitive products of general applicability, and to notify the PRC – including an "explanation and justification" – fifteen days in advance for changes to rates not of general applicability.[21] Further, for rate decreases and for all competitive product NSAs, the USPS must make certifications and submit data to demonstrate compliance with the PAEA's Section 3633 pricing requirements.[22]

The Act also subjects the USPS to new forms of potential legal liability. For any product that is not covered by the postal monopoly, the Act waives any USPS claim of sovereign immunity for suits against it brought in federal court for any violation of federal law.[23] Further, the Act explicitly provides that for claims against it regarding competitive products, the USPS "shall be considered a person" under the antitrust laws, including under Section 5 of the FTC Act for unfair methods of competition.[24] The PAEA additionally subjects the USPS to claims

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[18] *See* PRC, Order No. 43, *supra* note 7.

[19] *See* Postal Regulatory Commission*, 39 CFR Parts 3001, 3010, 3015, and 3020: Administrative Practice and Procedure, Postal Service: Final Rule Correction*, 72 Fed. Reg. 64,155 (Nov. 15, 2007).

[20] 39 C.F.R. § 3015.7(a)-(c). *See also* Postal Regulatory Commission, Order No. 26*, Order Proposing Regulations to Establish a System of Ratemaking*, PRC Docket No. RM2007-1, 72 FED. REG. 50,744, 50,762-65 (Sept. 4, 2007) [hereinafter "PRC, Order No. 26"].

[21] 39 C.F.R. § 3015.5(a),(b).

[22] *See* 39 C.F.R. § 3015.3 (concerning decrease in rates of general applicability); 39 C.F.R. § 3015.5 (concerning changes in NSA rates).

[23] 39 U.S.C. § 409(e)(1)(A)-(B).

[24] *Id.* In this manner, the PAEA effectively overrules *United States Postal Serv. Flamingo Indus. (USA) Ltd.*, 540 U.S. 736 (2004). In *Flamingo Indus.*, the Supreme Court held that because the USPS is part of the United States government, it is not a "person," and thus is not subject to suit under the Sherman Act.

concerning both market-dominant and competitive products under Section 5 of the FTC Act for unfair or deceptive acts or practices and the Trademark Act of 1946.[25]

B. Response to Federal Register Notice Requesting Comments

On May 1, 2007, the FTC issued a Federal Register Notice (FRN) soliciting comments to aid in preparing this report.[26] The FRN included eleven questions designed to solicit information concerning broadly the following issues: (1) legal requirements that burden only private competitors; (2) government-imposed burdens on the USPS that affect its ability to compete; and (3) methodology for accounting for these differences when determining the USPS's costs for the purpose of setting prices for competitive products. Due to requests from numerous parties, the Commission issued an FRN extending the deadline for comments until August 6, 2007.[27]

Eighteen parties submitted 20 comments in response to the FRN.[28] The responses included submissions by the USPS, Federal Express Corporation, United Parcel Services,[29] a variety of mailers,[30] the American Postal Workers Union, the National Association of Letter Carriers, a member of the Postal Regulatory Commission, the Consumer Postal Council, and six members of the general public. In preparing the report, FTC staff consulted with representatives from the USPS, the Board of Governors of the USPS, the Government Accountability Office, the Board of Governors of the Federal Reserve System, the Department of Treasury, the PRC, the Australian Government Productivity Commission, and Congressional staff. FTC staff also had discussions with representatives from private express companies and mailers.

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[25] 39 U.S.C. § 409(d)(2)(B).

[26] Federal Trade Commission, *United States Postal Service Study*, 72 FED. REG. 23,820 (May 1, 2007).

[27] *See* Press Release, Federal Trade Commission, *FTC Extends Public Comment Period on Postal Study* (June 12, 2007), *available at* http://www.ftc.gov/opa/2007/06/fyi07257.shtm.

[28] The submissions can be found at http://www.ftc.gov/os/comments/USPS%20Study/index.shtm. For the remainder of this Report, we cite these submissions as follows: [Commenter Name], [Comment #], at [Page #].

[29] In addition to UPS's submission, J. Gregory Sidak submitted a comment at the request of UPS.

[30] Parcel Shippers Association; Mailer's Council; Mail Order Association of America; ADVO, Inc.; ValuPak Direct Marketing Systems, Inc.; and Association of Priority Mail Users.

C. The United States Postal Service and Competitive Mail Products

The U.S. Constitution provides Congress the power to "establish post offices and post roads."[31] Congress created the Postal Service as an independent establishment of the executive branch of the Government of the United States, with its basic function defined as "the obligation to provide postal services to bind the Nation together through the personal, education, literary, and business correspondence of the people."[32] The USPS is required to provide service at uniform rates for one class of letter mail to virtually all U.S. addresses six days a week and reasonable access to postal facilities for the population.

To fund this universal service obligation, Congress has granted the USPS two monopolies. First, the USPS enjoys a monopoly over the delivery of "letters," which includes personal correspondence, bills, postcards, and advertising. Second, the USPS also enjoys the exclusive right to access citizens' mailboxes. In addition to these monopolies, by virtue of its status as a federal governmental entity, the USPS is exempt from certain state and local legal requirements, such as taxes and licensing. At the same time, because the USPS is a federal government entity, it must comply with a host of federal requirements that do not apply to private firms, such as restrictions on its ability to manage its labor costs and to configure its network.

In fiscal year 2007, the Postal Service handled 212 billion pieces of mail and earned nearly $75 billion in revenue.[33] When the Constitution was written, mail was the principal means to communicate if people could not meet face to face. Electronic communication systems, starting with the telegraph, have provided alternatives that have displaced mail for many types of communications. The advent of the Internet has had a similar effect on the USPS. As people opt to communicate, share documents, and engage in financial transactions online, the volume of first class mail (including postcards, letters, advertisements, bills, and statements of account) has declined.[34] Specifically, first-class volume has fallen 7.5 percent since 2001, and a

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[31]U.S. CONST. art. I, § 8. cl. 7.

[32]39 U.S.C. § 101(a).

[33]*See* UNITED STATES POSTAL SERVICE, 2007 AUDITED FINANCIAL STATEMENT 10 (2007) [hereinafter "USPS 2007 FINANCIAL STATEMENT"], *available at* http://www.usps.com/financials/_pdf/FY2007USPSAnnualFinancialStatements.pdf. The USPS primarily serves the U.S. domestic market, with less than 3 percent of total revenue coming from international operations. *Id*.

[34]*Id*. As the USPS explains:

> The long-term continued decline in single-piece volume reflects the impact of electronic diversion as business, nonprofit organizations, governments, and households continue to move their correspondence and transactions to electronic

key driver of this decline has been the marked reduction in single-piece mail, which fell by 4.7 percent from 2006 to 2007 alone.[35] As a result of these trends, the USPS increasingly relies on advertising mail to provide revenue.[36] For example, in 2007, standard mail volume (which primarily consists of bulk advertising to multiple delivery addresses) was 104 billion pieces, compared to 96 billion first-class mail pieces.[37] This represents a 15.1 percent increase in standard mail volume since 2001. Although the Internet appears to have caused consumers to substitute away from the USPS for many of their communication needs, the rise of e-commerce also has increased the demand for parcel shipments to consumers.[38]

In addition to its market-dominant operations, the USPS provides competitive mail products such as express mail, priority mail, and parcels sent in bulk by large mailers. In fiscal year 2006 (the last year for which comparable data exists), the USPS earned $6.5 billion, or 9

> alternatives, such as Internet bill payment, automatic deduction, and direct deposit.

Id.

[35]*Id.* at 26.

[36]According to Household Diary Study data supplied by the USPS, in Fiscal Year (FY) 2006, only 5.1 percent of mail volume was described as either "personal" or "social" correspondence, 24 percent was described as "transaction," and 55 percent was described as advertising. In 1998, advertising mail volume – within both standard and first-class mail – exceeded that of non-advertising mail for the first time. *See* R. Richard Geddes, *Policy Watch: Reform of the U.S. Postal Services*, 19 J. ECON. PERSPECTIVES 217, 221 (2005).

[37]*See* UNITED STATES POSTAL SERVICE, 2006 ANNUAL REPORT 26 (2006) [hereinafter "USPS 2006 ANN. REP."]. Standard mail volume also exceeded first-class volume in 2005. *Id.* In addition, according to Household Diary Study data supplied by the USPS, in FY 2006, 5.9 percent of first-class mail was advertising matter (excluding advertising that may be contained in bills, statements, or periodicals).

[38]*See id.* at 21 ("The Internet and electronic commerce also have a positive impact on our business by stimulating uses of postal services, such as package delivery and targeted ad mail.); UNITED PARCEL SERVICE, 2005 ANNUAL REPORT 9 (2006) ("Internet purchasing drives direct-to-consumer transactions, increasing small package shipments."), *available at* http://files.shareholder.com/downloads/UPS/201853012x0x36793/D27CA411-E8CD-4D4D-BD5E-75EBA20081FB/2005%20Annual%20Report.pdf; Michael A. Crew & Paul R. Kleindorfer, *Access and the USO for Letters and Parcels*, *in* COMPETITIVE TRANSFORMATION OF THE POSTAL AND DELIVERY SECTOR 4-5 (Michael A. Crew & Paul R. Kleindorfer eds., 2003) ("While the parcel market is currently relatively small for most USO providers, parcel post is expected to grow significantly as a result of the growth in B2B and B2C commerce.").

percent of its total revenue, from the sale of these products.[39] Several private carriers compete with the USPS in this business segment, including United Parcel Service (UPS), Federal Express, and DHL. The USPS derives substantially less revenue from competitive products than the two largest private carriers, UPS and Federal Express, which earned $30.5 billion and $11.4 billion in revenues in 2006, respectively.[40]

D. Summary of Conclusions

Based on the comments received in response to the FRN, our consultations with various governmental agencies and interested private entities, and a review of the relevant public material, the Commission offers the following conclusions:

- ***From the USPS's perspective, its unique legal status likely provides it with a net competitive disadvantage versus private carriers*:**

    - ***Federally-imposed restraints on the USPS's operations increase its costs to provide competitive products by an estimated $330-$782 million a year***. Because of its status as a federal governmental entity, the USPS has legal and political restraints on its operations that reduce its efficiency in providing competitive products. Our analysis of data from the USPS shows its economic burdens ranged from $330 million to $782 million in FY 2006 (4-9 percent of competitive products revenue), depending on how costs are allocated to competitive products operations. The largest of these estimated constraints are those related to managing labor costs, which the USPS estimates account for $306 - $724 million in additional costs, or 3-8 percent of competitive products revenue. Further, the universal service obligation and other constraints on optimizing its operations network require the USPS to establish its network in a way that may increase both institutional costs and costs directly attributable to competitive products.

    - ***However, because the USPS is a federal government entity, the USPS's competitive products operations enjoy an estimated implicit subsidy of between $39-$117 million a year.*** By virtue of its status as a federal governmental entity, the USPS is able to avoid costs associated with various federal, state, and local legal requirements that its private competitors incur. The USPS also avoids costs through preferential interest rates on its debt. Based on the information we received, we estimate the value of these implicit subsidies ranged from $39 million to $117 million in FY 2006 (.6% - 1.8% of competitive products revenue), depending on how they are allocated to the USPS's competitive products operations. In addition to these avoided costs, the USPS enjoys other less

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[39] *See* United States Postal Service [hereinafter "USPS"], Comment 18, at 2.

[40] *See* Chapter I.C., *infra*.

quantifiable advantages, such as the power of eminent domain and limits on the extent to which it can be sued.[41] Although earning a return on equity is not a legal requirement, we estimate that the USPS's competitive operations would have to more than double the current net income those operations produce to earn a rate of return equal to the average return on equity of its private competitors.

- ***From a market-wide perspective, the federally-imposed restrictions that impose economic burdens on the USPS and the implicit subsidies that provide the USPS an economic advantage should be viewed as two distortions that compound each other and negatively affect the provision of competitive mail products.*** The USPS's burdens cause it to utilize more resources than necessary to produce competitive products. Its implicit subsidies partially mask these inefficiencies from consumers, creating incentives for consumers to purchase more competitive mail products from the USPS than they otherwise would if the products were priced based on their full costs. The net economic effect of these two factors is to divert some portion of sales from lower-cost suppliers of competitive mail products or other communications media to the USPS, which produces competitive products at a higher cost due to its economic burdens. These distortions reduce overall economic efficiency because more resources are used to produce the current volume of competitive products than is necessary.

- ***Congress may wish to consider acting to reduce the constraints on the USPS's competitive products operations.*** Congressional action would be required to reduce the USPS's legal constraints. Elimination of these constraints, especially with respect to the ability to manage labor costs and configure its network, would help the USPS to reduce its costs of providing competitive products. Not only would this action reduce the economic burdens associated with USPS production of competitive products, but it also may enhance competition and consumer welfare by making the USPS a more efficient competitor.

- ***At the same time, the PRC may wish to consider requiring the USPS to account for its implicit subsidies when making pricing and production decisions.*** The PRC could take action to require the USPS to account for its implicit subsidies pursuant to its oversight authority to assure that competitive products are not subsidized. Subsidies artificially reduce the USPS's costs of supplying competitive products. Although these subsidies represent only a small portion of total competitive products revenue, because net income from competitive products is relatively small and competitive products as a group must cover at least 5.5 percent of the USPS's institutional costs going forward, accounting for implicit subsidies may have an impact on the solvency of the Competitive Products Fund. We estimate that accounting for implicit subsidies results in negative net income for competitive products under some scenarios. Consequently, the USPS may charge prices for competitive products that are lower than they would be if it were to account for its

[41]We collectively refer to these avoided costs as "implicit subsidies" throughout the remainder of the report.

implicit subsidies. The interference with normal market forces caused by these subsidies, however, results in price signals that convey the wrong information about relative scarcities in the market for competitive mail products, which leads to inefficient marketplace decisions and reduced consumer welfare.

- ***Worksharing and recent PRC regulations requiring contribution to institutional costs may reduce any advantage the USPS's postal monopoly provides it in the delivery of competitive products.*** The USPS has developed transportation, processing, delivery, and retail networks to provide products reserved to it under the postal monopoly. The USPS also uses these networks to provide its competitive products, which likely allows it to generate economies of scope. Its competitors cannot generate similar scope economies because they are legally prohibited from delivering products that are covered by the postal monopoly. If the postal monopoly is necessary to provide the current form of universal service or if universal mail service is a natural monopoly, then any scope economies that the USPS enjoys may naturally flow from market conditions relating to universal mail service. To the extent that the USPS's scope economies in delivering competitive products are not a result of market forces in the presence of the current universal service requirement, its effects on competition are uncertain. First, through workshare rates, the USPS's competitors purchase access to certain parts of its networks. Further, the PRC has promulgated rules that require the USPS's competitive products collectively to cover 5.5 percent of the USPS's institutional costs. To the extent that these institutional costs represent shared network costs, the USPS's competitive products currently must contribute revenue to maintain these networks.

- ***In the longer term, a variety of options exist to eliminate the legal differences between the USPS and its private competitors*:**

  - ***Congress and the PRC may wish to consider whether relaxing the current mailbox monopoly to allow consumers to choose to have private carriers deliver competitive products to their mailboxes would create net benefits for consumers.*** The statutorily-provided monopoly on mailbox access limits consumer choice and artificially increases the costs of private carriers to deliver the subset of competitive products that otherwise could be delivered to consumers' mailboxes. Relaxation of the mailbox monopoly, however, also raises issues related to privacy and the enforcement of laws that protect the integrity of the mail.

  - ***Congress may wish to consider whether the scope of the postal monopoly could be narrowed to allow greater competition while still maintaining universal service.*** In general, competition provides consumers lower prices, better quality, and more variety. Therefore, restrictions on competition should be put in place only when they are necessary to provide consumers a benefit that the market cannot. Such restrictions, moreover, should be narrowly drawn to displace competition only as much as needed to provide this benefit. Allowing competition over a larger variety of mail is likely to benefit consumers with lower prices and increased quality. After completion of the PRC's study on the universal service obligation and the postal monopoly, Congress may wish to consider whether the scope of the postal monopoly could be narrowed to allow greater competition while still maintaining universal service.

- ***Establishing the USPS's competitive products division as a separate corporate entity – with either private or governmental ownership – arguably would eliminate many of the major remaining major legal differences between the USPS and its private competitors.*** Corporatization raises a host of issues beyond the scope of this report. Upon completion of GAO's study of the future business model of the USPS, however, Congress may wish to consider this option.

The remainder of this report is organized as follows. Chapter One provides an overview of the postal and mailbox monopolies and the competitive products industry. Chapter Two catalogs the legal differences that arise as a result of the USPS being a federal entity, including federal, state, and local legal obligations from which the USPS is exempt, as well as the legal and political constraints placed upon the USPS by Congress. Chapter Three examines benefits that the USPS may derive from its postal and mailbox monopolies. Chapter Four provides some broad estimates of the magnitude of the USPS's burdens and subsidies and discusses the economic consequences of these market distortions. Finally, Chapter Five examines some possible courses of action for eliminating these legal differences.

CHAPTER I

OVERVIEW OF THE POSTAL AND MAILBOX MONOPOLIES AND THE COMPETITIVE PRODUCTS INDUSTRY

This chapter discusses the history of the USPS's postal and mailbox monopolies and provides an overview of the current competitive products industry.

A. The Postal and Mailbox Monopolies

The U.S. Constitution provides Congress the power to "establish post offices and post roads,"[42] and the U.S. Supreme Court has held that Congress may regulate the "entire postal system of the Country."[43] Congress created the Postal Service as an independent establishment of the executive branch of the Government of the United States, with its basic function defined as "the obligation to provide postal services to bind the Nation together through the personal, education, literary, and business correspondence of the people."[44] The USPS is required to provide universal service, which entails three elements: universal coverage of the postal network, uniform prices for one class of letter mail, and uniform service.[45] In practice, the USPS must provide service to virtually all addresses six days a week and charge the same price to deliver similar items regardless of delivery location.[46] Congress has granted the USPS monopolies over the delivery of certain correspondence and access to citizens' mailboxes to assure that the USPS earns sufficient revenue to fulfil its mission of providing universal service. In addition, the USPS has issued regulations pursuant to these statutes to define the scopes of these monopolies.

Preserving the uniformity of service and pricing components of the universal service obligation are the primary justifications for these monopolies.[47] If the USPS could charge higher

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[42]U.S. CONST. art. I, § 8. cl. 7.

[43]*Ex parte Jackson*, 96 U.S. 727, 732 (1878).

[44]39 U.S.C. § 101(a).

[45]"[The USPS] shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities." *Id.*

[46]For example, the USPS charges $0.41 to deliver a letter anywhere in the United States regardless of whether the delivery address is in the same town or across the country in a remote location.

[47]*See* USPS, Comment 18, at 4-5 (noting assurance of universal service as a rationale for a postal monopoly); Sidak, Comment 17, at 10-11 (discussing the Supreme Court case *Air*

prices, or provide lower quality service (e.g., less frequent deliveries) for higher-cost customers (those in sparsely populated areas or urban "park and loop" routes) relative to lower-cost customers (e.g., those in densely populated areas with curbside or clusterbox delivery), it could cover costs on all routes and thus provide universal service without monopoly protection. Because it must provide the same prices and service levels to all customers, however, the USPS funds the universal service obligation by earning profits on low-cost deliveries to subsidize high-cost deliveries. If competition were allowed, it is feared that entrants would undercut the USPS's prices to low-cost customers, leaving the USPS to serve only high-cost customers. This sort of "cream-skimming" would lead the USPS to charge still higher prices if it is to meet all the components of its universal service obligation.

1. Postal Monopoly

The Private Express Statutes (PES), and regulations the USPS has promulgated pursuant to these statutes, define the scope of the USPS's letter monopoly.[48] Part of the PES resides in the criminal code and provides penalties of fines or imprisonment[49] for carrying "letters or packets" outside of mail[50] or establishing a network that includes "regular trips or at stated

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Courier Conference of Am. v. Am. Postal Workers Union, 498 U.S. 517 (1991)); Sidak, Comment 17, at 23 (mailbox access restrictions enacted to prevent private delivery of bills that was depriving USPS of revenue); *see also* GENERAL ACCOUNTING OFFICE, INFORMATION ABOUT RESTRICTIONS ON MAILBOX ACCESS, GAO/GGD-97-85, at 13 (May 1997) [hereinafter "GAO MAILBOX REP."] (noting that Congress enacted mailbox restrictions to protect USPS revenue by preventing private companies, especially utility companies, from delivering circulars and account statements without postage). Some commentators, however, expressed doubt that the postal monopoly is necessary for the provision of universal service. *See* Federal Express, Comment 9, at 8 ("The persistence of the postal monopoly is due mostly to an illusion that it is necessary to sustain universal service. . . . There is no reason to suppose that the Postal Service would abandon rural areas or raise prices sharply without the postal monopoly.").

[48]The Private Express Statutes are set forth in 18 U.S.C. §§ 1693-99 and 39 U.S.C. §§ 601-06. *See also* 39 C.F.R. § 310.1(f). *See also Associated Third Class Mail v. U.S. Postal Service*, 600 F.2d 824, 825 n.2 (D.C. Cir. 1979) (*citing* 18 U.S.C. §§ 1694-99 and 39 U.S.C. §§ 601-06, and characterizing them as the Private Express Statutes).

[49]*See* 18 U.S.C. § 1693 ("Whoever, being concerned in carrying the mail, collects, receives or carries any letter or packet, contrary to law, shall be fined under this title or imprisoned not more than thirty days, or both."); *Flamingo Indus.*, 540 U.S. at 741 ("Under the [Postal Reorganization Act of 1970], the Postal Service retains its monopoly over the carriage of letters, and the power to authorize postal inspectors to search for, seize and [effect the forfeiture of] mail matter transported in violation of the monopoly.").

[50]*See* 18 U.S.C. § 1694. "Packets" are "two or more letters, identical or different, or two or more packets of letters, under one cover or otherwise bound together." 39 C.F.R. § 310.1(b).

periods over any post route."[51] The PES also make it a criminal offense to mail a letter through a private carrier that is operating in violation of the PES.[52] The Postal Service regulation that implements the prohibition embodied in the PES provides:

> It is generally unlawful under the Private Express Statutes for any person other than the Postal Service in any manner to send or carry a letter on a post route or in any manner to cause or assist such activity. Violation may result in injunction, fine or imprisonment or both and payment of postage lost as a result of the illegal activity.[53]

The USPS has issued regulations pursuant to the PES to define the term "letter," which, because the PES focus on the carriage of letters, defines the scope of the postal monopoly.[54] Specifically, the USPS has defined a letter to be "a message directed to a specific person or address and recorded in or on a tangible object."[55] The USPS, in turn, defines a message as "any information or intelligence that can be recorded on tangible objects, including, but not limited to, paper in sheet or card form, recording disks, and magnetic tape."[56] As a practical matter, the current definition of "letter" encompasses account statements, bills, post cards, and personal correspondence (which are classified as First Class mail), as well as advertising circulars and handbills that are addressed to a specific person (which are classified as "Standard Mail").[57]

The PAEA sets out specific exceptions to the postal monopoly. First, it expressly exempts from the monopoly letters that weigh 12.5 ounces or more.[58] Second, the PAEA codified and modified an existing regulatory exemption to the PES based on prices by allowing letters to be carried outside of the mail when the amount paid for private carriage is at least six-

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[51] 18 U.S.C. § 1696(a).

[52] 18 U.S.C. § 1696(b).

[53] 39 C.F.R. § 310.2(a).

[54] *See* Sidak, Comment 17, at 12.

[55] 39 C.F.R. § 310.1(a).

[56] UNITED STATES POSTAL SERVICE, DOMESTIC MAIL MANUAL § 508.5.1.2 [hereinafter "DMM"]; *see also* 39 CFR. § 310.1(a)(1), (2), (4). The USPS further defines "[m]ethods by which messages are recorded" to include "the use of written or printed characters, drawing, holes, or orientations or magnetic particles in a manner having a predetermined significance." *Id.* § 310.1(a)(4).

[57] *See* USPS, Comment 18, at 4; Sidak, Comment 17, at 12-13.

[58] 36 U.S.C. § 601(b)(2).

times the current charge for the first ounce of a single-piece first class letter ($2.46).[59] Third, the Act allows private carriage that is within the scope of specific exemptions to the letter monopoly, which are carved out in USPS regulations.[60] USPS regulations currently provide twelve exceptions to the definition of a letter,[61] five general exceptions to the PES,[62] and eight instances in which it has decided to "suspend" the PES.[63] Among other things, the regulations allow the use of a "special messenger."[64] By permitting "carriage prior or subsequent to mailing," they also provide the foundation for the workshare programs that allow mailers and shippers to substitute their sorting and transportation efforts for the USPS's by entering the mailstream nearer the point of delivery.[65] In this manner, worksharing effectively has opened up a great deal of the upstream postal network to competition.[66] Further, as will be discussed in more detail below, the suspension of the PES for "extremely urgent letters" has allowed the development of private express carriers.[67]

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[59] 36 U.S.C. § 601(b)(1). The current rate for the first ounce of a first class letter is $0.41. *See Postal Regulatory Commission, Postal Rates and Fees Effective May 14, 2007*, *available at* http://www.prc.gov. The PAEA supercedes a USPS regulation that allows private carriage if the amount paid is "at least three dollars or twice the applicable U.S. postage for First-Class Mail (including priority mail) whichever is greater." 39 C.F.R. § 320.6.

[60] 39 U.S.C. § 601(b)(3).

[61] 39 C.F.R. §§ 310.1(7)(i)-(xii). The exceptions include: telegrams; checks and certain other instruments shipped between financial institutions; newspapers; and periodicals. DMM § 508.5.1.2.

[62] 39 C.F.R. §§ 310.2(d)(1)-(5); 310.3.

[63] 39 C.F.R. §§ 320.2-320.9.

[64] 39 C.F.R. § 310.3(d).

[65] 39 C.F.R. § 310.3(e).

[66] *See* USPS, Comment 18, at 7-8; Robert Cohen *et al.*, *Universal Service Without Monopoly*, *in* CURRENT DIRECTIONS IN POSTAL REFORM (Michael A. Crew & Paul R. Kleindorfer eds., 2000); Elcano et. al, *Hiding in Plain Sight: The Quiet Liberalization of the United States Postal Service*, *in* CURRENT DIRECTIONS IN POSTAL REFORM (Michael A. Crew & Paul R. Kleindorfer eds., 2000).

[67] 39 C.F.R. § 320.6.

The PAEA also repealed the statutory authority for the USPS to issue regulations to define the scope of its monopoly.[68] The Act also specifically prohibits the USPS from establishing any rule or regulation "the effect of which is to preclude competition or establish the terms of competition unless the Postal Service demonstrates that the regulation does not create an unfair competitive advantage for itself or any entity funded (in whole or in part) by the Postal Service."[69] The extent to which the PAEA grants the PRC the authority to issue regulations that define the scope of the letter monopoly is unclear. 39 U.S.C. § 601(c) provides that the PRC may promulgate "any regulation necessary to carry out" the section of the PAEA codifying the exceptions to the PES (39 U.S.C. §§ 601(a)-(b)). It is unclear, however, whether this legislative grant of authority includes the ability to issue regulations that further refine the scope of the postal monopoly.[70]

2. Mailbox Monopoly

Congress enacted the restriction on mailbox access in 1934 in response to concerns about private companies, especially utilities, circumventing the postal service and placing circulars and account statements into mailboxes.[71] Specifically, the statute states:

> Whoever knowingly and willfully deposits any mailable matter such as statements of accounts, circulars, sale bills, or other like matter, on which no postage has been paid, in any letter box established, approved, or accepted by the Postal Service for the receipt or

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[68] *See* 39 U.S.C. § 601 (repealing previous 39 U.S.C. § 601(b), which stated that "the Postal Service may suspend the operation of any part of this section upon any mail route where the public interest requires suspension."). The USPS's previous ability to define the scope of its monopoly in effect gave it the power to limit the scope of its competitors' businesses. In this manner, the USPS was able to impose a regulatory risk on its competitors that it did not face. The PAEA appears to have removed this legal advantage.

[69] 39 U.S.C. § 404a(1).

[70] *See* Federal Express, Comment 9, at 10 ("The legal effect of the PAEA on the postal monopoly is so far largely unrecognized, but may be profound. . . . Since the PRC is no longer required to give deference to USPS regulations based on a repealed statutory provision, it appears that the PRC will be required to go back to the underlying postal monopoly statutes, statutes which date from 1872 and whose current meaning is far from clear."). If Congress authorized the PRC to alter the scope of the postal monopoly, for example by refining the definition of a "letter," the PRC effectively could avoid the explicit proscription on transferring any product covered by the postal monopoly to the competitive products list. *See* 39 U.S.C.§ 3462(b)(2).

[71] *See* GAO MAILBOX REP., *supra* note 47, at 13.

> delivery of mail matter on any mail route with intent to avoid payment of lawful postage thereon, shall for each such offense be fined under this title.[72]

The USPS's Domestic Mail Manual, which is incorporated by reference into the USPS regulations,[73] expands the scope of the statutory monopoly by providing "every letterbox or other receptacle intended or used for the receipt or delivery of mail . . . may be used only for matter bearing postage."[74] Currently, the U.S. is the only country with such restrictions on mailbox access.[75]

Because the mailbox monopoly requires all "matter" in a mailbox – not merely matter covered by the PES – to bear postage, it effectively expands the postal monopoly by increasing the cost and/or reducing the quality of non-USPS delivery of matter that legally may be carried outside of the mail. It is also important to note that the mailbox monopoly does not explicitly limit mailbox access to the USPS. Rather, it prohibits mailbox access for the purpose of delivering mail without postage. Thus, it appears that anybody could place any mailable matter in a mailbox and not violate 18 U.S.C. § 1725 or USPS regulations as long as the matter has the requisite postage.[76]

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[72]18 U.S.C. § 1725.

[73]39 C.F.R. § 111.1.

[74]DMM § 508.3.1.3. The USPS's regulations that define the mailbox monopoly may go beyond the scope of 18 U.S.C. § 1725, which prohibits only the depositing of "mailable matter" into a mailbox with "the intent to avoid payment of lawful postage." Because competitive products do not require postage, it is unclear that Congress intended Section 1725 to apply to competitive products (which, of course, did not exist at the time Congress enacted Section 1725). The Domestic Mail Manual also restricts items placed upon, supported by, attached to, hung from, or inserted into a mailbox. *Id.* The USPS does not classify door slots, nonlockable bins or troughs used with apartment house mailboxes, or support posts as subject to these restrictions. DMM § 508.3.1.2. Further, the Postal Service allows customers to attach newspaper receptacles to their mailbox posts, and for newspapers "regularly mailed as periodicals" to be placed in the mailboxes of "rural route and highway contract route" subscribers on Sundays or holidays. DMM § 508.3.2.10-11. The USPS also prevents any private delivery to Post Office boxes. DMM § 508.4.4.2; *see also* Federal Express, Comment 9, at 12-13.

[75]*See* Geddes, *supra* note 36, at 219; UPS, Comment 19, at 14; Federal Express, Comment 9, at 11; GAO MAILBOX REP., *supra* note 47, at 12 (noting that neither Australia, Canada, France, Germany, The Netherlands, New Zealand, Sweden, nor the United Kingdom have mailbox access restrictions).

[76]Of course, the matter may violate other statutes preventing, for example, traffic in obscene or hazardous materials.

Any mailbox that meets the specifications set out by the USPS becomes part of the postal delivery network. As such, the mailbox and the mail within it enjoy protection under federal laws against theft and destruction.[77] The Supreme Court has upheld the constitutionality of the mailbox monopoly to a First Amendment challenge, reasoning that postal consumers have implicitly agreed to abide by statutory and regulatory restrictions on mailbox access in exchange for the USPS agreeing to deliver and pick up their mail and for protection of their mail and mailboxes by the federal government.[78]

B. The Competitive Products Industry

The ability of private competitors to provide express service derives from USPS regulations suspending the PES for "extremely urgent letters."[79] A carrier can qualify for this suspension of the PES based on the timeliness of delivery. Specifically, the USPS allowed private carriage of letters when they were delivered within 12 hours or by noon of the addressee's next business day, but "only if the value or usefulness of the letter would be lost or greatly diminished if it is not delivered within the set time limits."[80] Prior to enactment of the PAEA, a carrier also could qualify for this exception if "the amount paid for private carriage of the letter is at least three dollars or twice the applicable U.S. postage First-Class Mail (including priority mail), whichever is greater."[81] As discussed above, the PAEA codified this suspension of the PES to be at least six times the current charge for the first ounce of a single-piece first class letter ($2.46), and it also allows private carriers to deliver letters that weigh 12.5 ounces or more.[82]

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[77]*See* USPS, Comment 18, at 5.

[78]*See United States Postal Service v. Council of Greenburgh Civic Ass'n*, 453 U.S. 114 (1981). Several commenters discussed this decision. *See* USPS, Comment 18, at 5; Sidak, Comment 17, at 24-26; Federal Express, Comment 9, at 11-12; *see also* GAO MAILBOX REP., *supra* note 47, at 14.

[79]39 C.F.R. § 320.6. *See* Sidak, Comment 17, at 18 ("Without [the extremely urgent letter] exception, UPS and other private firms would be unable to compete in the express mail business"); Federal Express, Comment 9, at 8-9 ("Express service might not exist today but for the fact that outcry over the USPS efforts to use the monopoly to suppress such services resulted in the 'urgent letter' exemption now contained in 39 C.F.R. § 320.").

[80]39 C.F.R. § (b)(1). *See also* Sidak, Comment 17, at 19 ("The Postal Service has said, and at least one court has agreed that, even if the time limits are met, the exception for extremely urgent letters does not apply if the value of the letter does not depend on the time limit.").

[81]39 C.F.R. § 320.6(c).

[82]*See supra* notes 58-59 and accompanying text.

The PAEA provided an initial list of competitive products.[83] On October 29, 2007, the PRC promulgated its final rule on competitive ratemaking and adopted an initial Mail Classification Schedule that categorized the following as competitive products:

- Priority Mail consists of Domestic Priority Mail and International Priority Mail (both inbound and outbound), referring to the delivery of documents and packages up to 70 pounds within 2 to 3 days on average.

- Express Mail consists of Domestic Express Mail and International Express Mail (both inbound and outbound), referring to mail that the Postal Service guarantees will be delivered either next-day or second-day.

- Bulk parcel post consists of Parcel Select, Parcel Return Service, and parcel post qualifying for BMC (bulk mail center), OBMC (origin bulk mail center), and barcode discounts, referring to medium- to high-volume parcel shipments eligible for certain discounts.

- Bulk international mail, which consists of International Priority Airmail, International Surface Air Lift, and M-bags, referring to services that provide discounts on large-volume international shipments of parcels or printed matter.

- Negotiated Service Agreements for competitive products (each one regarded as a separate product), including International Customized Mailing Agreement, which refer to specialized service agreements between the Postal Service and a specific mailer providing for customized pricing and modifications to current mailing standards.[84]

Competitive products collectively account for a relatively small proportion of USPS revenues. In 2006, the USPS had $72.8 billion in revenue, of which $69.2 billion came from providing mail services.[85] According to the USPS: "In FY 2006 the competitive products category of domestic postal services – principally bulk parcels, Express Mail, and Priority Mail – comprised 9 percent of the Postal Service's total revenue, while the competitive products category of international services – bulk international mail – comprised 0.3 percent of the Postal Service's total revenue."[86] In dollar terms, Priority Mail accounted for $5.04 billion, Express

[83] *See* 39 U.S.C. § 3631.

[84] *See* PRC, Order No. 43, *supra* note 7. The PRC also noted that mailgrams were discontinued in August 2006. *See* PRC, Order No. 26, *supra* note 20, at 50,766 n.73.

[85] UNITED STATES POSTAL SERVICE, COST & REVENUE ANALYSIS, FISCAL YEAR 2006 [hereinafter "USPS 2006 CRA"], *available at* http://www.usps.com/financials/_pdf/fy06cra.pdf.

[86] *See* USPS, Comment 18, at 2.

Mail accounted for $0.92 billion, parcel post accounted for $1.2 billion, and international mail accounted for $1.82 billion.[87]

C. Structure of the Competitive Products Industry

Calculating the U.S. shares of competitive products revenue is difficult because the revenue data that the various firms publish differs in the definition of the product, the definition of the geographic area, and the beginning and ending dates for the year covered.[88] That said, the estimated share data in Table 1 should reflect the relative sizes of the leading firms that supply competitive products. We estimate the Postal Service's share of domestic competitive products as 15.9 percent, while the Postal Service reports an estimate of 11 percent.[89]

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[87]USPS 2006 CRA. Parcel post and international mail revenue data contain both competitive and market-dominant products, but data obtained by the FTC does not provide separate revenue amounts for market-dominant and competitive products within these broad categories.

[88]Nothing in this report defines a relevant product or geographic market for antitrust purposes.

[89]USPS, Comment 18, at 2.

Table 1
2006 Revenues for Competitive Products

	Revenue (billions)	Share
UPS[90]	$30.5	54.0%
Federal Express[91]	$11.4	20.2%
Postal Service[92]	**$9.0**	**15.9%**
DHL[93]	$5.6	9.9%

Within these segments, UPS is the leading firm in the delivery of packages, and Federal Express is the leading firm in the delivery of overnight mail. Both of these firms, however, are strong participants in the other markets. The Postal Service's share in the delivery of both parcels and express mail dropped substantially once competition in this segment was opened,

[90] 2006 revenue for U.S. domestic package delivery. *See* UNITED PARCEL SERVICE, 10K FOR FISCAL YEAR ENDING DECEMBER 31, 2006, at 19 (Mar. 1, 2007), *available at* http://files.shareholder.com/downloads/UPS/201853012x0xS1193125%2D07%2D44043/1090727/filing.pdf.

[91]Revenue for U.S. express and ground delivery for the year ending May 31, 2007. *See* FEDERAL EXPRESS 10K FOR FISCAL YEAR ENDING MAY 31, 2007, at 41 (Jul. 13, 2007), *available at* http://ir.fedex.com/sec.cfm?DocType=Annual&Year=2007.

[92] The Postal Service figure comes from totaling revenues generated from Priority Mail, Express Mail, Mailgrams, Parcel Post, and International Mail for the year ending September 30, 2006, as reported in its Cost and Revenue Analysis for Fiscal Year 2006. As noted *supra*, at note 87, because parcel post and international mail revenue data contain both competitive and market-dominant products, this figure likely represents a slight overstatement of USPS revenue for competitive mail products.

[93]DPWN's 2006 revenue for express delivery in the Americas was 4.4 billion euros. Deutsche Post World Net, 2006 Annual Report 47 (2006) [hereinafter "DPWN 2006 ANN. REP."], *available at* http://financialreports.dpwn.com/2006/ar/servicepages/downloads/files/entire_dp_ar06.pdf. Since this is revenue for all of the Americas, DHL's U.S. market share will be overstated somewhat.

and has continued a steady decline.[94] DHL, the smallest provider of competitive products, is owned by Deutsche Post World Net (DPWN), which in 2006 had total revenue of 60.5 billion euros. In its 2006 Annual Report, DPWN states that it has recently strengthened its position in the U.S. market.[95]

Relative prices for competitive products are difficult to assess, as most commercial customers have private contracts with one or more of the various carriers, potentially offering substantial discounts off the single-piece prices given on the firms' web sites. Appendix Tables A1-A13 display this price information for shipments of various sizes and urgency for three domestic routes. These prices are representative as to the directional magnitude in the differences in prices charged by USPS, UPS, Federal Express and DHL. Numerous city pairs were reviewed. Prices for other pairs may differ, but the differences shown in the examples are consistent for the carriers for all locations reviewed.

Relative to its private competitors, the Postal Service has substantially less latitude to vary its prices among its customers. Judging from publicly available data, however, it would seem that the Postal Service offers prices that are much lower that those offered by its competitors. The federal government's contracts with UPS and Federal Express are public information, and likely more indicative of the prices charged to their typical customers. These data suggest that for large accounts, UPS and Federal Express offer rates comparable to those posted by the USPS.[96]

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[94] *See* PRESIDENT'S COMMISSION ON PRIVATIZATION, PRIVATIZATION: TOWARD MORE EFFECTIVE GOVERNMENT, REPORT OF THE PRESIDENT'S COMMISSION ON PRIVATIZATION 101, 112 (David Linowes ed., 1988); GENERAL ACCOUNTING OFFICE, POSTAL SERVICE REFORM: ISSUES RELEVANT TO CHANGING RESTRICTIONS ON PRIVATE LETTER DELIVERY, GAO/GGD-96-129A/B, at 43 (Sept. 1996), *available at* http://www.gao.gov/archive/1996/gg96129b.pdf; National Association of Letter Carriers, Comment 15, at 7.

[95] DPWN 2006 ANN. REP. 26.

[96] Consistent with this observation, we understand from the USPS that private carriers routinely offer its commercial customers prices that are discounts off their published prices.

CHAPTER II

LEGAL DIFFERENCES ARISING FROM THE USPS'S STATUS AS A FEDERAL ENTITY

This chapter discusses those constitutional and statutory provisions that, on balance, either impose greater burdens on private companies that produce competitive products than on the Postal Service itself, or alternatively impose greater burdens on the Postal Service than on its private competitors. The PAEA modified a number of these provisions, and this chapter therefore first identifies the requirements in place prior to enactment of the PAEA, and then discusses any changes effected by that statute.

A. Implicit USPS Subsidies

1. Advantages Arising From the United States Constitution

The Supremacy Clause of the United States Constitution provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the contrary notwithstanding.

The Supremacy Clause thus creates, *inter alia*, "in the absence of Congressional consent, . . . an implied constitutional immunity of the national government from state taxation and from state regulation of the performance, by federal officers and agencies, of governmental functions."[97] Thus, as the Supreme Court has held more recently, "It is well settled that the activities of federal installations are shielded by the Supremacy Clause from direct state regulation unless Congress provides 'clear and unambiguous' authorization for such regulation."[98]

These principles apply with particular force to the Postal Service because Article I of the Constitution empowers Congress "[t]o establish Post Offices and post Roads,"[99] and the

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[97] *Penn Dairies Inc. v. Milk Control Comm'n*, 318 U.S. 261, 269 (1943).

[98] *Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 180 (1988) (citing *California ex rel. EPA v. State Water Res. Control Bd.*, 426 U.S. 200, 211 (1976); *Hancock v. Train*, 426 U.S. 167, 178-79 (1976); *Mayo v. United States*, 319 U.S. 441, 445 (1943). By contrast, a state or local regulation whose "legal incidence" falls on an entity other than the federal government or its instrumentalities is not necessarily barred by the Supremacy Clause. *United States Postal Serv. v. Town of Greenwich*, 901 F. Supp. 500, 507 (D. Conn. 1995) (quoting *United States v. Windsor*, 496 F. Supp. 581, 591 (D. Conn. 1980)).

[99] U.S. CONST. art. I, § 8, cl. 7.

Supreme Court has held that this power "embraces the regulation of the entire postal system of the country."[100] Moreover, since 1970, the Postal Service has by statute been classified as "an independent establishment of the Government of the United States"[101] that is to "be operated as a basic and fundamental service provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people."[102] As a consequence, the Postal Service is exempt from a number of different types of state and local statutes and regulations that apply to private firms, which we discuss below. It is important to emphasize, however, that Congress can by statute authorize state and local regulation, including taxation, of federal instrumentalities – provided that its consent is "clear, express and affirmative"[103] – and Congress expressly took that step with respect to certain types of state and local regulations when it enacted the PAEA.

a. *State and Local Taxes and Fees*

The Supreme Court has determined that the Supremacy Clause prevents the states from imposing taxes directly upon the United States.[104] Thus, for example, state and local governments cannot assess *ad valorem* property taxes against property belonging to the United States.[105] Similarly, state and local governments cannot tax the income of federal agencies[106] and

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[100]*Ex parte Jackson*, 96 U.S. 727, 732 (1878).

[101]39 U.S.C. § 201; *see generally, Flamingo Indus.*, 540 U.S. at 739-40.

[102]39 U.S.C. § 101(a).

[103]*United States v. City of Adair*, 539 F.2d 1185, 1189 (8th Cir. 1976)*; accord, e.g.*, *Mayo v. United States*, 319 U.S. 441, 446 (1943); *United States v. Nashville,* 808 F.2d 1205, 1208 (6th Cir. 1987).

[104]*South Carolina v. Baker,* 485 U.S. 505, 523 (1988); *United States v. New Mexico,* 455 U.S. 720, 733 (1982); *United States v. Tax Comm'n of Miss.*, 421 U.S. 599, 604-05, 612 (1975); *United States v. County of Allegheny,* 322 U.S. 174, 177 (1944); *Mayo,* 319 U.S. at 447; *McCulloch v. Maryland,* 17 U.S. 316, 436 (1819); *United States v. City of Leavenworth*, 443 F. Supp. 274, 278 (D. Kan. 1977) ("the possessions, institutions and activities of the federal government, in the absence of congressional consent, are not subject to any form of state taxation.").

[105]*West v. Oklahoma Tax Comm'n*, 334 U.S. 717, 723 (1948); *accord, e.g.*, *Mayo,* 319 U.S. at 447 n.11 ("A state cannot tax land of the United States situated within the state even though the state has not ceded sovereignty to the United States") (citing *Van Brocklin v. Tennessee*, 117 U.S. 151, 177 (1886)); *United States v. Hawkins County* 859 F.2d 20, 23 (6th Cir. 1988) (Tennessee cannot impose ad valorem tax on real property owned by the United States)*; Nashville*, 808 F.2d at 1208; *United States v. Colorado*, 627 F.2d 217, 219 (10th Cir. 1980).

[106]*See generally United States v. County of Fresno* , 429 U.S. 452, 464 (1977).

cannot impose sales taxes on purchases made by, or leases effected by, federal agencies.[107] The treatment of state and local franchise, license, and other fees under the Supremacy Clause is somewhat more complex. In general, state and local governments cannot impose such fees on federal agencies. For example, in *Mayo v. United States*, the Supreme Court determined that the Supremacy Clause prevented the state of Florida from assessing a fee against the United States for the inspection of fertilizer purchased for the United States under direction of the Secretary of Agriculture.[108] By contrast, however, state and local governments may permissibly collect reasonable user and other fees from federal agencies that represent compensation for state and local government services, such as charges for water, sewage, electrical and other services from state and local utilities.[109]

As the foregoing discussion suggests, state and local taxes – such as income taxes, real property taxes, sales and use taxes, personal property taxes, and franchise taxes and fees – cannot be assessed against the Postal Service, as a consequence of its status as part of the United States Government.[110] By contrast, private firms such as Federal Express and UPS must pay a variety of state and local taxes, including "real property taxes, sales and use taxes, personal property taxes and income and franchise taxes."[111] Like private companies, however, the Postal Service must pay "specific service fees, such as sewage and water fees, which are measured by use."[112] Moreover, the Postal Service leases approximately 25,000 of its facilities – accounting for approximately one-third of its total interior square footage – and a portion of the rent it pays for these facilities covers the property taxes which the facilities owners must in turn pay to state and local governments.[113] Furthermore, the Postal Service states that while private corporations, "including major Postal Service competitors, have a history of negotiating tax reductions or incentives in exchange for locating their operations in particular jurisdictions," the Postal Service

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[107] *United States v. Lohman*, 74 F.3d 863, 867 (8th Cir. 1996), *cert. denied*, 518 U.S. 1018 (1996); *United States v. Kabeiseman*, 970 F.2d 739, 743 (10th Cir. 1992); *United States v. California Bd. of Equalization*, 650 F.2d 1127, 1132 (9th Cir. 1981), *aff'd*, 456 U.S. 901, *reh. denied*, 456 U.S. 985 (1981).

[108] *Mayo*, 319 U.S. at 447.

[109] *United States v. City of Huntington*, 999 F.2d 71, 73, 74 (4th Cir. 1993) ("user fees are payments given in return for a government-provided benefit"), *cert. denied*, 510 U.S. 1109 (1994); *accord, e.g.*, *Colorado*, 627 F.2d at 220-21.

[110] *See Mayo,* 319 U.S. at 447.

[111] Federal Express, Comment 9, at 7.

[112] Federal Express, Comment 9, at 7; *see generally United States v. City of Huntington*, 999 F.2d 71, 73, 74 (4th Cir. 1993), *cert. denied*, 510 U.S. 1109 (1994); *Colorado*, 627 F.2d at 220-21.

[113] USPS, Comment 18, at 30.

must serve all locations and by statute cannot lobby or negotiate for locational inducements or similar incentives provided by local governments or private parties.[114]

The PAEA did not effect any changes in the immunity of the Postal Service from state and local taxes, and it therefore remains as an advantage that the Postal Service possesses over private firms such as Federal Express, UPS and DHL.

b. *State and Local Zoning , Land Use Regulations, and Building Codes*

The Supreme Court also has determined that the Supremacy Clause precludes direct state regulation of a federally owned facility performing a federal function – even if the federal function is carried out by a private contractor – unless Congress clearly authorizes such regulation.[115] Thus, for example, the U.S. District Court for the District of New Jersey determined that the Postal Service was not required to comply with the land use regulations of the township of Middletown, New Jersey, and that a criminal action against the Postal Service based on alleged zoning violations therefore was properly dismissed.[116] Similarly, the District Court for the District of Connecticut determined that the Supremacy Clause precluded the town of Greenwich from imposing the state building code or building permit fee schedule on the Postal Service in connection with the construction of a new post office on property leased by the Postal Service because there was no evidence that Congress had granted clear and unambiguous authorization for the post office to be subjected to building code regulations or permit fees.[117]

The PAEA, however, changed the USPS's responsibilities with respect to compliance with state and local zoning and land use regulations. First, the Postal Service must now comply with national building codes, which state and local building codes typically incorporate by reference. In particular, "each building constructed or altered by the Postal Service" must now be constructed or altered "to the maximum extent feasible as determined by the Postal Service, in compliance with 1 of the nationally recognized model building codes and with other applicable nationally recognized codes."[118]

Second, the Postal Service must now attempt to conform with state and local zoning laws, land use laws, and environmental laws. In particular, PAEA regulations provide that:

[114] *Id.*

[115] *Goodyear*, 486 U.S. at 182.

[116] *Middletown Twp. v. United States Postal Serv.*, 601 F. Supp. 125, 128 (D.N.J. 1985).

[117] *Town of Greenwich,* 901 F. Supp. at 505.

[118] 39 U.S.C. § 409(f)(1).

> Each building constructed or altered by the Postal Service shall be constructed or altered only after consideration of all requirements (other than procedural requirements) of zoning laws, land use laws, and applicable environmental laws of a State or subdivision of a State which would apply to the building if it were not a building constructed or altered by an establishment of the Government of the United States.[119]

The USPS describes the PAEA as largely codifying pre-existing standard postal practices related to the construction or alteration of postal facilities, both with compliance with local law and its interaction with local officials.[120] It explains that prior to the PAEA, the USPS would require its contractors to obtain all routine permits and comply with the local laws to the extent feasible. The USPS reports that in only very rare circumstances did the USPS rely on its federal status to continue the operational practice in question.[121] Federal Express suggests in its comments that, because the PAEA provisions appear to give the Postal Service some discretion with respect to how to comply with these state and local statutes and regulations, it will continue to suffer from some degree of disadvantage vis-á-vis the Postal Service.[122] The degree of discretion enjoyed by the USPS, however, remains unclear. Even if USPS wished to refrain from compliance in any particular circumstance – and there is no indication that it would ever wish to do so – once Congress has consented to making particular state laws and regulations applicable to a given federal agency, the Supremacy Clause may no longer provide any immunity to that agency from the state and local laws and regulations at issue.

c. *Other State and Local Statutes and Regulations*

Although the Supremacy Clause completely immunizes the United States and its instrumentalities from state and local taxation, the extent to which it provides immunity from state and local regulation of the performance of governmental functions is not as absolute; rather the latter determination rests in part on the feasibility of performing the federal function at issue while at the same time complying with the state and local regulations. The Supreme Court has held that, in general, federal law preempts local law whenever the "challenged state statute

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[119]39 U.S.C. § 409(f)(2). This subsection also prescribes a number of steps the Postal Service must take to meet the requirements of subsections 409(f)(1) and (f)(2), including in particular consulting with appropriate State or local officials; upon request submitting building plans to and permitting inspections by such officials; and giving due consideration to the recommendations of such officials in the course of construction, 39 U.S.C. § 409(f)(3),(4), and establishing procedures "for soliciting, assessing, and incorporating local community input on real property and land use decisions." 39 U.S.C. § 409(f)(5).

[120]USPS correspondence (Nov. 29, 2007).

[121]*Id.*

[122] *See* Federal Express, Comment 9, at 2 (the "wiggle room" that the Postal Service retains is "still formidable, and probably unquantifiable").

'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'"[123] Therefore, if a conflict exists between a state or local government statute or regulation and a Postal Service regulation, the Postal Service regulation likely preempts the state or local statute or regulation.

Thus, for example, in 1981 the U.S. Court of Appeals for the Ninth Circuit considered a Pittsburg, California, municipal trespass ordinance that expressly prohibited postal letter carriers from crossing private lawns without first securing "the prior express consent of the owner, lessee, or other person in charge thereof."[124] The court determined that this requirement "obstruct[ed] the execution of Congressional objectives in the area of mail delivery" – and was therefore invalid under the Supremacy Clause – because although the postal regulation at issue authorized postal letter carriers to cross lawns "if patrons do not object," the local ordinance prohibited the carriers from crossing any lawn without first obtaining the express consent of the owner.[125] The court distinguished an earlier decision by the U.S. Court of Appeals for the Eighth Circuit because the St. Louis, Missouri, ordinance at issue in that case permitted postal letter carriers to cross lawns if the "express *or implied* consent of the owner or his agent" was present.[126] As a consequence, the court in that case determined that the St. Louis ordinance did not conflict with the postal regulation and therefore was not invalid under the Supremacy Clause.[127]

Federal Express and UPS both contend that they are disadvantaged, vis-á-vis the Postal Service, because they must comply with state and local statutes and regulations governing the operation of motor vehicles, such as by paying titling and registration fees, although the Postal Service need not do so. They also contend that they are disadvantaged because they must pay parking tickets but the Postal Service is not required to do so. It is not clear, however, that the Supremacy Clause requires this result. Thus, as the U.S. Court of Appeals for the Tenth Circuit recently stated:

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[123] *Perez v. Campbell*, 402 U.S. 637, 649 (1971) (citing *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)); *accord, e.g.*, *United States v. Pittsburg*, 661 F.2d 783, 785 (9th Cir. 1981); *Rust v. Johnson*, 597 F.2d 174, 179 (9th Cir. 1979), *cert. denied*, 444 U.S. 964 (1979).

[124] *Pittsburg*, 661 F.2d at 784.

[125] *Id.* at 785-86.

[126] *Id.* at 786 n.5 (emphasis added) (citing *United States v. Nat'l Assoc. of Letter Carriers, AFL-CIO*, 597 F.2d 121, 122, 124 (8th Cir. 1979)).

[127] *Nat'l Assoc. of Letter Carriers,* 597 F.2d at 124. The court expressly found that both the city ordinance and the Postal Service regulation permitted letter carriers to "cross lawns in the absence of customer objection (withdrawal of implied consent)." *Id*.

> [A] federal officer is not entitled to Supremacy Clause immunity unless, in the course of performing an act which he is authorized to do under federal law, the agent had an objectively reasonable and well-founded basis to believe that his actions were necessary to fulfill his duties.[128]

As the foregoing discussion suggests, the Supremacy Clause prevents enforcement of state and local regulations – other than taxation requirements – only if such enforcement actually interferes with the execution of a Postal Service function. Thus, it is not clear that the Constitution precludes local jurisdictions from ticketing Postal Service vehicles. Moreover, we understand that the Postal Service has agreed to pay parking fines in some jurisdictions, and that the Postal Service does not pay parking fines in other jurisdictions because those jurisdictions simply refrain from ticketing Postal Service vehicles.[129] Nevertheless, it is possible that jurisdictions do not ticket USPS vehicles because they believe the Constitution bars them from doing so. Whether this belief is accurate or not, the USPS does enjoy a *de facto* economic advantage in this area relative to its private competitors.

2. <u>Access To Federal Funding</u>

As amended by the PAEA, Title 39 now provides that the capital of the Postal Service shall be held in two separate funds – the Postal Service Fund and the Competitive Products Fund[130] – and that "[t]he capital of the Postal Service at any time shall consist of its assets, including the balance in the [Postal Service] Fund and the balance in the Competitive Products Fund, less its liabilities."[131] The Competitive Products Fund may be used by the Postal Service, without fiscal year limitation, "for the payment of – (A) costs attributable to competitive products; and (B) all other costs incurred by the Postal Service, to the extent allocable to competitive products."[132] The Competitive Products Fund may contain, subject to withdrawal by the Postal Service, only

> (1) revenues from competitive products; (2) amounts received from obligations issued by [the] Postal Service [for competitive products operations]; (3) interest and dividends earned on investments of the Competitive Products Fund; and (4) any other receipts of

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[128] *See Wyoming v. Livingston*, 443 F.3d 1211, 1222 (10th Cir. 2006).

[129] *See* Federal Express, Comment 9, at 7.

[130] 39 U.S.C. § 2001(1)-(2).

[131] 39 U.S.C. § 2002(b).

[132] 39 U.S.C. § 2011(a)(2)(A)-(B).

the Postal Service (including from the sale of assets), to the extent allocable to competitive products.[133]

By contrast, the Postal Service Fund may also contain, *inter alia*, "amounts appropriated for the use of the Postal Service;" amounts secured through Postal Service civil forfeiture proceedings; and transfers from the Department of the Treasury Forfeiture Fund (but only for federal law enforcement related purposes).[134]

The Postal Service is authorized "to borrow money and to issue and sell such obligations as it determines necessary," in an amount of up to $3 billion – for capital improvements and to defray operating expenses arising from all its products – in any given year.[135] Although the obligations of the Postal Service Fund are "exempt both as to principal and interest" from all state and local taxes (except estate, inheritance, and gift taxes), the obligations of the Competitive Products Fund, as to either principal or interest, expressly are not exempt from any state or local taxes.[136] The aggregate amount of such obligations outstanding at any one time – for both market-dominant product operations and competitive product operations – cannot exceed $15 billion.[137] The Postal Service may require the Secretary of the Treasury to lend it up to a total balance of $2 billion at any given time, but according to the USPS, this requirement is "inapplicable to borrowing for the Competitive Products Fund."[138] Although separate procedures govern the issuance and sale of obligations for the Postal Service Fund and the Competitive Products Fund,[139] obligations for both funds expressly are not obligations of the United States – and payment of the principal of or interest on these obligations is not guaranteed by the United States – unless the Secretary of the Treasury, at the request of the Postal Service, determines that "it would be in the public interest to do so."[140]

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[133] 39 U.S.C. § 2011(b)(1)-(4).

[134] 39 U.S.C. § 2003(b)(3), (7), (8).

[135] 39 U.S.C. § 2005(a)(1). "Obligations," when referring to debt instruments issued by the Postal Service, are defined to include "notes, bonds, debentures, mortgages, and any other evidence of indebtedness. 39 U.S.C. § 2001(3).

[136] *Compare* 39 U.S.C. § 2005(d)(4) *with* 39 U.S.C. § 2011(e)(4)(d).

[137] 39 U.S.C. § 2005(a)(2)(C); *accord, e.g.*, UPS, Comment 18, at 8.

[138] *See* USPS, Comment 18, at 11 (citing 39 U.S.C. §§ 2005(b)(2), 2006(b)).

[139] *Compare* 39 U.S.C. § 2005 *with* 39 U.S.C. § 2011(e).

[140] 39 U.S.C. §§ 2005(d)(5), 2006(c), 2011(e)(4)(E).

UPS argues that this proviso gives the Postal Service a continued advantage with respect to securing financing for its operations,[141] although it is not clear to what extent the Secretary of the Treasury will be willing to guarantee the debt of the competitive operations of the Postal Service. Prospective purchasers of Postal Service obligations may nevertheless be willing to receive a lower interest rate from such obligations than from private obligations because they assume – whether or not correctly – that the federal government will stand behind Postal Service debt instruments, just as many private investors now apparently believe that the federal government will take steps to prevent default on obligations issued by the Federal National Mortgage Association or Freddie Mac.[142]

According to the USPS, although it enjoys nominal legal access to private debt markets, in practice, "Treasury always precludes Postal Service borrowing outside of the Federal Financing Bank."[143] Whenever the Postal Service determines to issue and sell obligations for either fund, it must notify the Secretary of the Treasury 15 days in advance; the Secretary may then elect to purchase such obligations upon such terms as may be agreed, but at an interest rate "no less than the prevailing yield on outstanding marketable Treasury securities of comparable maturity, as determined by the Secretary."[144] Thus, in recent practice, the USPS's cost of debt has been 12.5 basis points over Treasury's cost of borrowing.[145] The USPS notes: "The policy basis for Treasury's decision is not to subsidize the Postal Service, but to consolidate all of the Government's borrowing and to avoid intramural competition in the financing markets to protect the overall public interest."[146]

3. Customs Treatment

Federal Express argues in its comment that, for many years prior to enactment of the PAEA, United States Customs and other border officials treated private company shipments less favorably than they treated Postal Service shipments.[147] The PAEA, however, amended Title 39 so that it now provides, in relevant part:

> With respect to shipments of international [competitive products] that are exported or imported by the Postal Service, the Customs Service and other appropriate Federal

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[141]UPS, Comment 19, at 8.

[142]*See infra* note 274 and accompanying text.

[143]USPS, Comment 18, at 27.

[144]39 U.S.C. § 2006(a).

[145]USPS, Comment 18, at 27.

[146]*Id.* at 28-29.

[147]Federal Express, Comment 9, at 2.

> agencies shall apply the customs laws of the United States and all other laws relating to the importation or exportation of such shipments in the same manner to both shipments by the Postal Service and similar shipments by private companies.[148]

Moreover, the Secretary of State – who is otherwise "responsible for formulation, coordination, and oversight of foreign policy related to international postal services and other international delivery services . . . " – is prohibited from concluding "any treaty, convention, or other international agreement" that would, "with respect to any competitive product, grant an undue or unreasonable preference to the Postal Service, a private provider of international postal or delivery services, or any other person."[149] With the enactment of these provisions, Federal Express recommends that the Postal Service and private companies "work together to establish a non-discriminatory international legal framework, not only at the U.S. borders, but also at borders around the world" and advises that, to that end, Federal Express will advocate changes in Universal Postal Union, foreign, and U.S. policies and regulations.[150]

4. The Federal Tort Claims Act

The Postal Service is also immune from liability for certain types of conduct under the Federal Tort Claims Act.[151] The sovereign immunity that the Postal Service would otherwise possess, as a part of the United States Government, has been waived by virtue of Title 39, which provides in relevant part that the Postal Service possesses the general power "to sue and be sued in its official name, . . ."[152] Title 39 also provides that the Federal Tort Claims Act "shall apply to tort claims arising out of activities of the Postal Service."[153] However, that statute reinstates

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[148]39 U.S.C. § 407(e)(2). The term "private company," for purposes of this subsection, is defined as "a private company substantially owned or controlled by persons who are citizens of the United States." 39 U.S.C. § 407(e)(1). Thus, although it presumably would apply to both Federal Express and UPS, it is unclear whether it would apply to companies such as DHL, which is now owned by Deutsche Post World Net.

[149]39 U.S.C. § 407(b)(1).

[150]*See* Federal Express, Comment 9, at 2.

[151]*See generally* 28 U.S.C. §§ 1346(b)(1), 2674.

[152]*See, e.g.*, *Dolan v. United States Postal Serv.*, 546 U.S. 481, 484 (2006).

[153]*Dolan*, 546 U.S. at 484 (quoting 39 U.S.C. § 409(c)). Federal Express notes – with respect to lawsuits filed against federal agencies such as the Postal Service pursuant to the Federal Tort Claims Act – that there is no right to a jury trial, that punitive damages may not be assessed, and that attorneys' fees are limited, but that it is probably impossible to quantify the amount that the Postal Service need not pay as a consequence of these provisions. Federal Express, Comment 9, at 7 n.16 (citing 28 U.S.C. §§ 2402, 2674, 2678).

the sovereign immunity of the United States Government with respect to certain categories of claims, including in particular "any claim arising out of the loss, miscarriage, or negligent transmission of letters or postal matter."[154] As a consequence, although the United States may be liable if postal employees commit torts under local law, it is not liable for claims involving failure to deliver mail as promised.[155] The Supreme Court has most recently interpreted the category as retaining Postal Service immunity

> only for injuries arising, directly or consequentially, because mail either fails to arrive at all or arrives late, in damaged condition, or at the wrong address. Illustrative [examples would be] personal or financial harms arising from nondelivery or late delivery of sensitive materials or information (*e.g.*, medicines or a mortgage foreclosure notice) or from negligent handling of a mailed parcel (*e.g.*, shattering of shipped china).[156]

By contrast, Postal Service sovereign immunity does not extend, for example, to tort liability for the negligent operation of a postal motor vehicle, or where mail left by postal employees causes someone to trip and fall.[157]

According to Federal Express, however, the most common claims a transportation company faces are that a shipment "was delayed, misdelivered or destroyed."[158] But, because private companies do not possess the USPS's immunity, they must limit their domestic liability by contract and their international liability is governed by the proscriptions of the Warsaw Convention.[159] According to Federal Express, this constitutes a significant difference between the Postal Service and its private competitors.[160]

5. Federal Income Taxes

Although the Postal Service has not in the past been required to pay federal income taxes, the PAEA established a new mechanism for imposing an internal tax on the income the Postal Service derives from its competitive products. In particular, Title 39 now provides that

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[154] *Dolan*, 546 U.S. at 485 (quoting 28 U.S.C. § 2680(b)).

[155] Federal Express, Comment 9, at 3.

[156] *Id.* at 7.

[157] *Dolan*, 546 U.S. at 483-87 (citing *Kosak v. United States*, 465 U.S. 848, 855 (1984)).

[158] Federal Express, Comment 9, at 8.

[159] Federal Express, Comment 9, at 7-8. With respect to the international liability of private firms under the Original Warsaw Convention, as amended by The Hague Protocol, *see, e.g.*, *Cont'l Ins. Co. v. Fed. Express Corp*, 454 F.3d 951 (9th Cir. 2006).

[160] *See* Federal Express, Comment 9, at 8.

beginning with fiscal year 2008 the Postal Service must "(1) compute its assumed Federal income tax on competitive products income for such year; and (2) transfer from the Competitive Products Fund to the Postal Service Fund the amount of that assumed tax."[161]

Section 3634 of Title 39 also prescribes the manner in which the "assumed Federal income tax" is to be calculated for each fiscal year and provides that the required transfer of that amount to the Postal Service Fund must be effected by January 15th of the following fiscal year.[162] The Postal Service expects that the monies thus transferred "will help to defray the cost of universal service requirements."[163] One would also expect this provision to eliminate any advantage the Postal Service previously possessed, vis-á-vis its private competitors, as a consequence of not having to pay federal income taxes on revenue derived from sales of its competitive products.

6. Eminent Domain

The Postal Service also possesses the general power of eminent domain; that is, the power "to exercise, in the name of the United States, the right of eminent domain for the furtherance of its official purposes."[164] The Fifth Amendment to the Constitution provides that private property shall not "be taken for public use, without just compensation," and the Supreme Court has held that if a particular taking serves a "public purpose," it satisfies the "public use" requirement.[165] Title 40 of the United States Code prescribes the procedures by which, consistent with this Constitutional restriction, the United States government, including the Postal Service, may exercise the right of eminent domain.[166] In particular, if the Postal Service were to initiate a condemnation proceeding "to acquire land, or an easement or right of way in land, for the public use," it would have to file a "declaration of taking" in an appropriate federal district court, which must include, *inter alia*, a statement "of the authority under which, and the public

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[161]39 U.S.C. § 3634(b)(1), (2); *see also* 39 U.S.C. § 3652(a) (first Postal Service report to the Postal Regulatory Commission due on December 29, 2007, which falls within fiscal year 2008); 39 U.S.C. § 102(10) ("year" means "a fiscal year").

[162]39 U.S.C. § 3634(a), (c).

[163]USPS, Comment 18, at 10.

[164]39 U.S.C. § 401(9); *accord, e.g.*, *Dolan*, 546 U.S. 481; *Flamingo Indus.,* 540 U.S. at 741.

[165]*Kelo v. City of New London*, 545 U.S. 469, 472 n.1 (2005) (quoting U.S. CONST., amend. V); *see also id.* at 480 (citing *Strickley v. Highland Boy Gold Mining Co.*, 200 U.S. 527, 531 (1906); *Fallbrook Irrigation Dist. v. Bradley*, 164 U.S. 112, 158-64 (1896)).

[166]39 U.S.C. § 410(b)(4)(A).

use for which, the land is being taken . . . ."[167] The declaration must also include a statement estimating the amount of money constituting "just compensation for the land taken," and the Postal Service would have to deposit that amount with the district court.[168] Thereafter, any "claimant with a compensable interest in the condemned property may present evidence at the compensation hearing as to the value of its interest and share in the proceeds."[169] Ultimately, the district court would determine the amount of compensation to be awarded, including interest, and would issue a judgment to that effect.[170] If the compensation finally awarded were to exceed the amount received by the person or persons entitled to compensation, the district court would also enter a judgment against the Postal Service for the amount of the deficiency.[171] UPS states in its comment that it is not clear whether the Postal Service has ever previously exercised its eminent domain authority, but it also characterizes that authority as "a powerful negotiating tool."[172]

7. Other Advantages

A number of other statutory provisions in certain circumstances may confer benefits upon USPS that are not available to its private competitors. Thus, for example, USPS possesses "the priority of the United States with respect to the payment of debts out of bankrupt, insolvent, and decedents' estates . . . ,"[173] and UPS argues that this provision places USPS ahead of commercial entities such as UPS and Federal Express with respect to these types of proceedings.[174] Moreover, because USPS is a part of the federal government, it is not required to pay a return on the capital the federal government provided for use in its competitive operations.[175] In addition, although private companies must cover unemployment compensation

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[167] FED. R. CIV. P. 71.1 governs the procedure for the condemnation of real and personal property under the power of eminent domain. *See generally The Calf Island Cmty.. Trust, Inc. v. YMCA*, 392 F. Supp. 2d 241, 245 n.2, 249 (D. Conn. 2005) [hereinafter "*Calf Island*"].

[168] 40 U.S.C. § 3114(a)(1),(5), (b).

[169] *Calf Island*, 392 F. Supp. 2d at 251 (citing *United States v. 58.16 Acres of Land*, 478 F.2d 1055, 1059 (7th Cir. 1973)).

[170] 40 U.S.C. § 3114(c)(1).

[171] 40 U.S.C. § 3114(c)(3).

[172] *See* UPS, Comment 19, at 12.

[173] 39 U.S.C. § 401(9).

[174] *See* UPS, Comment 19, at 12.

[175] *See id.* at 8. Title 39 provides that "[t]he initial capital of the Postal Service shall consist of the equity, as reflected in the budget of the President, of the Government of the United

through a tax imposed in advance of any claims filed, USPS instead pays only for those claims that are actually filed, and UPS argues that as a consequence, private companies pay more for unemployment compensation.[176]

The Postal Service also possesses the authority to carry out searches and seizures in the enforcement of laws protecting the mails,[177] and a number of criminal statutes respectively prohibit practices such as mail fraud, theft of the mail, and damaging a Postal Service mailbox.[178] Federal Express argues that the authority of the United States Postal Inspection Service (USPIS) to enforce these statutes gives the Postal Service a competitive advantage because it is able to promise that the foregoing criminal statutes protect the security of that mail, while the same laws do not cover its private competitors.[179] To the extent that this constitutes a competitive advantage, however, it may be an unavoidable consequence of Postal Service law enforcement efforts with other federal government agencies. In particular, the FTC works closely with the Postal Service and the USPIS in a number of areas, including, for example, the ongoing efforts of the Identity Theft Task Force established by the President and law enforcement actions addressing a variety of different types of mail fraud and related practices that may also violate the Federal Trade Commission Act because they constitute unfair or deceptive acts or practices.

According to UPS and Federal Express, the USPS received substantial appropriations to fund increased security required by the Department of Homeland Security (DHS).[180] UPS notes that "it and other private entities must comply with stringent DHS regulations without the benefit of federal funding."[181] Of course, because of its governmental status, the USPS is likely to have greater security concerns than its competitors. UPS also notes that although private companies must "compete for and purchase, for substantial sums, commercial radio spectrum allocated and assigned by the Federal Communications Commission," the USPS is neither required to

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States in the former Post Office Department." 39 U.S.C. § 2002(a).

[176]*See* UPS, Comment 19, at 12-13.

[177]*Dolan*, 546 U.S. 481.

[178]*See* 18 U.S.C. §§ 1341, 1342, 1705, 1708.

[179]*See* Federal Express, Comment 9, at 16.

[180]*See* UPS, Comment 19, at 9 (the USPS received $1 billion to cover security improvements since 2002); Federal Express, Comment 9, at 13 (USPS received $500 million in 2002 for increased security requirements) (citing James I. Campbell Jr., *Beyond the Monopoly: other Legal Restraints on Entry into U.S. Postal Markets*, at 57-58 (Nov. 17, 2002), *available at* http://jcampbell.com/articles/CP_US_policy.pdf)).

[181]*See* UPS, Comment 19, at 9.

purchase nor compete for this spectrum.[182] Finally, the USPS enjoys an increased demand for its products to the extent that other federal government agencies view only USPS postmarks as valid certification[183]

B. Restraints on the USPS's Operations

Although the Constitution and a number of statutes provide economic advantages for the Postal Service as compared to its private competitors, the Postal Service also must comply with a number of statutory and regulatory requirements that do not apply to its private competitors. These legal requirements generally reduce the USPS's ability to operate as efficiently as it could in the competitive products market, for two principal reasons. First, a variety of statutory and regulatory provisions require the Postal Service to pay more for labor, products, and services than its private competitors must pay. Second, Section 3633(a)(3) of Title 39 requires the PRC to ensure that all competitive products collectively cover "an appropriate share of the institutional costs of the Postal Service," and the PRC has determined to require competitive products collectively to cover 5.5 percent of Postal Service institutional costs. A number of the factors discussed in this section raise Postal Service costs and therefore may increase both its institutional costs – with a consequent increase in the magnitude of the 5.5 percent allocation of such costs for competitive products as a group – and the costs directly attributable to USPS competitive products operations.

1. Employment and Labor Law Requirements

Postal Service operations are heavily labor-intensive. In fiscal year 2006, compensation and benefits expenses totaled $56.5 billion, or 78.6 percent of total Postal Service expenses.[184] A number of employment and labor statutes and regulations apply to the Postal Service but not to its private competitors, and as a consequence, aggregate Postal Service labor costs tend to be higher than private counterparts. Private firms operate under state employment laws and the National Labor Relations Act or the Railway Labor Act, while the Postal Service is governed by the NLRA,[185] in most respects, and by a number of other federal statutes. In particular, Postal Service employees cannot establish union shops and do not have the right to strike,[186] but they

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[182]*Id.* at 12.

[183]*See id.* at 13.

[184]USPS, Comment 18, at 12.

[185]*See generally* 39 U.S.C. §§ 1201-04, 1208.

[186]5 U.S.C. § 7311(3), (4).

can by majority vote select a labor organization as their bargaining unit[187] and negotiate collective bargaining agreements with the Postal Service.[188]

The Postal Service argues that a number of differences between the employment and labor laws with which it must comply and those laws that apply to private firms place it at a competitive disadvantage. In particular, when collective bargaining negotiations between the Postal Service and its employees are not successful, binding arbitration must be used to produce an agreement,[189] while this is not the case in the private sector. Moreover, the fringe benefit program for Postal Service employees can never "on the whole [be] less favorable to [Postal Service] officers and employees than fringe benefits in effect" on July 1, 1971, when the Postal Service was created as a replacement for the Post Office Department.[190] By contrast, the Postal Service notes, no private firm operates under such a statute, and many private firms have in fact curtailed employee benefits in recent years.[191]

With respect to retirement benefits, most Postal Service employees hired after December 31, 1983, are covered by the Federal Employees Retirement System, which contains both defined benefit and defined contribution components. By contrast, private employers are generally covered by the Employee Retirement Income Security Act of 1974 and have significant discretion (subject to collective bargaining obligations) over the type of retirement plans they offer their employees. The Postal Service estimates that in 2006, its FERS plan added $3.61 to the average hourly wage of its employees, while retirement benefits added $1.21 to the average hourly wage of workers in private industry, and $0.97 to the average hourly wage of workers in the private production, transportation, and material moving occupations.[192] Moreover, most Postal Service employees hired before 1984 are covered by the Civil Service Retirement System, and the Postal Service estimates that although it has paid $85 billion more into the fund than it should have for employees whose service combined both the Post Office Department and the Postal Service, it has been unable to persuade the Office of Personnel Management (OPM) to refund that amount.[193] Furthermore, the Postal Service estimates that

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[187] 39 U.S.C. § 1203.

[188] 39 U.S.C. §§ 1202-06, 1209. In addition, unlike private sector managers and supervisors, organizations representing Postal Service supervisors and managers have formal statutory rights to participate in planning and developing Postal Service pay policies and certain fringe benefit and other programs. 39 U.S.C. § 1004(b)-(h).

[189] 39 U.S.C. § 1207.

[190] 39 U.S.C. § 1005(f); USPS, Comment 18, at 13.

[191] USPS, Comment 18, at 13.

[192] *See id.* at 14.

[193] *See id.*

through 2016 it will have to pay OPM $5.4 to $5.8 billion per year to cover the cost of health benefits for its retirees.[194] By contrast, private employers are not required by statute to prefund annuitant health benefits from company-sponsored plans.[195] The Postal Service also states that it will have to pay OPM $250 million more per year than comparable private employers to cover the cost of the Medicare Part D program for Postal Service retirees.[196]

Further, the Postal Service concludes that differences between the statutes that govern its relationship with its employees and the statutes that govern private employer relationships with their employees mean that it must pay its employees substantially more per hour than private sector employees receive. In particular, the USPS cites an estimate from the 2003 Report of the President's Commission on the United States Postal Service that in most localities, the Postal Service must pay its employees 21.2 percent more than private sector employees.[197] A number of analyses presented by the Postal Service during the arbitration proceedings that led to the 2000-2003 collective bargaining agreement between the American Postal Workers Union (APWU) and the Postal Service provide similar data, although it should be noted that the APWU criticized many aspects of those analyses. Thus, for example, one job analysis provided by the Postal Service estimated the average wage premium across the APWU bargaining unit to be 26.5 percent versus comparable private sector jobs. Similarly, a survey provided by the Postal Service estimated that all Postal Service new hires received a starting wage that averaged 28.4 percent more than the wage they had received in their previous jobs. The APWU raised a number of concerns about the data used and conclusions presented in these analyses and in particular argued that when properly measured the compensation of Postal Service workers was in many respects comparable to that of UPS and Federal Express workers. The neutral arbitrator concluded, however, "that APWU-represented employees do in general receive a wage premium," but "hesitate[d] to quantify that premium."[198]

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[194]*Id.* at 14-15 (citing 5 U.S.C. § 8909(a)).

[195]Financial Accounting Standards Board, Summary of Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, available at* http://72.3.243.42/st/summary/stsum158.shtml. However, Statement No. 158 does require publicly traded corporations to accrue for health benefits for retirees.

[196]USPS, Comment 18, at 15.

[197]*Id.* at 13 (citing PRESIDENT'S COMMISSION ON THE UNITED STATES POSTAL SERVICE, EMBRACING THE FUTURE, MAKING THE TOUGH CHOICES TO PRESERVE UNIVERSAL SERVICE 118-20 (July 31, 2003) [hereinafter "PRESIDENTIAL COMM'N REP."]. *See also* Geddes, *supra* note 36, at 220 ("econometric estimates consistently show that, except for some senior management positions, postal workers' wages are about 30 percent more than those of comparable private sector workers").

[198]Arbitration Proceedings and Collective Bargaining Agreement Between American Postal Workers Union, AFL-CIO and U.S. Postal Service, November 21, 2000 - November 20,

That attrition at the USPS is extremely low and that there are many more people seeking jobs at the USPS than there are openings also provide indirect evidence that Postal Service workers earn wages that are higher than comparable private sector wages. For example, the USPS's General Counsel reports that the USPS has "a backlog in excess of 400,000 applicants for employment and an attrition rate that is virtually non-existent."[199] Further, the 2003 Presidential Commission on Postal Reform found evidence of a low turnover rate.[200]

The USPS also is limited in its ability to outsource delivery routes to private carriers, which can save the USPS significantly. For example, the USPS has estimated that the additional annual cost for an additional city delivery point was $295, compared to $143 for a rural delivery point, and $90 for a new highway contract delivery point.[201] The key factor driving these differences, according to the USPS, is the labor contracts, which vary by type of route: members of the National Association of Letter Carriers (NALC) service city routes; members of the National Rural Letter Carriers Association service rural routes; and contract carriers' compensation is established by contract with the USPS.[202] Despite the potential savings associated with contract delivery, in its recent contract with the NALC, the USPS has agreed to a five-year moratorium on contracting out for mail delivery, which can reduce labor costs.[203] According to one commenter, these concessions were the direct result of pending legislation supported by the NALC that would have prohibited the USPS from contracting out delivery for any route with at least one family per mile, or more than 99 percent of all postal routes.[204]

2003 (before Arbitrators Stephen B. Goldberg, Carin A. Clauss, and Robert A. Dufek): *Supplemental Opinion Dealing With Economic Issues* (issued by Stephen B. Goldberg, the Neutral Arbitrator), at 203-207.

[199]*See* Mary Anne Gibbons, *Universal Service Providers: Defensive Moves on the Level Playing Field*, *in* REGULATORY AND ECONOMIC CHALLENGES IN THE POSTAL DELIVERY SECTOR 270 (Michael A. Crew & Paul R. Kleindorfer eds., 2005).

[200] PRESIDENTIAL COMM'N REP., *supra* note 197, at 118.

[201]U.S. GOVERNMENT ACCOUNTABILITY OFFICE, USPS NEEDS TO CLEARLY COMMUNICATE HOW POSTAL SERVICES MAY BE AFFECTED BY ITS RETAIL OPTIMIZATION PLANS, GAO-04-803, at 17 (July 2004).

[202]*Id.*

[203]*See* ADVO, Comment 11, at 12.

[204]*Id.*

2. The Universal Service Obligation

The Postal Service must "provide universal service to all parts of the country";[205] that is, it must

> receive, transmit, and deliver throughout the United States, its territories and possessions, and . . . throughout the world, written and printed matter, parcels, and like materials and provide such other services incidental thereto as it finds appropriate to its functions and in the public interest. The Postal Service shall serve as nearly as practicable the entire population of the United States.[206]

Congress, moreover, requires the USPS to provide universal service six days per week; annual appropriation riders enacted each year since 1984 have required the Postal Service to continue to provide "6-day mail delivery and rural delivery of mail" at not less than 1983 levels.[207] Thus, as the Postal Service notes: "Its mission requires it to be the one service delivering personally to virtually every address in America six days a week."[208]

To satisfy these universal service requirements, the Postal Service delivers 703 million pieces of mail on a typical day and maintains "between 300 and 400 major facilities, 37,000 retail offices, and 250,000 carrier routes."[209] According to the USPS's general counsel, one study has shown that of 27,166 post offices, only 4,525 had positive revenues, resulting in annual losses of $1.27 billion.[210] Similarly, the cost of the universal service obligations' delivery aspect has been estimated to be $2.5 to $9.8 billion per year.[211] To keep up with the growth of

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[205]*Flamingo Indus.*, 540 U.S. at 741 (*citing* 39 U.S.C. §§ 101, 403).

[206]39 U.S.C. § 403(a); *see generally Greenburgh Civic Assoc.*, 453 U.S. 114, 133 (1981).

[207]USPS, Comment 18, at 18; *see, e.g.*, Transportation, Treasury, Housing and Urban Development, the Judiciary, the District of Columbia, and Independent Agencies Appropriations Act 2006, Pub. L. No. 109-115, Div. A, Title VI, 119 Stat. 2396, 2490 (2005).

[208]USPS, Comment 18, at 12.

[209]*Id.* at 6.

[210]*See* Gibbons, *supra* note 199, at 268. Based on fiscal year 1999 data, a group of PRC economists estimated that serving consumers on unprofitable delivery routes, maintaining too many small post offices, and providing air parcel post service to Alaska cost the USPS 5 percent of its total annual expenditures. Robert Cohen *et al.*, THE COST OF UNIVERSAL SERVICE AND ITS IMPACT ON COMPETITION 13, *available at* http://www.prc.gov/tsp/114/cost_of_universal_service.pdf.

[211]Gibbons, *supra* note 199, at 268.

the United States, the Postal Service adds almost two million new delivery points every year.[212] In recognition of the foregoing requirements, Title 39 authorizes an annual appropriation of $460 million "[a]s reimbursement to the Postal Service for public service costs incurred by it in providing a maximum degree of effective and regular postal service nationwide, in communities where post offices may not be deemed self-sustaining, as elsewhere . . . ."[213] However, as the Postal Service points out, none of that amount has been requested in the President's budget since 1983, when it was first excluded for budgetary constraint reasons.[214]

The universal service requirement increases Postal Service costs and therefore may increase both the magnitude of the 5.5 percent allocation of institutional costs for competitive products as a group and the costs directly attributable to USPS competitive products.

3. Restrictions On Closing Post Offices

Congress requires the USPS to "establish and maintain postal facilities of such character and in such locations that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services."[215] The Postal Service can close a post office only if certain conditions are satisfied. In particular, Title 39 requires the Postal Service to

> provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining. No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective postal services be ensured to residents of both urban and rural communities.[216]

Title 39 also prescribes extensive procedures that the Postal Service must follow prior to making a determination "as to the necessity for the closing or consolidation of any post office."[217] In particular, the Postal Service must provide at least sixty days' advance notice to members of the community in which a post office is to be closed; must consider and make extensive written

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[212] USPS, Comment 18, at 19.

[213] 39 U.S.C. § 2401(b)(1)(A), (G) (providing for an amount equal to 5 percent "of the sum appropriated to the former Post Office Department by Act of Congress for its use in fiscal year 1971"). That amount is $460 million. USPS, Comment 18, at 19.

[214] USPS, Comment 18, at 19.

[215] 39 U.S.C. § 403(b)(3).

[216] 39 U.S.C. § 101(b).

[217] 39 U.S.C. § 404(d)(1).

findings with respect to a number of different factors before determining to close a post office; and must make public any such determination at least sixty days before the post office at issue is to be closed. Each such determination can then be appealed "by any person served by such office" to the Postal Regulatory Commission, and the PRC may then affirm or set aside, but may not modify, that determination.[218]

As a consequence of the foregoing restrictions, the Postal Service, unlike its private competitors, cannot readily rationalize the number and size of its facilities to make their collective configuration as efficient as possible. Moreover, because, unlike its private competitors, the Postal Service must keep open many post offices located on extremely valuable real estate, it must incur extremely large and chronic opportunity costs arising from its inability to sell those properties on the open market.[219] For these and other reasons, the foregoing restrictions increase Postal Service costs and therefore may increase both the magnitude of the 5.5 percent allocation of institutional costs for competitive products as a group and the costs directly attributable to USPS competitive products operations. By contrast, these restrictions do not apply to private competitors.

4. Pricing Restrictions

The USPS lacks the freedom to set prices for competitive products that its competitors enjoy. Although the PAEA has increased the USPS's flexibility to set prices for competitive products, its prices are still subject to an after-the-fact review by the PRC to assure compliance with prohibitions on cross subsidies and below-cost pricing.[220] Further, the USPS is subject to complaints from competitors and customers about its competitive products prices that could initiate regulatory proceedings. The USPS additionally has expressed concern that the PRC's rules for customized pricing for individual consumers may limit its flexibility to compete.[221] Specifically, it notes that because the PRC has classified each NSA as a separate product, the USPS must engage in a lengthy proceeding to determine whether the NSA should be classified as a competitive or market-dominant product.[222] The USPS contends: "This prior review may substantially limit the Postal Service's ability to respond to contract solicitations and negotiations."[223]

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[218] 39 U.S.C. § 404(d); *see* USPS, Comment 18, at 18.

[219] Of course, this opportunity cost is ameliorated to some extent because the USPS does not pay property tax on these facilities. *See supra* pages 24-26.

[220] *See* 39 C.F.R. §§ 3015.2-1305.3, 1305.7.

[221] USPS Correspondence (Nov. 29, 2007).

[222] 39 C.F.R. § 3015.4.

[223] USPS Correspondence (Nov. 29, 2007).

The USPS also notes that several special requirements that private competitors do not confront reduce the USPS's pricing flexibility in pricing market-dominant products. For example, in "establishing or revising" a modern rate system for market-dominant products, as required by the PAEA, the PRC must take into account, *inter alia*, the "educational, cultural, scientific, and informational value to the recipient of mail matter."[224] The Postal Service advises that these considerations have led the PRC to permit a rate for Periodicals that covers 100.2 percent of costs. By contrast, the rate for the comparable category of Standard Mail Regular covers 170.8 percent of costs. If the USPS were allowed to raise the cost coverage for Periodicals to 120 percent, for example, it could increase its annual revenues by $500 million.[225] The Postal Service also estimates that the statutory provisions that prescribe specific advantageous rate differentials for charitable and other nonprofit mailings – as compared to similar commercial mail – reduce its annual revenue by $1.1 billion.[226] The Postal Service notes that while Congress formerly paid the Postal Service the "revenue forgone" for statutorily reduced-rate mail, it now does so only for certain types of such mail, for which it has authorized reimbursement at the rate of $29 million per year through 2035.[227] The link between these strictures on market-dominant pricing and competitive products pricing and costs, however, appears tenuous. Although these restrictions lead to lower contributions to institutional costs, they neither increase institutional costs nor increase costs attributable directly to competitive products.

5. Alaska Bypass and International Mail Transportation Requirements

A number of other special requirements that private competitors do not confront increase Postal Service costs. For example, as the Postal Service points out, the most detailed portion of Title 39 may be Section 5402, which prescribes extensive and explicit regulations governing the transportation of mail by air to bush points within the State of Alaska. The Postal Service estimates that these statutory provisions produced a net deficiency of $97.5 million in FY 2006. Moreover, while the Department of Transportation regulates the rates for international mail transportation for the Postal Service, the free market sets the corresponding rates paid by private shippers. As a consequence, the Postal Service estimates that in fiscal year 2006, for example, it had to pay an estimated $65 million to $98 million more for international mail transportation than did private shippers.[228] These expenditures place a direct burden on Postal Service competitive products operations that its private competitors do not bear, because although the PAEA classifies "single-piece international mail" as a market-dominant product, it classifies

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[224] 39 U.S.C. § 3622(c)(11).

[225] USPS, Comment 18, at 18 (citing 39 U.S.C. §§ 3621(a), 3622(c)(11), 3685).

[226] *Id.* (citing 39 U.S.C. § 3626(a)(6)).

[227] USPS, Comment 18, at 18 (citing 39 U.S.C. § 2401(e)).

[228] USPS, Comment 18, at 19.

"bulk international mail" as a competitive product.[229] Furthermore, to the extent that these restrictions increase the institutional costs of the Postal Service, they place additional costs on its competitive products operations that its private competitors do not confront.

6. Restrictions On Purchases of Products and Services

The Postal Service, like other parts of the federal government, also must comply with a number of federal statutes not applicable to private sector firms that raise the costs associated with purchasing products and services, such as the Davis-Bacon Act. Under this legislation, the USPS's contracts for public buildings and public works in a given local area worth more than $2,000 must require the contractors involved to pay all the laborers and mechanics they employ on those contracts the prevailing wage for that area, as calculated by the U.S. Department of Labor.[230] The Postal Service must also comply with the Miller Act, which requires all federal government contracts for public buildings and public works worth more than $100,000 to require the contractors to post both a performance bond, for the protection of the government, and a payment bond, for the protection of "all persons supplying labor and material in carrying out the work provided for in the contract for the use of each person."[231] In addition, the Postal Service must comply with the Javits-Wagner-O'Day Act, which establishes preferential suppliers for certain goods and services.[232] All of these requirements increase Postal Service costs, and therefore may increase both the magnitude of the 5.5 percent allocation of institutional costs for competitive products as a group and the costs directly attributable to USPS competitive products.[233] By contrast, private competitors are not required to comply with these statutes.

7. Restraints on Financing and Investing

The Postal Service notes that, unlike private firms, it is not permitted to secure financing in the equity markets by issuing shares and paying dividends. Moreover, it is not permitted to invest its own funds directly, and although it may ask Treasury to invest on its behalf in any securities deemed appropriate, as a matter of policy Treasury will not invest in equities.[234] The Postal Service argues that the costs produced by these limitations on the manner in which it may

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[229]*Compare* 39 U.S.C. § 3621(a)(10) *with* 39 U.S.C. § 3631(a)(4).

[230]*See generally* 40 U.S.C. §§ 3141-3147; 39 U.S.C. § 410(b)(4)(A). The Service Contract Act imposes similar obligations covering service employees who work on federal Government contracts worth more than $2,500. *See* 41 U.S.C. § 351; 39 U.S.C. § 410(b)(5)(B).

[231]40 U.S.C. §§ 3131, 3133; 39 U.S.C. § 410(b)(4)(A).

[232]USPS, Comment 18, at 9 (citing 41 U.S.C. §§ 46-48).

[233]41 U.S.C. §§ 46-48c.

[234]USPS, Comment 18, at 27-29.

secure financing outweigh the benefits it receives from being able to borrow from Treasury, and that, as a consequence, "prices for all [its] products, competitive and market-dominant, were higher during [Fiscal Year 2005 and Fiscal Year 2006] due to the net disadvantage compared to private company opportunities."[235]

[235] *Id.* at 29.

CHAPTER III

ADVANTAGES ARISING FROM THE USPS'S POSTAL AND MAILBOX MONOPOLIES

The USPS enjoys an exclusive right to deliver certain types of mail and exclusive access to consumers' mailboxes. This chapter explores the competitive advantages that the USPS derives from these monopolies.

A. Postal Monopoly

One obvious benefit to the USPS from the postal monopoly is that it creates a price floor for the USPS's competitors. Under the PAEA, a private company can carry matter subject to the postal monopoly outside of the mail only when the amount paid for private carriage is at least six times the current charge for the first ounce of a single-piece first class letter (currently, $2.46).[236] First, this price floor means that no customer rationally would turn to a private carrier to deliver a non-expedited letter given the much lower USPS price. In this manner, the price floor defines the scope of the monopoly. Second, even if a private carrier would be willing to offer a price below $2.46 to deliver an expedited letter, it is prohibited from doing so. Thus, if this price floor is binding, consumers pay more for some competitive products than they otherwise would, hence reducing output and welfare.[237]

The postal monopoly potentially could provide the USPS three additional advantages over private firms in selling competitive products. First, the USPS would have an advantage over private firms if it benefitted from economies of scope by producing both market-dominant and competitive products. Economies of scope occur whenever a multi-product firm can produce goods at a lower cost than could be achieved by producing those goods in separate firms. The universal service obligation requires the USPS to deliver to most addresses, six times a week. Further, the USPS has a network of retail post offices. The ability to share the network established to deliver products covered by the postal monopoly may reduce the USPS's cost of providing competitive products. As the USPS notes in its comments:

> Contracted surface transportation handles both market-dominant and competitive products on the same vehicles. . . . As a result transporting market-dominant and competitive products separately could entail significant network changes and likely higher costs for both product groups.
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> Priority Mail flats and small parcels . . . are delivered on regular city routes with market dominant products. In that case, separate delivery would be even more costly.

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[236] 18 U.S.C. § 601(b)(1).

[237] *See* Federal Express, Comment 9, at 8-9; Sidak, Comment 17, at 19.

> Window operations are designed to accommodate both competitive and market-dominant products and the special services that support them. The reach and accessibility of these services depend on the availability of a national network. When a package or item cannot be delivered because of size, signature requirements, or other factors, convenience to the customer depends on access to the nearest retail outlet.[238]

If delivering monopoly products lowers the USPS's costs of producing competitive products, then it enjoys an advantage over its private competitors that the PES prevent them from duplicating.[239]

The consensus appears to be that the postal monopoly provides the Postal Service with some economies of scope in the provision of competitive products. The extent of these economies, however, ultimately is an empirical question. One commenter cites five studies that claim to support the existence of "substantial" economies of scope among various aspects of postal delivery both in the U.S. and abroad.[240] The USPS also reports that there are significant economies of scale and scope in processing, transportation, delivery, and retail functions.[241] By contrast, another commenter described economies of scope for the Postal Service as "usually quite limited" and are likely present only for last-mile delivery of competitive products that are similar to market-dominant products in size and shape.[242] The author offers anecdotal support for this claim, observing that the Postal Service's inability to garner a large market share in competitive products belies the existence of substantial economies of scope, or at least suggests

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[238] *See* USPS, Comment 18, at 7.

[239] The Postal Service's private sector rivals have operations in other countries and offer some services (e.g., Kinko's Office and Print Services) that the Postal Service cannot. This may enable the Postal Service's private sector rivals to realize some scope economies that the Postal Service cannot realize.

[240] *See* Sidak, Comment 17, at 41.

[241] USPS, Comment 18, at 6.

[242] *See* Institute for Research on the Economics of Taxation, *Government-Imposed Advantages and Burdens on the Postal Service's Competitive Products: Two Wrongs do not Make a Right*, IRET POLICY BULLETIN (No. 91), at 19 (July 30, 2007) [hereinafter "IRET"] ("Because of the specialized nature of postal delivery, the reality seems to be that few economies of scope are available unless products are shaped like letters, can be handled like letters, and can be placed in mailboxes like letters.").

that other operational burdens (e.g., its universal service obligation) counterbalance them.[243] Others examining this issue also have reached different conclusions.[244]

Any scope economies that the USPS enjoys may naturally flow from market conditions relating to universal mail service. To the extent that universal mail service is best characterized as a natural monopoly, scope economies accruing to only one firm is merely the natural outcome of the market process.[245] Further, if the provision of universal service in its current form requires the maintenance of a monopoly provider, then the postal monopoly should be viewed as a marketplace distortion that Congress has chosen to assure that the United States has a postal network that offers ubiquitous coverage at uniform prices and service levels.[246] If delivery of mail subject to the postal monopoly is not a natural monopoly and the PES are not necessary to assure universal service, however, then any economies of scope the USPS enjoys are not a result of market forces in the presence of the current universal service requirement.[247]

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[243]*Id.* at 17.

[244]*See*, *e.g.*, Testimony of John C. Panzar (witness for the Postal Service) and J. Stephen Henderson (witness for UPS) in the 1997 rate case, PRC Docket R97-1, both of whom assume the existence of economies of scope. For evidence of diseconomies of scope, *see* J.R. Norsworthy, Show-Ling Jang, & Wei-Ming Shi, *Productivity and Cost Measurement for the United States Postal Service: Variations among Regions*, *in* COMPETITION AND INNOVATION IN POSTAL SERVICES 141, 151 (Michael A. Crew & Paul R. Kleindorfer eds., 1991). The lack of consistent evidence on economies of scope may be due in part to difficulties in estimating cost functions that are sufficiently "well-behaved" to facilitate rigorous testing for economies of scope. A rigorous test for economies of scope would need to analyze how the costs of a multi-product firm changed as it reduced production of one of its outputs all the way to zero. *See* Lars-Hendrick Röller, *Proper Quadratic Cost Functions with an Application to the Bell System*, 72 REV. ECON. & STAT. 202 (1990).

[245]A natural monopoly exists when the lowest total cost per unit can be achieved with only one firm operating to serve market demand. For a discussion of natural monopoly in the multiproduct firm context, *see* W. KIP VISCUSI ET AL., ECONOMICS OF ANTITRUST AND REGULATION 404-08 (4th ed. 2005).

[246]*See* USPS, Comment 18, at 4-5; American Postal Workers Union [hereinafter "APWU"], Comment 1, at 7. *See also* Gibbons, *supra* note 199, at 268 ("[P]rivate providers can tailor their networks to demand and profitability. They can decide what markets to service, how often to serve them, and at what price. . . . Hence, private carriers have the luxury of being able to 'cream skim' the most lucrative markets, leaving only the unprofitable and high-cost markets for the postal operator.").

[247]*See* Federal Express, Comment 9, at 9-10; Sidak, Comment 17, at 30; Geddes, *supra* note 36, at 225.

It is unclear whether the provision of universal service is a natural monopoly or whether universal service in its current form would not exist absent monopoly protection, and resolution of this debate is beyond the scope of this report.[248] Even if economies of scope are an artificial advantage, however, they may no longer provide a substantial benefit to the USPS. The USPS's competitors regularly purchase access to the USPS's networks through workshare rates. Currently, UPS, Federal Express, and DHL account for the majority of Parcel Select workshare volume.[249] The Postal Service offers customers who provide partial transportation and sortation a discount equal to avoided attributable cost.[250] Thus, private competitors who take advantage of workshare rates pay the USPS the incremental cost associated with the delivery services they purchase plus that product's full contribution to institutional costs. Under the PRC's competitive

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[248]For example, Crew & Kleindorfer observe that the postal monopoly is based on the theory that the USPS is an "unsustainable natural monopoly" because its economies of scale and scope are insufficient to prevent competitive entry, but that monopoly protection is necessary to assure lowest-cost production. *See* MICHAEL A. CREW & PAUL R. KLEINDORFER, DEVELOPING POLICIES FOR THE FUTURE OF THE UNITED STATES POSTAL SERVICE 11 (2003) [hereinafter "CREW & KLEINDORFER, POLICIES"], *available at* http://crri.rutgers.edu/pub/wp/ftcf20.pdf. Further, these authors note that given the requirements of uniform price and service standards that go along with the universal service obligation, monopoly protection is necessary to prevent cream-skimming and the subsequent "graveyard spiral" of the USPS. *See id.* at 11-12; *see also* Michael A. Crew & Paul R. Kleindorfer, *Efficient Entry, Monopoly, and the Universal Service Obligation in Postal Service*, 14 J. REG. ECON. 103 (1998). Several economists from the PRC, however, have presented empirical work that shows the USPS could continue to provide universal service in its present form without monopoly protection with a very modest rate increase. *See, e.g.*, Robert Cohen et al., *An Empirical Analysis of the Graveyard Spiral*, *in* COMPETITIVE TRANSFORMATION OF THE POSTAL AND DELIVERY SECTOR (Michael A. Crew & Paul R. Kleindorfer eds., 2003); Robert Cohen et al., *A Comparison of the Burden of Universal Service in Italy and the United States*, *in* POSTAL AND DELIVERY SERVICES: PRICING, PRODUCTIVITY, REGULATION AND STRATEGY (Michael A. Crew & Paul R. Kleindorfer eds., 2002); Robert Cohen et al., *supra* note 66.

[249]*See* Nat'l Assoc. of Letter Carriers [hereinafter "NALC"], Comment 19, at 5 (UPS, Federal Express and DHL together account for 67 percent of all Parcel Select volume); Parcel Shippers Assoc. et al., [hereinafter "PSA"], Comment 16, at 4-5 (the majority of the 200 million parcels entered at the destination delivery unit (DDU) rate were entered by Federal Express SmartPost). In addition, the Postal Service also allows rivals to locate drop boxes outside of Post Offices for a fee, but it appears that only one private express carrier (Federal Express) currently uses this service. *See* USPS, Comment 18, at 8.

[250]*See* UPS, Comment 19, at 15. Workshare rates allow competitors to deposit shipments at the facility that delivers mail to the addressee (DDU rate); the mail processing plant that services the addressee (DSCF rate); the auxiliary service facility that serves the addressee (ASF rate); or a bulk mail center other than the one that serves the addressee (OMBC rate). *See* PSA et al., Comment 16, at 4-5.

products ratemaking rules, the USPS's competitive products collectively must cover 5.5 percent of institutional costs. Thus, although we are unable to determine whether this is an appropriate approximation of any cost advantage that the USPS may enjoy due to scope economies, USPS's competitive products are required to contribute toward maintaining the monopoly products networks just as competitors who access the USPS network do.

A second advantage of the postal monopoly, apart from economies of scope, is that the network of retail outlets that exists due to the postal monopoly also likely provides the USPS's competitive products an advantage. The postal monopoly in combination with the universal service obligation – and the concomitant legal and political restrictions on closing post offices – results in the USPS having many more retail outlets than it would otherwise. Although this inability to structure its network optimally imposes costs on the USPS (*see* Chapter II.B, *supra*), it also likely leads to increased demand for its competitive products by reducing consumer costs of using the USPS.[251]

A third possible advantage that the postal monopoly bestows upon the Postal Service is the ability to cross-subsidize competitive products with monopoly revenue or to refuse to provide network access to its competitors on reasonable terms.[252] Cross-subsidization can occur in two ways:[253] the Postal Service could use high prices for its monopoly products to subsidize prices for its competitive products below the level they would otherwise be, or it could bundle the two types of products together such that the additional revenue from adding the competitive products does not cover their cost.[254] As discussed above, pursuant to the PAEA, the PRC has promulgated regulations that "prohibit the subsidization of competitive products by market-dominant products."[255] If effective, this regulation would prevent the Postal Service from using below-cost pricing either to capture a larger market share than it would otherwise have or, in the extreme case, to force rivals to exit the market. Presumably, this regulation also would apply to discounts on a bundle of market-dominant and competitive products that may be offered in NSAs going forward.

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[251] *See* Federal Express, Comment 9, at 16 (also noting that postmarks by the USPS creates a legal presumption for certain government purposes (*e.g.*, tax filing)).

[252] *See* VISCUSI, *supra* note 245, at 548.

[253] *See* David Sappington & J. Gregory Sidak, *Competition Law for State-Owned Enterprises*, 71 ANTITRUST L.J. 479 (2003).

[254] The Belgian postal operator De Post/La Poste offered such a bundled discount to customers. The European Commission decided that De Post/La Poste abused its dominant position through such conduct. *See* Commission Decision 2002/180, *De Post/La Poste*, 2002 O.J. (L 61) 32.

[255] 39 U.S.C. § 3633(a)(1). *See also* PRC, Order No.43, *supra* note 7.

The USPS also could use its postal monopoly to affect competition in the competitive products market if it denied competitors reasonable access to its networks.[256] Currently, this does not appear to be an issue. As discussed above, the Postal Service allows competitive products rivals to access its delivery system. Further, it is also important to note that the PAEA removed the USPS's immunity under the Sherman and the FTC Acts for its competitive products operations.[257] The USPS thus would be subject to scrutiny by the antitrust enforcement agencies and private parties if it were to use its postal monopoly to affect competition adversely in the competitive products market.

B. Mailbox Monopoly

The mailbox monopoly reduces competition by granting the USPS exclusive access to consumers' mailboxes. This government-imposed restriction on competition raises private competitors' costs of delivering competitive products that otherwise could fit into a mailbox. Whereas the USPS can deliver such competitive products directly to these mailboxes, private competitors must park their vehicles and take the parcel to the customer's door, perhaps having to return if the customer is not present and has not authorized the package to be left. In this manner, the mailbox monopoly makes non-USPS delivery of competitive products less attractive, likely causing some consumers to use USPS services who otherwise would not or to use them less intensively.

Although no commenters provided estimates of the costs of the mailbox monopoly, it may be substantial. According to UPS:

> [T]he Postal Service mailbox monopoly has the direct effect of raising the labor costs private sector competitors incur for delivery to many customers. The effect is most pronounced where the Postal Service, unlike private competitors, can deliver to a mailbox or bank of boxes that are a significant distance from a customer's door, such as in apartment buildings, rural areas, and some cluster housing. . . . The added labor costs for private companies to deliver, or in many cases re-deliver, to a residential door are quite large.[258]

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[256]*See* VISCUSI ET AL., *supra* note 245, at 548-51; *cf. Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398, 408-09 (2004).

[257]39 U.S.C. § 409.

[258]*See* UPS, Comment 19, at 14.

Further, Federal Express notes that some studies have shown that delivery to the door is twice as expensive as curbside delivery.[259] Thus, the economic importance of the mailbox rule has escalated as curbside boxes have become the most common type of mail receptacle.[260]

The USPS, however, contends that "since the size of most standard boxes is insufficient for the delivery of all but the smallest parcels and flats," the mailbox monopoly primarily affects the delivery of market-dominant products.[261] Further, the USPS notes that private carriers have the legal right "to organize their own networks of delivery receptacles, standing alongside postal boxes."[262] The USPS also has expressed the view that this would include the ability to affix receptacles to the same post that holds the mailbox as long as the private carrier's receptacle did not interfere with delivery of the mail or create undue confusion on the part of the consumer or the letter carrier.[263]

Ultimately, the extent to which the restriction on mailbox access affects competition between the USPS and private carriers is related to the costs that it imposes on private carriers. According to USPS data, in FY 2007, 30 percent of its delivery points were either "park and loop" or foot delivery. Thirteen percent of delivery points are in locked cluster boxes, for which the USPS has the key. Forty percent of delivery points are curbside mailboxes and another 16 percent of delivery points are mailboxes located primarily in common areas of apartment buildings or condominiums. For park and loop and foot delivery, the letter carrier walks a route to customers' doors. In these cases, there is no reduction in competition between the USPS and private carriers because they both must incur the same cost of delivery. However, for the remaining 70 percent of delivery points, private carriers must incur an additional expense of door delivery for competitive products that otherwise would fit into a customer's mailbox.

If most competitive products are too large to fit in most mailboxes, however, both the USPS and its private competitors must incur the additional cost of delivery to the door, and the mailbox monopoly may not have a large adverse effect on competition. Confidential data submitted to the FTC suggest that between 20 and 33 percent of competitive mail products delivered to consumers may fit into a mailbox. Of course, even if this is the case, if the mailbox monopoly were relaxed consumers may purchase mailboxes large enough to accommodate the size of many competitive products. Further, if the postal monopoly were further narrowed, the current mailbox access restriction would become an even more important impediment to private carriers, as a large portion of competitive products would be able to fit into mailboxes.

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[259] Federal Express, Comment 9, at 12.

[260] *Id.*

[261] USPS, Comment 18, at 5.

[262] *Id.*

[263] *See* USPS correspondence (Nov. 29, 2007).

Similar to the mailbox monopoly, users of Post Office boxes ("PO boxes") can receive mail only from the USPS. According to one commenter, a private carrier may not even hand an item over for final delivery by the USPS to a post office box.[264] As the same commenter noted, this restriction means that "if the PO box is the only address a sender has, he has no choice but to use USPS, held captive to the service merely by the address."[265] Of course, a consumer with a PO box can accept delivery from private carriers at their business or residence (or another convenient address). Further, it is unclear the extent to which the USPS discloses the restrictions on delivery to PO box customers.

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[264]*See* Federal Express, Comment 9, at 12-13 ("A letter which originates with a competitor company – for example, a Federal Express Envelope item – cannot be delivered to a post office box. We cannot even hand over an item for final delivery by USPS that is addressed to a PO Box."). A private carrier, however, could dropship an item into the mailstream at the P.O. box owner's DDU if they pay the appropriate postage. *See also* Damien Geradin & J. Gregory Sidak, *The Future of the Postal Monopoly: American and European Perspectives After the Presidential Commission and Flamingo Industries*, 28 LAW & ECON. REV. 168 (2005).

[265]Federal Express, Comment 9, at 12.

CHAPTER IV

ACCOUNTING FOR COST DIFFERENCES DUE TO DIFFERENT LEGAL REQUIREMENTS

This chapter estimates the costs associated with the USPS's legal constraints, along with the value of its implicit subsidies, and concludes that the USPS's unique legal status likely places it at a net competitive disadvantage relative to private carriers. It also explains how accounting for the USPS's implicit subsidies may affect the USPS's net income for competitive products and why economic efficiency is advanced when the USPS accounts for both the actual costs it incurs and those that it avoids by virtue of its unique legal status. Finally, this chapter discusses the possible competitive implications associated with the USPS accounting for its implicit subsidies.

A. Estimating and Accounting for the USPS's Economic Burdens and Benefits

1. Legal Constraints

The USPS provided the FTC with estimates of the magnitude of the costs associated with some of its legal constraints that it could quantify. The first column in Table 2 presents the USPS's estimates of these economic burdens as they apply to total USPS operations. In theory, the USPS's burdens (and benefits) associated with either market dominant or competitive products should be directly allocated to that product. Those implicit subsidies not allocated based on identified assets (e.g., licensing fees and parking tickets for a mixed-use vehicle, etc.) to competitive products may present a more complex challenge. The FTC lacks detailed USPS cost allocation data (e.g., percentage of vehicle costs assigned to competitive products), but more aggregated data supplied by the USPS shows that in 2006 the USPS attributed roughly 58 percent of its costs to either market-dominant or competitive products and the remaining 42 percent were unallocated. Competitive products were directly attributed with 16 percent of the total incremental costs.

To determine the extent to which the USPS's burdens affect its costs for competitive products, the second and third columns allocate a proportion of these burdens to competitive products based on two alternative methods. First, a low-end estimate is obtained by assuming that all of the USPS's burdens affect only institutional costs, of which 5.5 percent is allocated to competitive products based on PRC requirements.[266] The high-end estimate is based on an allocation to competitive products based on the percentage of revenue produced by competitive products.[267]

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[266]*See* PRC, Order No. 43, *supra* note 7.

[267]Competitive products revenue for FY 2006 of $9 billion divided by total mail revenue of $69 billion equals 13 percent. USPS 2006 CRA, *supra* note 85.

Table 2
Estimated USPS Burdens
As applied to the Competitive Products

Burdens	Estimate ($Millions)		
	Total	5.5%	13%
Alaska Bypass Service	$98	$5	$13
International Air Transportation	$98	$5	$13
Medicare Part D	$250	$14	$33
Wage Premium[268]	$5,567	$306	$724
No Markup on Periodicals	$500	$28	$65
Non Profit Mail	$1,071	$59	$139
Total	$7,584	$417	$986

These data show that the USPS's costs are higher by $417 - $986 million than they would be without the constraints identified by the USPS. Not surprisingly, the wage premium represents the largest economic burden for the USPS, at $306-$724 million, or approximately 3-8 percent of competitive products revenue. It is unclear how restrictions on periodical pricing and non-profit mail affect competitive products costs. Although these restrictions lead to lower contributions to institutional costs, they neither increase institutional costs nor increase costs attributable directly to competitive products. Nevertheless, even without these burdens included, total USPS burdens range from $330 million to $782, or approximately 4-9 percent of competitive products revenue.

2. <u>Implicit Subsidies</u>

Two confidential comments and a public study addressed specifically to the FTC's FRN included estimates of the value of some of the USPS's implicit subsidies. Below, we utilize the limited data received to provide an approximation of what the actual value of these subsidies might be under various assumptions.

[268]This is calculated based on a 21.2 percent wage premium (*see* page 39, *supra*) applied to all bargaining employees, whose total FY 2006 compensation was $31,824 million.

a. *Subsidies Due to the USPS's Federal Status*

Table 3 presents the estimate of the subsidies allocated to competitive products that the USPS enjoys by virtue of its status as a federal governmental entity. Subsidies identified benefit both market dominant and competitive products and in most instances are not readily assignable to either category. The low end of the range is based on the assumption that implicit subsidies are included as an institutional cost, which would require competitive products to cover 5.5 percent of the total cost of these implicit subsidies. The high end of the range is based on allocating the subsidies based on competitive products revenue, which would require competitive products to cover 13 percent of their cost.[269]

Table 3
Estimated USPS Implicit Subsidies from Federal Status
As applied to the Competitive Products

Exemptions	Estimate
State and Local Income Taxes	Dependent upon net income[270]
Sales and Use Tax	$11-26 million
Property Tax and Real Estate Taxes	$7-41 million
State Sales Tax Gas & Diesel	$4-8 million
State Franchise Taxes	$1-2 million
Business Licensing Fees, Franchise Fees, Business Tax, etc.	$2-5 million
Parking Tickets	$2-4 million
Vehicle Registration Fees	$6-15 million
Tolls	$4-10 million
Tax Compliance	$1-2 million
Total	$38-113

[269]The subsidies, as a whole, were estimated by FTC staff based on confidential submissions by outside parties as well as other public comments.

[270]State and local income taxes are dependent upon earning net income. State and local income taxes are approximately 2 percent of net income. *See* UNITED PARCEL SERVICE, ANNUAL REP. (FORM 10-K), at F 39 (Mar. 1, 2007).

The magnitude of these subsidies is significantly smaller than the USPS's estimated economic burdens. The total estimated subsidies for the quantifiable items range from $38 million to $113 million or 0.4-1.3 percent of current incremental plus allocable institutional costs of 0.6-1.8 percent of competitive products revenue. The largest item of subsidy presented in the table is property and real estate tax.[271] This represents almost one-third of the total subsidies listed, amounting to less than 0.5 percent of competitive products revenue and less than 0.6 percent of competitive products incremental cost.

b. *Borrowing Advantage*

The PAEA allows the Postal Service to issue obligations for use in the Competitive Products Fund.[272] The issuance of debt by the Postal Service may result in the Postal Service obtaining favorable interest rates compared to private sector competitors.[273] The assumed cost

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[271]The calculation of the upper bound of the real estate and property taxes used the $290 million book value (historical values which for real estate are generally significantly than market values) for buildings, land and leasehold equipment before depreciation as stated by the USPS. *See* USPS 2006 ANN. REP. at 44. An average effective tax rate of 1.15% (*see* IRET, *supra* note 242, at 9, for methodology to calculate effective tax rate) was applied to this along with the revenue allocation method resulting in a $37.7 million real estate tax subsidy. Adding the estimate for property taxes results in an estimated $41 million implicit subsidy for real estate and property taxes. This a conservative estimate as real estate taxes are generally based on an assessed value which is a percentage of market value. As stated by Postmaster General John Potter, "The Postal Service does not routinely assess the market value of the individual properties it owns," thereby making a true market value estimate of real estate taxes difficult. Institute for Research on the Economics of Taxation, IRET ADVISORY (No. 155), at 2 (June 24, 2003). A further issue in estimating real estate taxes is the USO requirement the USPS has. This requires far more facilities than would be expected for a competitive products operation. Facilities in place primarily to service the USO would likely have their costs and associated values attributed directly to the market dominant products thereby reducing the market value of properties used to calculate the implicit subsidy had market values been known.

[272]39 U.S.C. § 2011.

[273] In its guidelines for implementing competitive neutrality, the Australian Government notes, "The market may also offer lower rates of borrowing to government businesses without an explicit guarantee because it considers that government ownership itself reduces the risk of default (i.e., that there is an implicit government guarantee for such business activities). You may therefore be charged a rate of interest that is less than that paid by your competitors purely as a consequence of government ownership." *See* DEP'T OF FINANCE ADMIN., AUSTRALIAN GOV'T, AUSTRALIAN GOVERNMENT COMPETITIVE NEUTRALITY GUIDELINES FOR MANAGERS: FINANCIAL MANAGEMENT GUIDANCE NO. 9, at 22 (Feb. 2004). As noted in Chapter II, however, the USPS also suffers disadvantages related to restrictions on its ability to finance its operations. *See supra* pages, 45-46.

of debt should be based on firms in comparable businesses with comparable debt-to-equity ratios. This cost of debt is likely to be higher than what the Postal Service currently pays on its debt. Interest rates paid would also likely be higher than what the Postal Service would pay if it were to issue new debt to fund its competitive operations. While the PAEA requires that the debt obligations used to fund the Postal Service's competitive products business explicitly state that the U.S. government does not guarantee payment of principal or interest, history suggests that bondholders often assume that the federal government guarantees the debt of government-sponsored enterprises despite such disclaimers.[274]

Determining whether the Postal Service's Competitive Products Fund is able to borrow at a lower cost than private competitors involves comparing the Postal Service's cost of debt for its Competitive Products Fund with some benchmark cost of debt for a private firm. The Department of Treasury is tasked with identifying the assets and liabilities of the Postal Service that are associated with providing competitive products. After identification and allocation, the debt allocated to the competitive products could be evaluated regarding its cost versus what is available to private competitors.

Only one commenter provided an estimate of the value of the advantage the USPS enjoys on debt payment. He determined that the USPS could borrow at 1.45 percentage points below what it could in the private market, assuming that it would have a Baa credit rating if it were a private company.[275] Using this assumption, he estimated that the USPS enjoys a $30.45 million yearly subsidy on its current $2.1 billion debt.[276] Allocating the USPS debt to competitive products using both the 5.5 percent and 13 percent results in a borrowing advantage to the USPS of between $1.4 million and $4 million annually.

Table 4 provides a *pro forma* income statement compiled from USPS FY 2006 data, which includes the PRC's proposed requirement that competitive products cover 5.5 percent of institutional costs and using the revenue allocation methodology. The first column presents a baseline level of net income after assumed federal income tax.[277] Columns 2 and 3 present

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[274] *See* Wayne Passmore, *The GSE Implicit Subsidy and the Value of Government Ambiguity*, 33 REAL ESTATE ECON. 465 (2005).

[275] *See* IRET, *supra* note 242, at 33.

[276] A higher rating would improve the interest rate and narrow the implicit subsidy. S&P currently rates UPS at AAA and Federal Express at BBB.

[277] The PAEA requires the Postal Service to compute its assumed federal income tax on competitive products income and transfer this assumed tax from the Competitive Products Fund to the Postal Service Fund. To accumulate net income so that the USPS would owe this assumed tax, the Postal Service must price and sell competitive products that not only cover their costs attributable and their share of institutional costs but also provide a profit. The legislation, although not specifying a requirement for profitability, contemplates that competitive products

ranges of implicit subsidies from Table 3 and the USPS's borrowing advantage. Accounting for these subsidies results in a slight net income for competitive products ($13 million) if they are assumed to be allocated using the PRC rulemaking methodology. If a percent revenue allocation were used, then the competitive products *pro forma* reports a net loss of $65 million.

will provide sufficient revenue to cover costs attributed, all other costs allocable to the competitive products, and their portion of institutional costs. Further, the legislation provides for the Department of Treasury to introduce substantive and procedural rules to determine the assumed federal income tax on the Competitive Products Fund for any year, thus presupposing that a profit would be achieved. The legislation does not impose a level of profitability such as a return on sales or a return on equity.

Table 4

Fiscal Year 2006 *Pro Forma*[278]

($ in Millions)

	Baseline	Implicit Subsidies using PRC Rule-making Allocation (5.5%)	Implicit Subsidies using Percentage Revenue Allocation (13%)
Competitive Products Revenue	$8,990	$8,990	$8,990
Competitive Products Incremental Costs	$7,318	$7,318	$7,318
Estimated Cost of Implicit Subsidies Due to USPS Federal status (Table 2)	-	$38	$113
Estimated Cost of Implicit Subsidies Due to Borrowing Advantage	-	$1	$4
Operating Profit	$1,672	$1,633	$1,555
Institutional Cost Allocation @ 5.5%	$1,620	$1,620	$1,620
Income Before Tax	$ 52	$ 13	$ (65)
Income Tax @ 35%[279]	$ 18	$ 5	N/A
Net Income	$ 34	$ 8	N/A

Revenue and Incremental costs from United States Postal Service Cost and Revenue Analysis Fiscal Year 2006; Operating Profit calculated as: (Competitive Products Revenue - Competitive Products Incremental Costs); Institutional Cost Allocation calculated as: [(Total Costs - Total Incremental Costs)* 0.055]; Operating Profit calculated as (Competitive Products Revenue - Competitive Products Incremental Costs - Cost of Implicit Subsidies); Income Before Tax calculated as: (Operating profit - Institutional Cost Allocation); Income Tax calculated as: (Net Income Before Tax * 0.035); Net Income calculated as: (Income before Tax - Income Tax).

[278]As noted *supra*, at note 87, because the USPS's 2006 CRA contains a small amount of market-dominant products in revenue and costs for international mail and parcel post, this figure likely represents a slight overstatement of USPS revenue for competitive mail products.

[279]Income Tax includes estimates for federal as well as state and local income taxes.

c. *Return on Equity*

If the Postal Service were a profit-maximizing private firm, it would only participate in a market if it believed that it could earn a sufficiently high return on the capital it invests to pay interest on any debt it incurred to enter this market and earn a return on capital sufficient to justify the investment after paying any required income taxes. The capital that it commits to a market would be funded by some mixture of debt and equity. For any given firm, a variety of factors combine to determine the optimal level of debt and equity. The PAEA does not impose a level of profitability such as a return on sales or a return on capital. It does, however, provide for payment of federal income taxes, thereby assuming some return on assets, capital, sales or equity. Providing for a targeted return on capital for competitive products would entail performing sophisticated modeling at various pricing levels for each of the competitive products and observing the inherent effects these price changes would have on volumes and net income. To compare the USPS competitive products group with private publicly traded competitors, returns on equity, assets, and sales are presented in Table 5.

Table 5

Return on Equity for Private Carriers Fiscal 2006

	Return on Equity	Return on Assets	Return on Sales
UPS	27%	13%	9%
Federal Express	16%	8%	6%
Expeditors International of Washington, Inc.	22%	13%	5%
CH Robinson Worldwide, Inc.	28%	16%	4%

The USPS reported net capital of $5.4 billion[280] in FY 2005 in its annual report. For FY 2006, it reported net capital of $6.3 billion on its balance sheet.[281] Net capital is comprised of "Capital Contributions of the U.S. Government" and "Retained Earnings." Using net capital as a proxy for equity would allow for computing an expected return on equity (ROE) for competitive products for the USPS. One method to compute the return on equity would be to use competitors' ROE to approximate what should be expected from the USPS in its marketing of

[280] UNITED STATES POSTAL SERVICE, 2005 ANNUAL REPORT 43 (2005).

[281] USPS 2006 ANNUAL REP., *supra* note 37, at 46.

competitive products. A second method would be to use the Capital Asset Pricing Model to compute an expected risk-adjusted return on equity.[282] To illustrate the effects of calculating a ROE for competitive products using the first method, the simple average of the four firms' ROE listed in Table 5 could be applied to the USPS's reported net capital. This would be 23.25%. Next, a methodology for allocating the net capital for USPS to competitive products would be selected. Similar allocation methodologies as used above, such as the PRC rulemaking rate of 5.5% or a revenue allocation method, provide a range of results useful for this illustration.[283] Table 6 shows the expected ROE using the net capital as reported in the USPS's annual report for 2006 and allocating the net capital (1) based on the PRC rulemaking rate of 5.5% and (2) through a revenue allocation using a rate of 13%.

Table 6

Estimated Return on Equity

	2006	Net Income Required to Provide ROE of 23.5%
USPS Net Capital	$6.3 Billion	
Competitive Products Net Capital Rulemaking Allocation 5.5%	$347 Million	$81 million
Competitive Products Net Capital Revenue Allocation Method 13%	$819 Million	$190 million

If net income as shown in the above table were achieved, the competitive products group would be able to provide funding to the Competitive Products Fund. Generating either of these net incomes would also imply that federal, state, and local income taxes could then be calculated.[284] The net income as calculated would be after the required deduction for the

[282]The Federal Reserve System is required to account for an implicit rate of return on equity when it prices services that it provides in competition with private banks. The Federal Reserve recently adopted the Capital Asset Pricing Model to determine its target ROE after using and evaluating a multiple approach format for 20 years. *See, e.g.*, Board of Governors of the Federal Reserve System, *Testimony Before the Surface Transportation Board Ex Parte No. 664* (Feb. 15, 2007).

[283]Other methods, such as the asset allocation methodology that the Treasury is developing or a cost allocation model, may be appropriate as well.

[284]State and local income taxes could also be calculated. The calculation of any income taxes is dependent upon the USPS's competitive products producing a positive net income.

assumed federal income taxes.[285] To achieve a net income of $81 million, it would be necessary for the USPS to earn net income before taxes of $125 million, which likely would require significant pricing and operational changes by the USPS. Increasing revenues and decreasing costs for competitive products to improve operating profits would be necessary to enable the USPS to post net income numbers to allow achievement of the above ROEs. Recommendations concerning operational and pricing changes to achieve a ROE as suggested above are beyond the scope of this report.

d. *Other Advantages*

There are other benefits that inure to the Postal Service as a result of its status that are more difficult to quantify. These include, for example, the ability to acquire property through eminent domain, disparate customs treatment, the use of highways from which commercial vehicles are restricted, and the ability to take advantage of the FTCA. Further, there is no estimate of the benefits it derives from its postal and the mailbox monopolies.[286] These benefits, if possible to estimate, would further reduce net income for competitive products which in turn would require additional revenue increases or cost reductions.

B. Net Competitive Effect on the USPS

Based on the estimates above, the USPS's unique legal status appears to cause it to suffer a net competitive disadvantage relative to its private competitors. Although we estimate that the USPS avoids $39-$117 million in costs that private carriers pay due to its federal status and its borrowing advantage, we estimate that federally-imposed constraints on its operations cause the USPS to incur $330-$782 million in additional costs. Thus, even if the USPS were required to account for the value of the implicit subsidies that we have estimated, its legal constraints still would cause it to incur costs that are $213-$743 million higher than they might otherwise be, with the caveat that this range is based only on estimates of those burdens and benefits that we have been able to quantify.[287]

Due to higher costs, the USPS's legal constraints are likely to cause it to charge higher prices for competitive products than it would otherwise. Broadly speaking, there are two types of costs: variable and fixed. Variable costs are those that vary with output, and the marginal cost of producing an extra unit of output is the additional variable cost associated with the increased production. For example, as the USPS expands its competitive products operation, it will require more personnel-hours, additional trucks, and more fuel. These additional labor and

[285] 39 U.S.C. § 3634.

[286] The requirement that competitive products cover 5.5 percent of institutional costs, however, may compensate for part of the cost of access to the postal network.

[287] This range is based only on estimates of those burdens and benefits that we have been able to quantify.

transportation costs are the marginal cost of producing additional competitive products. Fixed costs, by contrast, are those that do not vary with output in the short run. For example, assuming that the stock of processing and retail facilities cannot be adjusted quickly, rental and insurance costs associated with the USPS's facilities are probably best viewed as fixed costs.

When exploring how the USPS is likely to react to a change in either its variable or fixed costs, there are two potential models that we can use to examine the USPS's pricing and output behavior. First, the USPS may set prices to maximize contributions to the Competitive Products Fund as a profit-maximizing private firm would. Profit-maximizing firms determine output levels by equating the marginal revenue and marginal costs associated with additional production.[288] Second, the USPS may maximize output of competitive products subject to the PRC's regulations that require each competitive product to cover its attributable costs and competitive products as a whole to cover their incremental costs (defined by the PRC as costs attributable plus group-specific costs) and 5.5 percent of institutional costs.[289] Under this scenario, the USPS would equate the price of a competitive product with its average total cost of production (defined as total variable and fixed costs divided by output). As we show below, regardless of the model used to examine the USPS's pricing and output decisions, the costs associated with its legal constraints are likely to lead the USPS to charge higher prices for competitive products than it otherwise would.

The largest share of the USPS's burdens, its wage premium, is best characterized as a variable costs. Further, there are variable cost components to the other burdens the USPS identified. If the USPS acts like a profit-maximizing firm with respect to the Competitive Products Fund, it will raise its price and reduce its output in response to an increase in costs for additional units of output. Similarly, if the USPS sets prices for competitive products to just meet its revenue floor, an increase in variable costs will lead it to raise prices and reduce output. Both of these possible responses to increased costs are shown in Figure 1.

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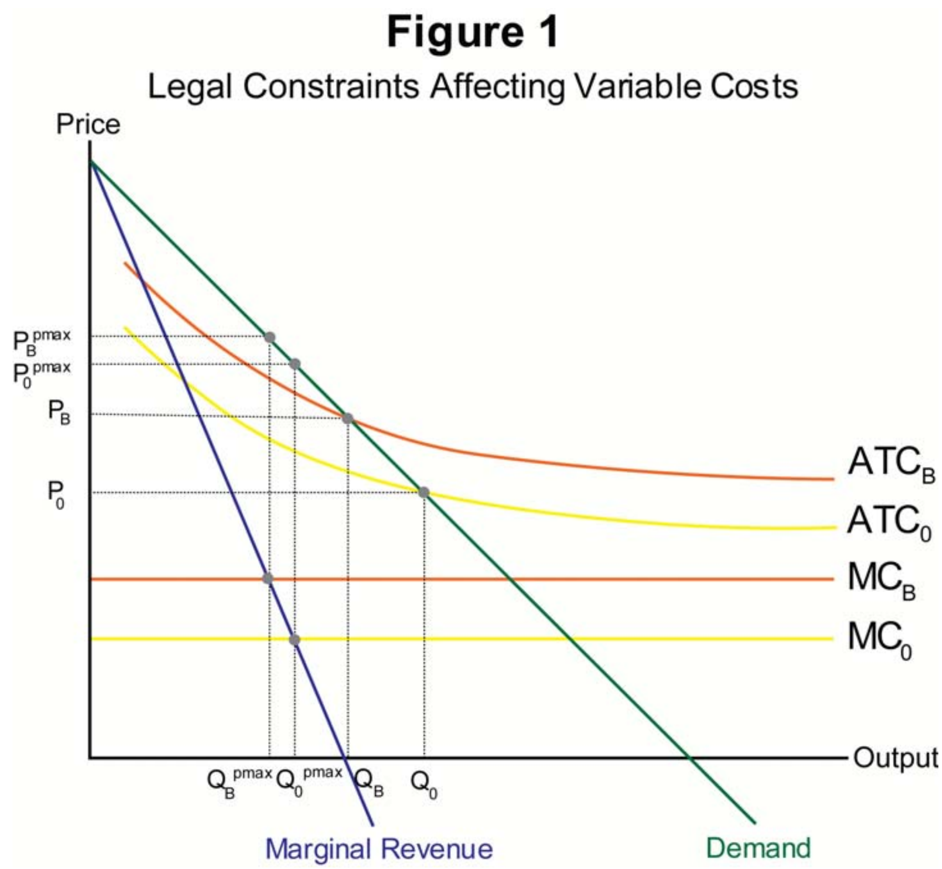
[288] *See* WALTER NICHOLSON, INTERMEDIATE MICROECONOMICS AND ITS APPLICATION 224-26 (9th ed. 2004).

[289] Sappington & Sidak model "managerially-oriented public enterprises" as maximizing a weighted average of profit and revenue. David E. Sappington & Gregory Sidak, *Incentives for Anticompetitive Behavior by Public Enterprises*, 22 REV. INDUS. ORG. 183, 190-92 (2003). Crew & Kleindorfer criticize this model of USPS pricing due in large part to its treatment of rates as determined by a single, unitary actor maximizing a variable. Rather, they view USPS rates as "the result of a complicated multi-party and adversarial process that is better characterized as a political economic rent-seeking game." CREW & KLEINDORFER, POLICIES, *supra* note 248, at 21. However, as the PAEA did away with rate cases and gave the USPS much greater freedom to price competitive products, this characterization may no longer be as accurate as it may have been at one time.

The higher marginal cost (MC_B) and average total cost (ATC_B) curves represent the increase in marginal and average total cost associated with higher variable costs of production. Under both the profit-maximizing and output-maximizing models, higher variable costs lead to lower output (Q_B vs. Q_0, and Q_B^{pmax} vs. Q_0^{pmax}) and higher prices (P_B vs. P_0 and P_B^{pmax} vs. P_0^{pmax}).



The fixed costs associated with the USPS's legal constraints also have the potential to affect pricing and output decisions in some circumstances. First, a change in fixed costs could affect pricing decisions directly to the extent that the USPS sets prices based on average total costs rather than marginal costs. For example, if the USPS were to maximize output of competitive products subject to its revenue floor, then an increase in fixed costs likely would necessitate an increase in price, or market exit if contributions to institutional costs were insufficient at new price and output levels. This scenario is shown in Figure 2 as an upward shift in the ATC curve (from ATC_0 to ATC_B), which causes prices to rise (P_0 to P_B) and output to fall (Q_0 to Q_B).

Second, costs that are fixed in the short run are variable in the long run.[290] Thus, burdens that raise the USPS's short-run fixed costs can affect long-run production and pricing decisions by affecting long-run marginal costs, as illustrated in Figure 1. Finally, fixed costs also affect the long-run solvency of the Competitive Products Fund, and thus decisions to participate in certain markets.

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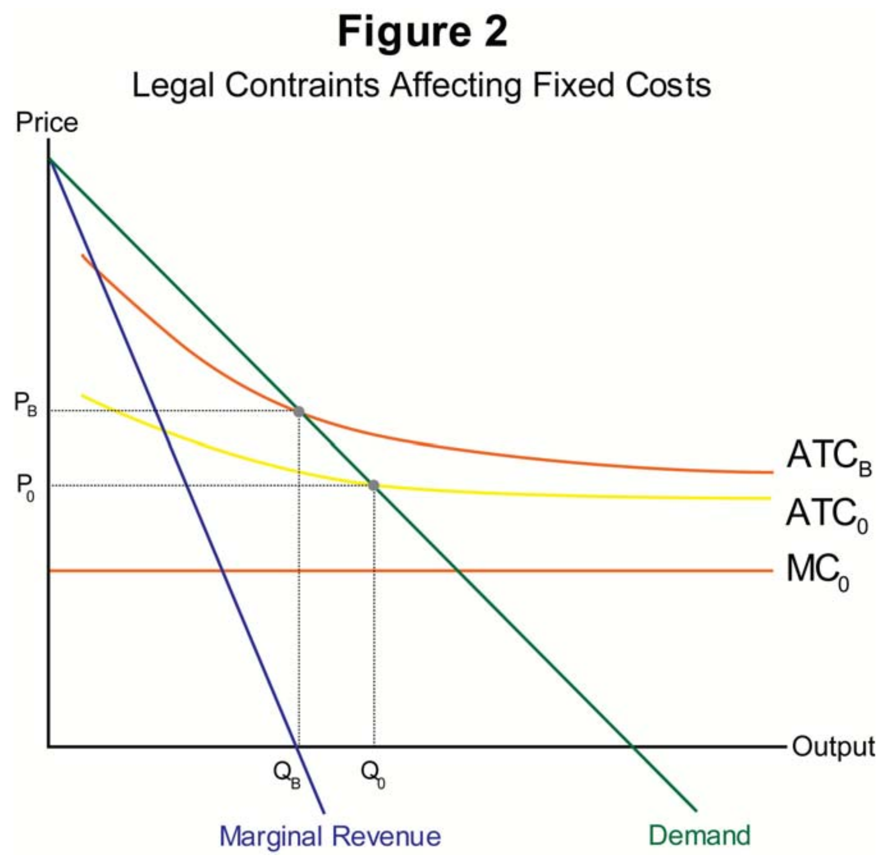
[290] *See* DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 32-33(3d ed. 2000); N. GREGORY MANKIW, PRINCIPLES OF MICROECONOMICS 283-84 (2d ed. 1998).



C. Efficiency Issues Related to Accounting for the USPS's Implicit Subsidies

Economic efficiency is advanced when firms base pricing and market participation decisions on the actual costs incurred in providing a product.[291] The extra costs that the USPS must bear due to the legal and political constraints on its competitive products operations represent actual production costs (e.g., wages) that must be borne by someone. At the same time, due to its unique status, the USPS is able to avoid certain costs that private competitors must pay. These implicit subsidies artificially reduce the actual costs that the USPS incurs to deliver competitive products. And, as discussed in more detail below, by avoiding certain costs that its private competitors must bear, the USPS likely sets lower prices for competitive products than it would if it were required to account for its implicit subsidies.

Many of the implicit subsidies identified in the previous sections can best be characterized as variable costs (e.g., gasoline taxes and vehicle licensing fees). In response to a reduction in costs for additional units of output, a profit-maximizing firm will lower its price and expand its output. Similarly, if the USPS sets prices for competitive products to just meet its

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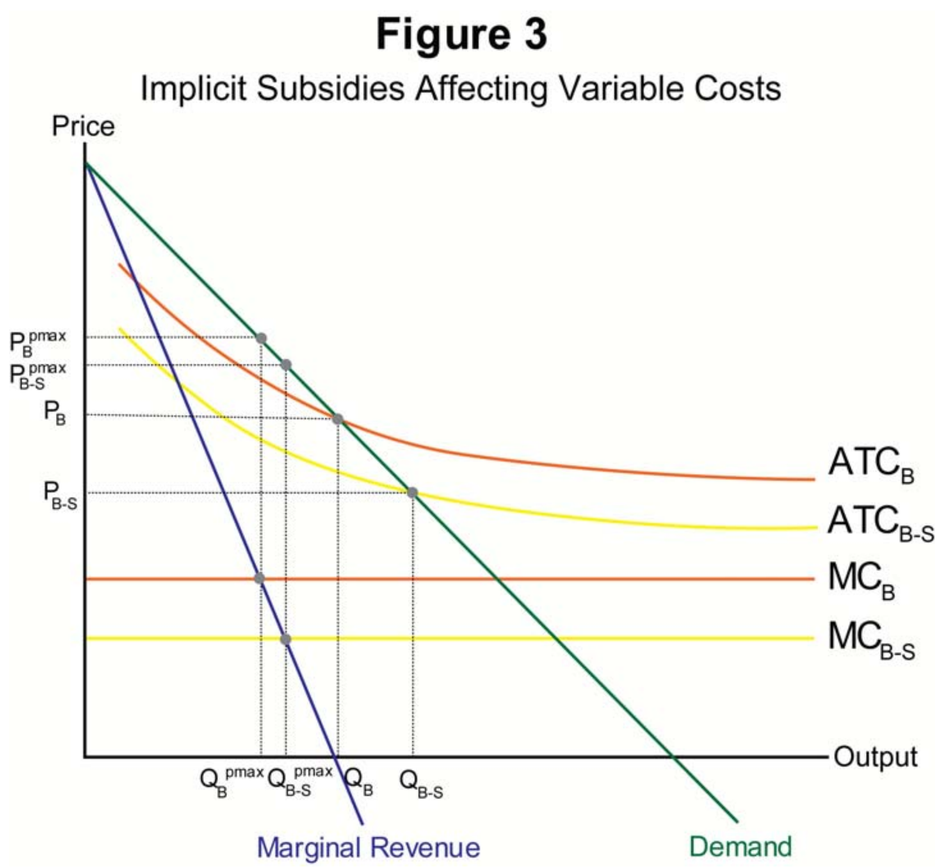
[291] *See* CARLTON & PERLOFF, *supra* note 290, at 12.

revenue floor, a decrease in variable costs will lower the revenue floor and thus lead it to lower price and expand output.

These scenarios are shown in Figure 3. The curves labeled MC_B, and ATC_B are the marginal cost and average total cost curves that include economic burdens associated with USPS's legal constraints from Figure 1. The curves labeled $MC_{B\text{-}S}$ and $ATC_{B\text{-}S}$ represent marginal and average total costs curves that include both the USPS's economic burdens and implicit subsidies. Under both the profit-maximizing and output-maximizing models, output is higher ($Q_{B\text{-}S}$ vs. Q_B and $Q_{B\text{-}S}^{pmax}$ vs. Q_B^{pmax}) and prices are lower ($P_{B\text{-}S}$ vs. P_B and $P_{B\text{-}S}^{pmax}$ vs. P_B^{pmax}) with implicit subsidies that reduce variable costs.



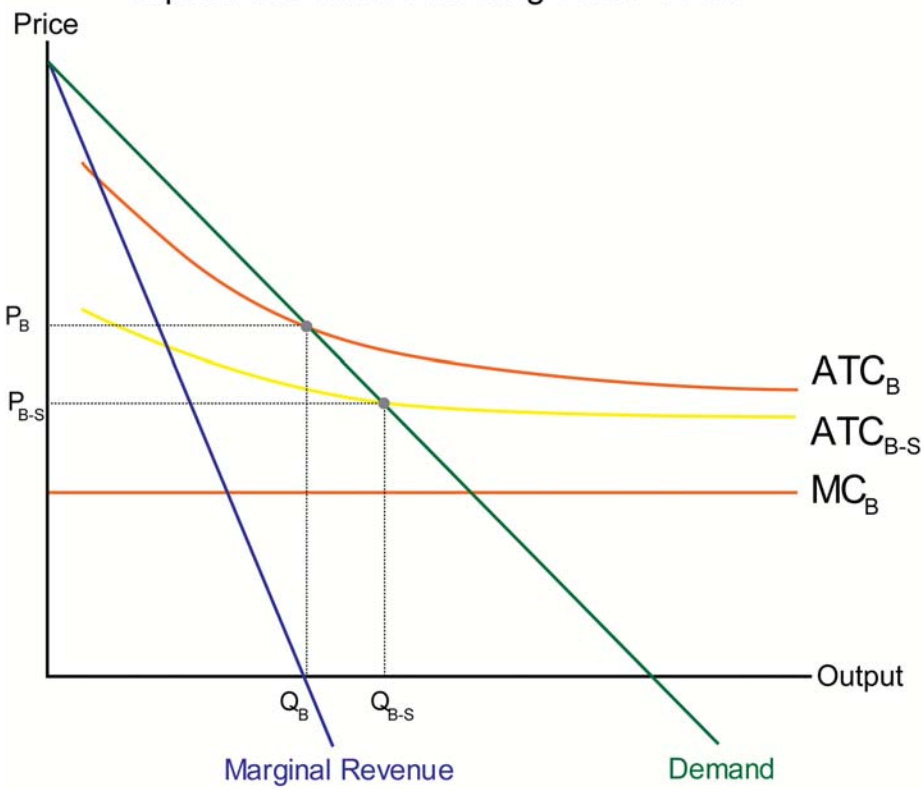
Some of the USPS's implicit subsidies are best characterized as avoided fixed costs (e.g., property taxes), which also could affect pricing and output decisions in some circumstances. As discussed in relation to costs associated with the USPS's legal constraints, a change in fixed costs could affect pricing decisions directly to the extent that the USPS sets prices based on average total costs rather than marginal costs. For example, as shown in Figure 4, if the USPS were to maximize output of competitive products subject to its revenue floor, a decrease in fixed costs will cause the ATC curve to shift downward (from ATC_B to $ATC_{B\text{-}S}$), leading to lower prices ($P_{B\text{-}S}$ vs. P_B) and higher output ($Q_{B\text{-}S}$ vs. Q_B).

Second, as discussed above costs that are fixed in the short run are variable in the long run, so that lower short-run fixed costs can affect long-run production and pricing decisions. And again, fixed costs also affect the long-run solvency of the Competitive Products Fund. That accounting for implicit subsidies results in low or negative competitive products income suggests that USPS participation in competitive markets may be greater than it otherwise would be without these subsidies.

In light of the above discussion, it is significant that although implicit subsidies may lead the USPS to charge lower prices (and hence sell more competitive products) than it otherwise might, to the extent that the USPS's economic burdens are greater than its implicit subsidies, prices will still be higher (and output lower) than they would if there were no legal constraints on the USPS's competitive products operations. Graphically, this means that $P_{B\text{-}S}$ and $P_{B\text{-}S}^{pmax}$ from Figures 3 and 4 likely lie above P_0 and P_0^{pmax} from Figures 1 and 2, and $Q_{B\text{-}S}$ and $Q_{B\text{-}S}^{pmax}$ from Figures 3 and 4 likely lie below Q_0 and Q_0^{pmax} from Figures 1 and 2. Nevertheless, the artificially low prices that are likely to result from the USPS's implicit subsidies mask from consumers the USPS's true costs of providing competitive products and, consequently, lead consumers to purchase more competitive products from the USPS than they otherwise would. This diversion of sales crowds out production by lower-cost private competitors. As a result, more of society's scarce resources are devoted to supplying the current volume of competitive mail products than is necessary.[292] For this reason, requiring the USPS to account for its implicit

Figure 4

Implicit Subsidies Affecting Fixed Costs



[292]One commenter suggested two additional inefficiencies attendant to subsidizing competitive products: (1) subsidization to generate additional revenue for market-dominant products limits the ability of citizens to judge whether the USPS's core service "provides good

subsidies is likely to enhance efficiency and consumer welfare by allowing consumers to base their marketplace decisions on the true cost of the USPS's competitive products.

In its comments, the USPS argues against requiring it to account for its implicit subsidies because, in its view, its federal governmental status provides at least as many economic disadvantages as economic advantages. Specifically, the Postal Service writes:

> The Postal Service does not believe that requiring the operations of the Competitive Products Fund to account for costs avoided by exemption from state and local law can be justified as a slate-balancing policy, at the same time that federal laws also: tightly bind the operations of that Fund within its historical market; require it for social policy reasons to follow high-cost, model employer policies not applicable to the competition; constrain its management of the size and location of its networks; impose multiple layers of transparency and oversight controls on top of those applicable to corporate disclosure; and generally require it to behave like the federal institution that it is. The question does not ask whether private competitors should be required to account for costs avoided by their exemptions from the federal laws listed in answer to Question 2 [of the FTC's federal register notice]. But the contrast from flipping the question to the other side can be illuminating in evaluating how balanced the slate is.[293]

This argument, however, misconstrues the concept of economic efficiency; as noted above, economic efficiency is advanced when decision-makers weigh all of the benefits of a decision against all of its costs.[294] Thus, requiring the USPS to factor in the cost of implicit subsidies leads to decisions that are more efficient from an economic standpoint.

Whether the USPS enjoys a net economic advantage or disadvantage by virtue of its unique status ultimately is irrelevant to the issue of efficient allocation of resources in the economy as a whole. It may be the case that the USPS's burdens are greater than its benefits so that it is disadvantaged relative to its private competitors. Nevertheless, the USPS must consider

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value for the money;" and (2) subsidization may help to perpetuate high labor costs: "if arbitrators base their decisions in part on how much they think the Service can afford, some of the money the Service does not pay in state and local taxes may be transformed into higher wages and benefits when they make their awards." *See* IRET, *supra* note 242, at 36.

[293] USPS, Comment 18, at 23.

[294] *See* William J. Baumol & J. Gregory Sidak, *Pricing of Inputs Sold to Competitors*, 11 YALE J. ON REG. 171, 178 (1994) ("A critical requirement for economic efficiency is that the price of any product be no lower than that product's marginal cost or its average incremental costs."); *see also* WILLIAM J. BAUMOL & ALAN S. BLINDER, ECONOMICS: PRINCIPLES AND POLICY 534 (2d ed. 1982); PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 130-31, (14th ed. 1992).

both actual costs and the value of its implicit subsidies for pricing and production decisions to be based on the actual costs society incurs when the USPS provides competitive products. As one commenter noted with respect to the argument that the USPS not be required to account for the value of its implicit subsidies due to the burdens imposed on it by Congress:

> [T]he Postal Service's special advantages and disadvantages in competitive markets both cause problems. If one looks only at the Postal Service's bottom line, the advantages, which lower the government enterprise's costs, and the disadvantages, which raise its costs, have partially offsetting effects. It might almost seem as though the two sides partially counterbalance each other, as though two wrongs make a right.
>
> From the perspective of the broader economy, however, the advantages and disadvantages rarely cancel out. In general, the advantages create distortions and the disadvantages cause additional distortions. In other words, the advantages do not correct the inefficiencies and higher costs caused by the burdens. Instead, the advantages generally take the form of transfers from others in the economy and act as indirect government subsidies that cover up some of the financial problems due to the Service's burdens.[295]

If the USPS were required to account for the value of its implicit subsidies, but also allowed to offset some of the costs imposed on it by the federal government, its marketplace decisions would still remain inefficient from an economic standpoint. The USPS must fund the additional costs that the federal government imposes on it in some manner. Examining the alternative means for funding these additional costs brings the issue into greater focus. If the USPS were to fund its actual costs with higher prices for market-dominant products, then there is a double misallocation of resources: competitive products sell for prices that are below cost, while market-dominant products sell for prices that are above cost.[296] Similarly, if the USPS were to fund its actual costs with a general subsidy, the price for competitive products would still be below costs, and taxes would be used to cover the subsidy.

According to the PRC, competitive products contributed 5.4 and 5.7 percent to the USPS's institutional costs in FY 2005 and FY 2006, respectively.[297] As discussed above, under the PAEA and relevant PRC regulations, going forward, the USPS will be required to pay for 5.5 percent of the USPS's institutional costs and to transfer the equivalent of federal income tax to the Postal Service Fund. Revenue from competitive products helps the USPS meet its universal

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[295] IRET, *supra* note 242, at 2.

[296] *See* VISCUSI, *supra* note 245, at 567-68; WILLIAM J BAUMOL, JOHN C. PANZAR & ROBERT D. WILLIG, CONTESTABLE MARKETS & THE THEORY OF INDUSTRY STRUCTURE 348 (1982).

[297] *See* PRC, Order No. 26, *supra* note 20, at 50,765; *see also* ADVO, Comment 11, at 4 (priority mail and express mail alone contributed $2 billion to institutional costs in 2006).

service obligation and stay within its price cap for market-dominant products, which reduces the burden on customers of market-dominant products. Several commenters expressed concern that requiring the USPS to account for its implicit subsidies may reduce or eliminate this contribution, resulting in upward pricing pressure for market-dominant products as these products would be left to generate sufficient revenue to assure universal service on their own.[298]

Although Congress has identified universal mail service in its current form (which includes uniform pricing and service standards) as an important social good, relying on the sale of subsidized competitive products may not be the most efficient way to generate revenue to support universal service. Subsidizing competitive products and restricting private carriers' abilities to compete via the postal and mailbox monopolies distort competition; subsidies artificially reduce the USPS's costs of supplying competitive products and the postal and mailbox monopolies artificially increase the costs of the USPS's competitors. In competitive markets, prices convey information about relative costs and consumer preferences and coordinate efficient consumer and producer decisions.[299] Interference with normal market forces results in price signals in the market for competitive mail products that convey the wrong information about relative scarcities. This false information causes consumers to make inefficient marketplace decisions, which reduces their welfare.[300]

There may be more efficient ways to assure universal service than to distort competition through the subsidized sale of competitive products. For example, Congress could fund unprofitable routes directly through general revenues.[301] Further, the USPS could contract for

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[298]*See* APWU, Comment 1, at 1-2 ("failure of the USPS competitive products will at once remove the contributions those products now make to the USPS, thus making it more difficult for it to provide universal postal services to the American Public"); Mailers Council, Comment 12, at 1 ("Without the revenue received from competitive products the price of postage for market dominant products would be much higher."); ADVO, Comment 11, at 3 ("The competitive products, if successful in the marketplace, will provide a contribution to total institutional costs that will reduce the rate burden on market-dominant products."); *id.* at 4 (stating that if the USPS were unable to compete in the competitive products market, it would be forced either to cut costs or raise rates for market-dominant customers and, "mailers in the market-dominant category would end up paying for those costs one way or another – either through reduced service and/or increased rates").

[299]*See* Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, *The Vital Role of Truthful Information in the Marketplace*, Roy H. Park Lecture, University of North Carolina School of Journalism and Mass Communication, at 5 (Oct. 11, 2007), *at* http://www.ftc.gov/speeches/majoras/071011UNCSpeech_DK.pdf.

[300]*See id.* at 7.

[301]Providing direct subsidies to the USPS to serve unprofitable routes, however, may reduce incentives for the USPS to reduce costs on these routes. *See, e.g.*, CREW &

delivery on high-cost routes, which could reduce the cost of universal service.[302] Another related option would be to auction the right to provide high-cost routes and counter service to private suppliers.[303] This sort of franchising could lead to pricing equal to the average cost of the most efficient producer, and in the case where a route would still be unprofitable at the uniform price even for the most efficient producer, this type of bidding would act to minimize the subsidy associated with universal service. These options have the potential to finance universal service at a lower cost to society than generating revenue with subsidized competitive products because they would not distort price signals in the market for competitive products. It is also important to note that the cost of universal service may be sensitive to its requirements. For example, some PRC economists have estimated that reducing delivery frequency for unprofitable routes would likely result in substantial savings.[304] Further, because consumers enjoy far more communications alternatives than they once did and advertising represents an ever-increasing share of mail, fewer deliveries may not pose a large cost to residential customers.[305]

Finally, it is important to note that if Congress were to act to reduce the USPS's economic burdens, it is likely that the USPS costs for competitive products would fall even after accounting for implicit subsidies. This action likely would allow the USPS to reduce the price it charges for competitive products, making it a more effective competitor. For example, assuming that the USPS's subsidies and burdens associated with competitive products are allocated evenly across total competitive products volume, the implicit subsidies that we have estimated result in a \$.02-\$.07 reduction in cost per piece of competitive mail, whereas the economic burdens associated with competitive products result in an estimated \$.19-\$.46 increase in per piece

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KLEINDORFER, POLICIES, *supra* note 248, at 14. For an alternative to direct funding of the USPS, *see* J. GREGORY SIDAK & DANIEL F. SPULBER, PROTECTING COMPETITION FROM THE POSTAL MONOPOLY 155-56 (1996) (suggesting direct subsidies to customers on unprofitable routes to allow them to pay for mail service that covers costs).

[302]*See supra* notes 201-202 and accompanying text.

[303]*See*, *e.g.*, CREW & KLEINDORFER, POLICIES, *supra* note 248, at 31-32; Geddes, *supra* note 36, at 224; Andrei Shleifer, *State versus Private Ownership*, 12 J. ECON. PERSPECTIVES 133, 136 (1998). Under this scheme, the franchise to provide the specified service would be awarded to the bidder offering to charge the lowest price. Assuming sufficient competition from efficient producers at the bidding stage, the price charged for the service will be equal to the average total cost of the lowest-cost producer. For a general appraisal of franchise bidding *see* Viscusi et al., *supra* note 245, at 464-500.

[304]*See* Robert Cohen et al., *The Cost of Universal Service in the U.S. and its Impact on Competition*, at 9-10 (2002), *available at* http://www.prc.gov/tsp/114/cost_of_universal_service.pdf; Robert H. Cohen et al., *supra* note 66.

[305]*See* Geddes, *supra* note 36, at 224-25; Cohen et al.(2002), *supra* note 304, at 10.

costs.[306] If the PRC were to require the USPS to account for it implicit subsidies *and* Congress relaxed the legal constraints on the USPS's competitive products operations, costs could *fall* by $.11-$.44 per piece, likely allowing the USPS to charge *lower* prices for competitive products.

D. Competition Issues Related to Accounting for the USPS's Implicit Subsidies

If the Postal Service is required to increase its prices for competitive products, it would likely experience a decline in market share. The extent of this decline depends on the elasticity of demand it faces for each product. In the most recent comprehensive rate case (2006), one witness provided estimates of demand elasticities for several of the Postal Service's products.[307] Table 7 provides a sample.

Table 7

Estimated Demand Elasticities for a Sample of Postal Products

Product	Estimated Elasticity
First-Class Single-Piece Letters	-0.18
First-Class Workshare Letters	-0.13
Priority Mail	-1.02
Express Mail	-1.64
Non-Destination Entry Parcel Post	-0.37
Destination-Entry Parcel Post Parcel Post	-1.40

[306] This calculation is based on FY 2006 competitive products volume of 1.71 billion pieces as derived from USPS data and includes the following categories: Priority Mail, Express Mail, Parcel Post, International Parcel Post (economy and airmail), International Express Mail, International Surface Airlift Mail, and International Priority Mail. *See* USPS, REVENUE, PIECES & WEIGHT REPORT, FY 2006, *available at* http://www.usps.com/financials/_pdf/Fy2006_RPWsummaryreport.pdf.

[307] *See* Postal Rate and Fee Changes, 2006: Docket No. R2006-1, the testimony of Thomas Thress (on behalf of the Postal Service), at 37 (2006).

These estimates indicate that, for instance, a 10 percent increase in the price of Priority Mail would cause volume to fall by 10.2 percent.[308] By contrast, the Postal Service's letter monopoly causes its demand to be much less elastic: a 10 percent increase in the price of both single-piece and workshare First-Class Mail letters would cause volume to fall by just 1.5 percent (the midpoint between demand elasticities for single-piece and workshare letters). Of the estimates that are available, Express Mail is the competitive product for which demand is most elastic.

One concern that some have voiced is that if the USPS is required to take account of its implicit subsidies when setting prices, competition in the competitive products industry would suffer because the USPS would provide less of a constraint on the pricing decisions of its private competitors.[309] Exit by the Postal Service would leave only three significant players, and the FTC is sympathetic to concerns that weakening one competitor in a market with few incumbent firms may have an adverse effect on competition.[310] There are major drawbacks, however, to having the government subsidize a competitor. First, the government may lack the knowledge and the skill to determine the appropriate subsidy. Second, the subsidy is likely to erode the recipient's incentive to compete: protected from market forces by the subsidy, the recipient may grow complacent. Third, the possibility of earning economic profits motivates firms to develop new products. If the government regularly subsidizes a competitor to constrain market prices, and thus profits, it would reduce the incentive to develop new products or otherwise innovate.

If market conditions were to lead the USPS to exit the competitive products market, any competition concerns could be reduced if the assets associated with competitive products were sold to an appropriate market participant. In this manner, USPS assets would not exit the market entirely, but merely be operated by a carrier that does not have the same constraints on its

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[308] Again, however, if competitive neutrality is implemented all else would not be equal. As the prices of all competitive products increased, the actual decline in volume for a single product would be less than these elasticity estimates reflect, to the extent that some postal products are substitutes for each other.

[309] *See* PSA, Comment 16, at 10; ADVO, Comment 11, at 5-6; APWU, Comment 1, at 1-2.

[310] If three firms were insufficient to guarantee competition and if entry by new firms did not occur, then one might argue against requiring the USPS to account for its subsidies because a subsidized Postal Service might play some role in constraining pricing in this industry. For example, after World War II, the U.S. government sold aluminum plants that had been federally-financed at a discount to Reynolds Aluminum and Kaiser Aluminum in order to promote competition in the aluminum market. *See* GEORGE DAVID SMITH, FROM MONOPOLY TO COMPETITION: THE TRANSFORMATIONS OF ALCOA: 1888-1986 (1988). An argument for subsidizing the Postal Service to restrain any market power that Federal Express or UPS may have would be similar to the argument that formed the basis for the decision to subsidize Reynolds Aluminum and Kaiser Aluminum. *See also* John McMillan, *Market Design: The Policy Uses of Theory*, 93 AER PAPERS AND PROCEEDINGS 139, 141 (2003).

operations.[311] Further, relaxation of the postal monopoly likely would encourage new entry or expansion by existing firms to provide competitive products to customers formerly served by the USPS by allowing these firms to enjoy scope economies. For example, if rural customers rely primarily on the USPS for competitive products because they lack many private alternatives, allowing a private carrier to deliver a greater breadth of products would increase their incentives to serve these high-cost populations. Finally, the PAEA retained single-piece parcel as a market-dominant product, so even those consumers who rely on the USPS for parcel shipping will retain at least one option.[312]

Although price increases may cause harm to the individual customers who purchase these products, to the extent they better align the Postal Service's prices with its costs it should lead to an increase in overall economic efficiency. Price increases would likely drive many Postal Service customers to its competitors with equal quality and innovativeness. All else being equal, this substitution would only occur if the competitors' prices lie below the Postal Service's new cost-based prices. Lacking any reason to believe that these competitors would set prices below their own costs, we can infer that the competitors' costs lie below those of the Postal Service. A more efficient allocation of resources necessarily emerges when customers are diverted from high- to low-cost providers.

Experiences of other federal agencies indicates a possibility that requiring the USPS to account for its implicit subsidies may make it a more efficient competitor.[313] Although viewpoints differ on the ultimate effects, the Federal Reserve's experience in fulfilling the requirements of the Monetary Control Act of 1980 (MCA) provides some perspective on the implementation of competitive neutrality principles. Among other things, the MCA required the Federal Reserve to more fully account for its costs – including costs it would incur if it were a private firm instead of a federal entity – in pricing certain inter-bank services (such as check clearing) where it competed with private firms. The Fed appears to have reduced its costs, but some observers express uncertainty over whether this decline was due to the elimination of diseconomies of scale, actual productivity enhancements brought on by competition from the private sector, or a reallocation of costs to less competitive services.[314] A more recent study finds small efficiency improvements in the early 1980s but more substantial improvements

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[311]However, separating USPS assets associated with competitive from those used to produce market-dominant products may be difficult in practice. *See infra* Chapter V.E.

[312]39 U.S.C. § 3621.

[313]In fact, some foreign postal services have become substantially more efficient after restructuring. *See* USPS, UNITED STATES POSTAL SERVICE 2002 TRANSFORMATION PLAN, App. H (2002) [hereinafter "USPS 2002 Transformation Plan"].

[314]*See* Ken S. Cavalluzzo, Christopher D. Ittner & David F. Larcker, *Competition, Efficiency, and Cost Allocation in Government Agencies: Evidence on the Federal Reserve System*, 36 J. ACCOUNTING RES. 1 (1998).

during the 1990s.[315] Further, as discussed in the previous section, if Congress were to take action to reduce the USPS's legal constraints, it is likely that even after accounting for its implicit subsidies, it would enjoy lower costs. These lower costs likely would translate into lower prices for the reasons discussed above, and given the estimated demand elasticities for competitive products, also translate into increased revenue.

[315] *See* Alton R. Gilbert, David C. Wheelock, & Paul W. Wilson, *New evidence on the Fed's Productivity in Providing Payments Services*, 28 J. BANKING AND FINANCE 2175 (2004).

CHAPTER V

ELIMINATING LEGAL DIFFERENCES

The PAEA asks the FTC to provide any guidance it believes appropriate to bring the legal differences between the USPS and its private competitors to an end. Possible approaches for permanently eliminating these legal differences include Congressional action to relax the USPS's legal and political constraints, requiring the USPS to account for its economic advantages in its cost structure, relaxation of the postal and mailbox monopolies, and some form of corporatization of the USPS. Below, we examine various approaches to eliminate the legal differences between the USPS and its private competitors, and offer more guidance.

A. Relaxing Legal and Political Constraints on USPS Operations

As discussed in Chapter II.B., the USPS is subject to various unique legal and political constraints that historically have limited its ability to compete. Accordingly, Congressional reform, especially in the area of employee pay and benefits, likely would make the USPS a more effective competitor. In this regard, the President's Commission on the United States Postal Service made several recommended legal changes to improve the USPS's ability to control labor costs: bringing health and retirement benefits into the collective bargaining process;[316] revising the existing statutory definition of comparable pay (39 U.S.C. § 101(c)) to consider a total benefits package;[317] making comparable pay a ceiling in collective bargaining;[318] revising the current statutory language that effectively freezes minimum fringe benefits at levels in existence in 1971;[319] amending statutory language to require future postal employees to be subject to normal federal employee Reduction-In-Force rules, rather than negotiated "no-layoff" provisions;[320] and repealing the statutory cap on top pay for USPS executives.[321]

With regard to increasing USPS's flexibility to manage its network, in its 2002 Transformation Plan the USPS urged Congress "to repeal administrative notice and appeal procedures mandated for closing post offices or replace them with more flexible procedures" and asked "Congress to refrain from adding amendments to annual Postal Service appropriations

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[316]*See* PRES. COMM'N REP., *supra* note 197, at 120.

[317]*Id.* at 119.

[318]*Id.* at 132. *See also* USPS 2002 TRANSFORMATION PLAN, *supra* note 313, at 53.

[319]PRES. COMM'N REP., *supra* note 197, at 120.

[320]*Id.* at 121. Three Commissioners did not agree with this recommendation.

[321]*Id.* at 132. The Presidential Commission notes that this would be similar to executive pay programs in place at TVA and the Federal Reserve.

bills that discourage post office closings and freeze service levels at the 1983 level."[322] The President's Commission has echoed this sentiment: "Existing statutes limiting the Postal Service's flexibility with regard to the closing and disposition of post offices should be repealed and similar provisions in annual appropriation acts should be avoided."[323] The President's Commission also advocated the creation of a Postal Network Optimization Commission "to make recommendations relating to the consolidation and rationalization of the Postal Service mail processing and distribution infrastructure."[324] The Presidential Commission further recommended granting the USPS more freedom to provide postal services outside of post offices and to close retail branches that are not necessary to provide universal service.[325]

The experience of foreign postal operators suggests that the Postal Service may realize large gains in efficiency if Congress gave it greater scope to restructure its retail and delivery network. Postal restructuring in Germany, which entailed the consolidation of numerous sorting centers and the closure of roughly 45 percent of existing post offices, led to a significant improvement in service (e.g., the speed of letter delivery). Moreover, Deutsche Post was able to attain these efficiency improvements without laying off workers. Postal restructuring in New Zealand, which involved the closure of one-third of existing post offices, led to a doubling of labor productivity, a 30 percent reduction in costs, an almost 30 percent reduction in the real price of letter postage, and a 30 percent increase in mail volume. As with Deutsche Post, New Zealand Post attained these efficiency gains with minimal labor disruptions.[326] In addition, these gains occurred along with continued provision of universal service in both countries.[327] Of course, any benefits in terms of efficiency gains by the USPS would have to be weighed against consumer losses in terms of the ability to access the postal network to purchase market-dominant products. If the USPS were to reduce the number of retail access points to reduce its costs, it may be able to reduce prices for both market-dominant and competitive products. However, some consumers of market-dominant products may suffer net welfare reductions if their costs to use market-dominant products rises substantially, for example if they must travel a significantly increased distance to mail letters or purchase stamps.

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[322]USPS 2002 TRANSFORMATION PLAN, *supra* note 313, at 52; *see also* PRES. COMM'N REP., *supra* note 197, at 80; ADVO, Comment 11, at 13. The USPS also has recognized the imperative to overhaul the postal network, has lifted its self-imposed moratorium on post office closures, and asked for the repeal or streamlining of restrictions and regulations on closing facilities. *See* USPS 2002 TRANSFORMATION PLAN, *supra* note 313, at v., 14, 51.

[323] PRES. COMM'N REP., *supra* note 197, at 103.

[324]*Id.*

[325]*Id.* at 81-82.

[326]*See* USPS 2002 TRANSFORMATION PLAN, *supra* note 313, at App. H.

[327]*See id.* at H-17, H-21.

With respect to restrictions on procurement, the Postal Service has suggested it should be allowed to follow the most effective commercial practices when contracting with suppliers. It suggests that the application of several federal statutes to the Postal Service should be reconsidered, including the Contract Disputes Act, the Davis Bacon Act, the Service Contract Act, and the Javits-Wagner-O'Day Act.[328] Instead, the USPS recommended, "Like other service providers, the postal enterprise should be subject to purchasing statutes and obligations applicable to commercial organizations, such as the Uniform Commercial Code, which deals with many forms of commercial transactions (contracts to buy and sell goods)."[329]
It also suggested reconsideration of those sections of Titles 39 and 49 of the United States Code that regulate transportation rates for the carriage of U.S. mail internationally.[330]

The USPS notes that although it is feasible to make legal changes to increase its flexibility with respect to competitive operations, as an administrative matter, "implementing such provisions would also have some cost and could reduce economies of scope."[331] Further, the USPS contends that the "public policy climate" is not favorable for substantial reforms in its competitive products operations: "The legal measures [that impose costs on the USPS] reflect judgments of fundamental legislative policy about how the federal government chooses to conduct postal operations in a democratic system as an employer and in service of the public interests."[332]

Conclusions:

- Congress may wish to consider taking steps to relax the legal and political constraints on the USPS if it is to be an effective participant in the competitive products market, especially with respect to managing its labor costs, which comprise nearly 80 percent of its total expenses. Further, Congress may wish to consider reducing the legal and political constraints that limit the USPS's flexibility to manage the configuration of its network by closing and consolidating processing centers and retail outlets when necessary. If consolidation of retail facilities were to provide a net disadvantage to some consumers, Congress may wish to consider reducing economic distortions by funding these retail outlets directly with lump-sum subsidies rather than requiring the USPS to finance their operation. Finally, Congress may wish to consider relaxing the application of procurement statutes to the USPS to provide it greater flexibility in contracting with the private sector.

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[328]*Id.* at 72.

[329]*Id.*

[330]*Id.* at App. 27.

[331]USPS, Comment 18, at 21.

[332]*Id.* at 21.

B. Competitive Neutrality

Assuming the USPS will remain a governmental entity with postal and mailbox monopolies, the PRC and Congress may wish to consider taking action to neutralize the effect of the USPS's implicit subsidies by requiring the USPS to account for them when calculating its costs. Because the PAEA requires competitive products to cover their attributable costs plus a share of institutional costs, competitive neutrality will force USPS prices for competitive products to reflect these subsidies and advantages. Competitive neutrality promotes economic efficiency by ensuring that the USPS, like its private competitors, is required to account for all relevant costs when making pricing and production decisions.[333]

There are two broad approaches to implementing competitive neutrality with respect to differences arising from the USPS's status as a federal government entity. Under an implicit approach, the USPS's legal status would remain unchanged, but it would be required to account for the value of its economic advantages. Accounting for these advantages implicitly could involve actual payments to state and local authorities, the Postal Service Fund, or to the Treasury, or it may merely require a bookkeeping entry. A second approach is explicitly to subject the USPS to the same legal requirements that apply to its private competitors. We examine both approaches to competitive neutrality.

1. Implicit Approach

One approach to neutralizing the USPS's advantages due to its U.S. governmental status would be to require the USPS to impute the value of its subsidies in cost calculations.[334] Under this implicit approach to competitive neutrality, the USPS would have to estimate the cost of the legal obligations from which it is exempt and account for these costs when making pricing and production decisions. For example, the USPS would have to price its competitive products based not only on actual costs it incurs (incremental costs plus 5.5 percent of institutional costs),

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[333]For discussions of why accounting for all relevant costs improves efficiency, see BAUMOL & BLINDER, *supra* note 294, at 534.

[334]The implicit approach to competitive neutrality has the advantage that it is likely to require only minimal revisions of the USPS's statutes. It appears that in the PAEA the Congress gave the PRC the power to require the USPS to account for legal differences when setting prices. Because Congress intended the PRC to utilize the FTC's report when promulgating rules to govern rate making for competitive products under 39 U.S.C. § 3633, *see* PAEA § 703(b), it is reasonable to assume that Congress also intended the PRC to have the authority to require the USPS to take implicit subsidies into account when setting rates for competitive products. Implicitly accounting for the subsidies by appropriately increasing price would eliminate any inefficiencies relating to pricing. Further, PRC rules pursuant to 39 U.S.C. § 3633 prevent the USPS from participating in any markets in which it does not cover attributable costs and a share of institutional costs.

but also estimated state and local taxes, parking tickets, and the difference between Treasury and commercial debt costs, among other costs. These payments could be made to the Postal Service Fund, the U.S. Treasury, or directly to the local jurisdictions. Alternatively, rather than the USPS actually making payments for these costs, the PRC could merely require that the USPS account for these costs when making pricing and production decisions. For example, the Federal Reserve System applies this form of competitive neutrality to services that it provides in competition with private banks by calculating a "private sector adjustment factor," which it uses to construct a *pro forma* balance sheet for competitive products.[335]

Under an implicit approach, the value of the USPS's advantages must be estimated. The extent to which the estimated subsidy values vary from actual values will distort competition by resulting in USPS costs that are either too high or too low compared to what they would be if the USPS were a private firm. Further, it is likely to be costly to estimate the USPS's implicit subsidies in a regulatory environment, both in terms of PRC staff time and legal costs incurred by interested parties.

Rather than trying to estimate actual state and local burdens with precision on a regular basis, an alternative approach would be for the PRC to require the USPS to pay a certain percentage of its competitive products revenue to various state and local governments as a proxy for payments that it otherwise avoids. For example, the Tennessee Valley Authority (TVA) is exempt from paying federal income taxes and state and local taxes but must pay certain states and counties an amount in lieu of taxes equal to five percent of TVA's gross revenues from the sale of power during the preceding year excluding sales or deliveries to other federal agencies and exchange sales with other utilities, with a provision for minimum payments under certain circumstances.[336] This scheme would be more difficult to implement in the context of the USPS, however, given the geographical scope of its operations compared to those of the TVA.

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[335] *See* Methodology to be Employed in Determining the Railroad Industry's Cost of Capital (Ex Parte 664): Testimony Before the Surface Transportation Board, at 14 (2007) (Statement of Gregory L. Evans, Assistant Director, Division of Reserve bank Operations and Payment Systems, Board of Governors of the Federal Reserve System). Section 11A(c)3 of the Federal Reserve Act states:

> Over the long run, fees shall be established on the basis of all direct and indirect costs actually incurred in providing the Federal Reserve services priced, including interest on items credited prior to actual collection, overhead, and *an allocation of imputed costs which takes into account the taxes that would have been paid and the return on capital that would have been provided had the services been furnished by a private business firm*, except that the pricing principles shall give due regard to competitive factors and the provision of an adequate level of such services nationwide." (Emphasis added)

[336]The TVA made $376 million in tax-equivalent payments to Valley states and counties in the fiscal year ending September 30, 2006. TENNESSEE VALLEY AUTHORITY, 2006 ANNUAL REPORT.

Alternatively, this proxy payment could take the form of a *pro forma* adjustment factor that would force prices to reflect true costs.

Assuming that both the postal and mailbox monopolies will exist, competitive neutrality also would require the USPS to account for these advantages implicitly when setting its prices for competitive products. As discussed above, the PRC has promulgated rules that require the USPS's competitive products collectively to cover 5.5 percent of the USPS's institutional costs. To the extent that these institutional costs represent shared networks costs, the PRC already has made a determination that the USPS's competitive products should pay to use networks developed to carry products covered by the postal monopoly. Although the FTC received no estimates of the actual costs borne by private express carriers due to mailbox restrictions, each reported that they were substantial. To implement competitive neutrality, the PRC could estimate the value of this subsidy with input from the USPS and its private competitors and require the USPS to take it into account when setting prices.

2. Explicit Approach

Congress may wish to consider taking action to make the USPS subject to the same state, local, and federal legal requirements as its private competitors. For example, Congress could amend federal law so that the USPS actually would pay relevant taxes, vehicle licensing and registration fees, and parking tickets to local and state jurisdictions. Further, it may wish to require the USPS to borrow in commercial markets rather than at preferential Federal Financing Bank rates. This explicit approach, moreover, would require Congress to change the laws so that the USPS would be subject to suit in the same manner as private firms and would strip the USPS's ability to use eminent domain. Further, Congress would have to require the USPS to use private debt markets and also eliminate other USPS advantages discussed in Chapter II, such as free spectrum and homeland security subsidies and exemptions.

An explicit approach likely would require Congress to make changes to the federal law governing the USPS. Further, it would impose costs on the USPS to comply with various new federal, state, and local legal requirements.[337] This approach, however, has the advantage of producing actual costs rather than potentially inaccurate estimates, and it eliminates the concomitant regulatory burdens that likely would be associated with arriving at such an estimate. For example, rather than requiring PRC staff to estimate – in a regulatory proceeding that will involve input from numerous interested parties – the property tax due on the 8,437 postal facilities that it owns and its 216,004-vehicle fleet,[338] an explicit approach would place the burden on local governments to levy actual bills. The explicit approach would work similarly

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[337]For example, one commenter noted that a 1992 survey of large Fortune 500 companies found that state income tax compliance costs averaged $633,000. *See* IRET, *supra* note 242, at 38.

[338]*See* USPS 2006 ANN. REP., *supra* note 37, at 22-23.

for other state and local legal requirements, such as registration and licensing fees and parking tickets.

If the USPS were required to pay property taxes, however, it would be important to guard against discriminatory taxation. Local taxing authorities have discretion in making property value assessments and thus could take advantage of the fact that the USPS's assets are very immobile.[339] As discussed earlier, it would be very difficult for the USPS to relocate postal facilities in response to high tax rates.

Although the efficiency effects of competitive neutrality are the same whether the USPS implicitly or explicitly accounts for subsidies, only when the USPS makes these payments directly to state and local governments are the distributional effects the same. When USPS business activity is excluded from the tax base, state and local governments must either raise taxes on the remaining tax payers or reduce services.[340] To the extent that the USPS makes payments directly to state and local governments, tax burdens are distributed more equitably. Further, in a general equilibrium sense, these distributional effects may have some effect on efficiency.[341]

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[339]When an enterprise with a monopoly franchise is required to maintain offices in a jurisdiction and not all of the entity's revenues come from residence in that jurisdiction, there is an incentive for the jurisdiction to shift tax liability to that entity because non-residents will bear some of the tax burdens. In contrast, when the enterprise faces competition from entities that do not face the same taxes in a jurisdiction, the jurisdiction loses the ability, in the long run, to shift tax burden to non-residents. *See, e.g.*, Pennsylvania Dep't of Revenue, *Electricity Generation Customer Choice and Competition*, at 6 (Aug. 1, 2000), *available at* http://www.revenue.state.pa.us/revenue/lib/revenue/2000_electricrpt.pdf ("Under a competitive generation market, a producer of power may have no physical presence in Pennsylvania, and may sell electricity to Pennsylvania consumers through intermediaries. As a result, out-of-state generators may escape taxation in Pennsylvania due to the lack of nexus. If only Pennsylvania-based electricity generators are subject to GRT [gross receipts tax], they would have a 4.4% (due to the 44 mill GRT rate) price disadvantage compared to out-of-state generators. Such a price differential would have the potential to drive generation facilities out of the state over time, as many consumers select lower-cost electricity suppliers. The same issue affects other state taxes as well.").

[340]*See* IRET, *supra* note 242, at 36.

[341]For instance, if the Postal Service does not pay state and local taxes, states and localities will have to increase taxes on others (including Federal Express and UPS). These higher taxes will further distort competition between the USPS and its private competitors.

Conclusions:

- Congress and the PRC may wish to consider taking the steps necessary to implement a competitive neutrality program for the USPS's competitive products. Pricing and production decisions should be based on true, not subsidized, costs. The implicit subsidies that the USPS receives due to its status as a federal governmental entity and its postal and mailbox monopolies mask from consumers the USPS's true costs of providing competitive services. Under the PAEA (and the PRC's implementing regulations) the USPS's competitive products must cover their incremental costs and 5.5 percent of institutional costs. Our estimates suggest that if the USPS accounts for these implicit subsidies, however, its net income for competitive products may be negative. Thus, the current practice of not requiring the USPS to account for these implicit subsidies is likely leading the USPS to charge artificially low prices for its competitive products. Accordingly, the USPS's current share of the competitive products industry likely is larger than it would be if its prices reflected true costs, which results in more of society's scarce resources being devoted to supply competitive mail products than is economically efficient. Competitive neutrality would help correct this misallocation of resources by assuring that USPS pricing is based on true costs. Further, there is reason to believe that requiring the USPS to take into account the costs associated with these legal differences may make it a more efficient competitor. Finally, although requiring the USPS to account for its implicit subsidies may reduce contributions toward providing universal service, contracting with private carriers may be a lower-cost method to provide universal service than to distort competition in the competitive products market.

- The PRC may wish to consider choosing an approach to competitive neutrality to account for the USPS's advantages that minimizes the sum of costs due to inaccurate estimates of the USPS's implicit subsidies and costs to implement the program. An explicit approach is likely best for subsidies that would be costly to estimate with accuracy, such as state and local taxes and licensing requirements. Although an explicit approach would impose costs on the USPS to comply with various state and local laws, its private competitors already incur these compliance costs. An implicit approach may be preferable to account for preferential borrowing rates, which may be relatively less difficult to estimate and may require extensive legislative and regulatory action to manage in an explicit manner. Further, accounting for any advantages that exist due to the postal and mailbox monopolies must be handled with an implicit approach as long as they remain in place. The USPS should endeavor to attribute the costs associated with its implicit subsidies to either competitive or market-dominant products to the fullest extent possible, rather than included as institutional costs. PAEA requirements may make allocation of these avoided costs between market-dominant and competitive products less daunting than it would appear at first blush. First, the PAEA requires the USPS to pay an equivalent of federal income taxes on revenues earned on its competitive products. The PAEA also requires the Department of Treasury to develop recommendations for the PRC to identify and value USPS assets associated with providing competitive products.[342] Thus, the USPS will have a methodology available to assign taxes and fees based on specific assets belonging to competitive products.

- Congress and the PRC may wish to consider implementing competitive neutrality in a way that is not contingent on action to relax the legal and political constraints on the USPS's operations. Whether the USPS enjoys a net economic advantage or disadvantage by virtue of its unique status is not fundamental to the issue of efficient allocation of resources in the greater economy. It may be the case that the USPS's burdens are greater than its benefits so that it is disadvantaged relative to its private competitors. Nevertheless, for pricing and production decisions to be based on the actual costs society incurs when the USPS provides competitive products, the USPS should account for: (1) its actual costs; and (2) the costs USPS imposes on society and that private competitors pay, but that it avoids by virtue of its unique status.

C. Modification of the Mailbox Monopoly

Modifying the mailbox monopoly to allow consumers to choose to permit private express companies to leave deliveries in their mailboxes would eliminate an important legal constraint on the USPS's competitors. As discussed in Chapter III, the mailbox monopoly imposes costs on the USPS's competitors to deliver a subset of competitive products to the majority of U.S. mailboxes that the USPS does not bear. Although we lack data to determine the exact proportion of competitive products that private express carriers could deliver to mailboxes absent the mailbox monopoly, confidential data submitted to the FTC suggest that between 20 and 33 percent of competitive mail products delivered to consumers may fit into a mailbox. Further, UPS and Federal Express both contend that the mailbox monopoly increases their costs.[343] By increasing the cost and reducing the convenience of non-USPS carriage, the mailbox monopoly likely causes the USPS to become a relatively more attractive option for delivery.[344] In this manner, the mailbox monopoly effectively expands the postal monopoly beyond the scope defined by the PES. Indeed, preventing diversion of mail not otherwise covered by the PES

[342] 39 U.S.C. § 2011(h)(1)(A)(i)(I).

[343] *See* Federal Express, Comment 9, at 12 (noting that part of its residential surcharge represents the increased costs of making deliveries to the recipient's door step); UPS, Comment 19, at 14 ("The added labor costs for private companies to deliver, or in many cases re-deliver, to a residential door are quite large.").

[344] *See* Consumer Postal Council, Comment 6, at 1 ("The prohibition of private citizens and business from using mailboxes injects unnecessary nuisance, cost and inefficiency into simple acts of community communication. Invitations to children's birthday parties, notices about important neighborhood events, and circular coupons from local businesses must all incur the cost, delay, and risk of misdelivery associated with reliance on the U.S. Postal Service.").

from the USPS's network was the primary rationale behind Congress' creation of the mailbox monopoly in 1934.[345]

The mailbox rule also restricts consumers' use of their mailboxes, which they typically own. As one commenter notes, "Because consumers generally purchase their mailboxes at their own expense, it logically follows that they ought to have the right to dictate the terms under which their property is utilized."[346] A 1997 GAO survey found that 58 percent of consumers favored allowing express mail companies to place deliveries in their mailboxes, and a plurality (48 percent) of consumers favored allowing companies to leave items such as utility bills in their mailbox.[347] Thus, it appears that not only would relaxation of the mailbox monopoly enhance consumer choice, but a majority of consumers may favor it.[348]

It also appears that the United States is the only country that reserves the mailbox only for the deliveries from the postal service.[349] In a GAO survey of eight EU countries, none answered that lack of exclusive access to mailboxes caused a significant loss in postal revenue, and six reported either minor or no problems with mailbox theft.[350] GAO, however, noted that some of these countries have a higher proportion of door slot or locked mailboxes than does the U.S., and only one service reported that it generally collected mail from customers' mailboxes.[351]

The USPS has raised some valid concerns associated with relaxing the mailbox monopoly. For example, sorting outgoing stamped mail from non-stamped competitive products

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[345]*See supra* Chapter I.A.2.

[346]Consumer Postal Council, Comment 6, at 1.

[347]GAO MAILBOX REP., *supra* note 47, at 15-16.

[348]It is possible that today more than 58 percent of consumers would be comfortable with private express carriers being allowed to deliver to their mailboxes given the rise of e-commerce and the associated increase in these carriers' deliveries to consumers.

[349]*See* Geddes, *supra* note 36, at 219; UPS, Comment 19, at 14; Federal Express, Comment 9, at 11; *see also* GAO MAILBOX REP., *supra* note 47, at 10 (noting that neither Australia, Canada, France, Germany, The Netherlands, New Zealand, Sweden, nor the United Kingdom have mailbox access restrictions).

[350]GAO MAILBOX REP., *supra* note 47, at 29. Canada and New Zealand reported minor problems associated with mail theft or investigating mail theft. Only France reported multiple problems associated with lack of exclusive access to mailboxes. *Id.* at 29-30.

[351]*Id.* at 30.

that have been delivered by a private carrier may reduce letter carrier efficiency.[352] Further, the USPS explains that if a mailbox were full of non-USPS matter, the carrier delivering to a curbside box may have to leave his or her vehicle to deliver directly to the consumer's door, further reducing efficiency. The USPS notes that such reductions in efficiency may harm consumers by delaying delivery times. If consumers become dissatisfied with mail service to their mailbox (due to clutter or security concerns), moreover, it may reduce demand by mailers for USPS products, ultimately leading to a diversion of mail from the USPS's network to other competing forms of communication like the Internet.[353] To the extent that elimination of the mailbox rule diverts mail from the USPS's network, it would reduce revenue and may compromise universal service.[354]

The USPS also has expressed several significant concerns related to the enforcement of prohibitions on mail fraud, mail theft, mail obstruction, and other federal prohibitions on mailing obscene or hazardous materials.[355] The USPS has explained that elimination of the mailbox monopoly could make investigations into suspected violations of these criminal provisions more difficult by jeopardizing the use of surveillance and electronic devices to identify suspects. For example, the USPS notes that the identification of suspects is made more difficult if others than postal customers and the Postal Service have regular access to the mailbox. Similarly, the Justice Department noted in connection with the 1997 GAO report that "without the mailbox restriction it would be more difficult to identify and apprehend violators delivering [sexually explicit and obscene material] because almost anyone could legally open mailboxes and not be a suspect."[356] The Justice Department also told GAO, however, that these problems could be tempered somewhat if only large delivery companies had access to mailboxes.[357] Further, the USPS worries that repeal of the mailbox monopoly could make it more difficult to establish federal jurisdiction to protect postal customers from child pornography and mail fraud schemes

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[352]*See* USPS, Comment 18, at 5. This concern would be present, however, only in those instances in which a consumer has left outgoing mail for USPS collection and receives a competitive product prior to USPS collection. Further, separate compartments for incoming and outgoing mail could alleviate this concern.

[353]USPS Correspondence (Nov. 29, 2007).

[354]*See* discussion at notes 71-72, *supra*, on the rationale behind the mailbox rule; *see also* GAO MAILBOX REP., *supra* note 47, at 21-22.

[355]*See, e.g.*, 17 U.S.C. § 1702 (imposing criminal penalties on taking, opening or destroying a letter before it has been delivered to the intended person with design to "obstruct correspondence"); 17 U.S.C. § 1708 (imposing criminal penalties for theft or receipt of stolen mail).

[356]GAO MAILBOX REP., *supra* note 47, at 23.

[357]*Id.* at 24.

that are intrastate in nature.[358] The USPS also notes that relaxation of the mailbox monopoly could increase vulnerability to explosive materials and other non-mailable hazardous materials and firearms.[359]

The USPS also expressed concern related to allowing access to locked cluster boxes, explaining that it would be inappropriate to give keys "to any and all who claim that they need access to locked boxes."[360] Further, within a given cluster box unit, even if some customers granted private carriers access to their box, others within the same cluster may not have done so. However, because cluster box units are opened from the back to expose multiple mailboxes, any private carrier would have access to all mail boxes within a given unit, whether or not all customers within the cluster box unit opted to permit private carriers to deliver to their specific mailbox within the cluster.

Further, relaxation of the mailbox rule implicates privacy issues. Identity thieves often steal mail from residents' mailboxes to harvest invoices and bills, credit card statements, financial records, and the like. They use this information to open new accounts and to access existing accounts. All told, identity theft causes billions of dollars of losses, and disrupts the lives of millions of Americans every year. Protecting mailboxes therefore is of critical importance in the efforts to stem this troubling crime. Allowing non-USPS deliverers access to mailboxes could make it more difficult to identify instances where an unauthorized person has access to a residential mailbox. Currently, one can easily spot an instance where someone other than an authorized USPS carrier accesses a mailbox. Expanding legal access to others could provide "cover" for identity thieves to work without detection.

There are likely means to relax the mailbox monopoly that simultaneously address the valid concerns expressed above. For example, the mailbox monopoly could be modified to allow consumers to permit only those carriers that satisfy certain criteria to deliver to their mailboxes. If the universe of those who have access to a mailbox is increased to only a few additional large private express companies, it is unclear that this would greatly decrease the ability to identify those who do not have legal access to a mailbox. Further, if a condition of certification to deliver to the mailbox was an agreement to cooperate with the USPIS to

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[358]USPS Correspondence (Nov. 29, 2007). *See also* GAO MAILBOX REP., *supra* note 47, at 31-32. According to the GAO, USPIS officials said that limiting legal access to mailboxes helps deter mail theft by making detection easier. These officials said that limited access makes it easier to investigate and resolve cases; because only the USPS letter carrier and the addressee have legal accesses to a mailbox, anyone other than these parties who access the mailbox is automatically suspect. *Id.* Of course, the mailbox rule only prohibits individuals from placing *non-stamped* matter into a mailbox. Thus, anybody could gain access to a mailbox without violating the mailbox rule if they are placing matter with postage into the mailbox.

[359]USPS Correspondence (Nov. 29, 2007).

[360]*Id.*

investigate and prevent crimes involving the mail, this could reduce concerns about negative effects on enforcement capability. Waiver of the mailbox monopoly only for carriers that have been certified could reduce concerns related to losing federal jurisdiction; accessing the mailbox without certification would still constitute a violation of federal law, even if it involved the delivery of purely intrastate matter. Further, a relaxation of the mailbox monopoly could be crafted to retain federal jurisdiction over those carriers who qualify for certification to deliver to mailboxes. Additionally, exclusive USPS access could be preserved for locked cluster boxes to eliminate privacy or security issues relating to allowing private carriers to have access to the mailboxes of consumers who do not want anyone other than the USPS to access their mailboxes.

Conclusions:

- Congress and the PRC may wish to consider whether relaxing the current mailbox monopoly to allow consumers to choose to have private carriers deliver competitive products to their mailboxes would create net benefits for consumers. Congress could accomplish this reform directly with legislation or grant the PRC the authority to do so, if it currently lacks the requisite regulatory authority.[361]

- Granting suppliers of competitive products access to a customer's mailbox would not jeopardize the Postal Service's revenue from market-dominant products; it would affect only USPS's revenues for products that Congress already has identified as competitive. Given the prices charged for competitive products, moreover, it appears unlikely that permitting consumers to allow private express carriers access to their mailboxes is likely to lead to significant amounts of extraneous material being placed in mailboxes. Consumers could take relatively simple and inexpensive actions (such as inserting a divider into their mailbox to create a separate section for outgoing USPS mail) to alleviate any increase in the cost of USPS collection.

- To address privacy concerns and concerns related to enforcing prohibitions on mail theft and the proliferation of hazardous or obscene material, mailbox access should be limited to only private express carriers that satisfy certain criteria. These criteria should include an agreement to cooperate with the USPIS in investigating mail-related crimes. Further, due to security and privacy concerns, the USPS should retain exclusive access to locked cluster boxes.

- As a preliminary measure to gather more information, Congress may wish to consider using the Mailbox Demonstration Project to determine whether an empirical relationship

[361]Because the USPS's regulations that define the mailbox monopoly prevent the deposit of competitive products into a mailbox, they may go beyond the scope of 18 U.S.C. § 1725. *See supra* note 74 and accompanying text. Thus, it is possible that the PRC could relax the mailbox monopoly by modifying the relevant regulations to allow competitive products to be delivered to consumers' mailboxes.

exists between the incidence of postal crimes and mailbox access by private express carriers.[362]

D. Elimination of the Postal Monopoly

Elimination of the postal monopoly would allow the USPS's private competitors to offer delivery of letters and standard mail. This measure would allow competitors the opportunity to develop economies of scope that the USPS enjoys. UPS referred to the postal monopoly "as the single most significant handicap UPS faces when competing against the Postal Service."[363] In addition to realizing economies of scope, elimination of the postal monopoly would mean elimination of the current statutory price floor for extremely urgent letters.[364] Both of these effects could lead to lower prices for competitive products. Further, Congress, through the PAEA, has already taken steps to narrow the postal monopoly and may have vested the PRC with the power to further limit the scope of the postal monopoly through rulemaking.[365] Thus, new Congressional action may not be required.

At the same time, the rationale underlying the postal monopoly is to provide the USPS with sufficient revenues to maintain its universal service obligation.[366] Without the postal monopoly, the fear is that competitors would "cream skim," or target those postal customers who are required to pay postal prices greater than the cost of serving them so that others receive subsidized service.[367] According to this argument, absent the ability to charge some consumers

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[362]The Mailbox Demonstration Project was proposed in earlier legislation (H.R. 3717, introduced in June 1996) to examine the effects of relaxing the mailbox monopoly in certain areas for three years. *See* GAO MAILBOX REP., *supra* note 47, at 11.

[363]UPS, Comment 18, at 13.

[364]*See* 39 U.S.C. § 601(b)(1). One commenter notes that "as a practical business matter, this price test has become the operative standard for establishing that a letter is eligible for delivery by private carriers. . . . Of course, one practical effect of the price test is that it sets a floor for the prices that private competitors may charge." Sidak, Comment 17, at 19. *See also* Federal Express, Comment 9, at 9 (noting that the exemption to the private express statutes based on price has kept prices "artificially high").

[365]*See* 39 U.S.C. § 601(c); *see also* Federal Express, Comment 9, at 10.

[366]*See Air Courier Conference of Am. v. Am. Postal Workers Union*, 498 U.S. 517 (1991).

[367]*See* Sidak, Comment 17, at 10-12; USPS, Comment 18, at 4-5; APWU, Comment 1, at 7. *See also* Gibbons, *supra* note 199, at 268 ("[P]rivate providers can tailor their networks to demand and profitability. They can decide what markets to service, how often to serve them, and at what price. . . . Hence, private carriers have the luxury of being able to 'cream skim' the most lucrative markets, leaving only the unprofitable and high-cost markets for the postal

prices above cost, the USPS would be forced to raise the rates for its monopoly products or stop serving high-cost communities. In this way, the suppression of competitive entry into the provision of market-dominant products is seen by some as necessary to preserve universal service.[368] Other commenters, however, expressed skepticism as to whether the postal monopoly is needed to preserve universal service.[369]

The EU has moved to liberalize their postal markets. A 1997 EU directive limited the allowable scope of the postal monopoly for its member states and further stated that within these narrow limits, markets should be reserved for the national postal operator only "to the extent necessary to ensure the maintenance of universal service."[370] Currently, five EU states have completely or substantially repealed their postal monopolies,[371] and another six have eliminated the monopoly on the equivalent to USPS standard mail.[372] A detailed examination of these experiences could be instructive as to the need for the postal monopoly to assure universal service as U.S. policy makers consider how to bring legal differences between the USPS and its private competitors to an end.

Conclusions:

- Congress may wish to consider whether the scope of the postal monopoly could be narrowed to allow greater competition while still maintaining universal service. In

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operator.").

[368]One commenter suggests that the uniform pricing is responsible for the erosion of the USPS's market share in competitive products because private competitors can always undercut the USPS on low-cost deliveries while the private carriers choose not to serve high-cost customers by charging prohibitively high prices. *See* National Association of Letter Carriers, Comment 15, at 4-5. The USPS does practice pricing based on the distance to the delivery point for priority mail and bulk parcel post, but does not otherwise vary prices to account for differences in other delivery costs.

[369]*See* Federal Express, Comment 9, at 9-10 (universal service exists "despite" the postal monopoly, not because of it); Geddes, *supra* note 36, at 224 (citing empirical studies that show most rural deliveries are profitable); Cohen et al. (2003), *supra* note 304.

[370]Council Directive 97/67, art. 7, 1997 O.J. (L 15) 20 (EC).

[371]Estonia, Spain, Finland, Sweden, and the United Kingdom. WIK-CONSULT, MAIN DEVELOPMENTS IN THE POSTAL SECTOR (2004-2006) 55 (2007), *available at* http://ec.europa.eu/internal_market/post/doc/studies/2006-wik-final_en.pdf. Further, it is expected that Germany, the Netherlands, and Slovakia will completely eliminate their postal monopolies within the next year. *Id.* at 56.

[372]*Id.* at 55.

general, competition provides consumers lower prices, better quality, and more variety. Therefore, restrictions on competition should be put in place only when they are necessary to provide consumers a benefit that the market cannot. Such restrictions, moreover, should be narrowly drawn to displace competition only as much as needed to provide this benefit. Because the postal monopoly distorts market outcomes in the competitive products sector, this approach would assure that consumers are not unnecessarily deprived of the benefits of competition. Further, this approach is consistent with the Presidential Commission's recommendation that the USPS focus on its core mission of delivering mail to everyone in the most cost-effective and efficient manner possible.[373]

- At the same time, we understand that Congress has expressed an intent to retain universal service when it passed the PAEA and that the issue of the proper scope of the postal monopoly is one of great complexity and is beyond the limited scope of this study. Accordingly, although the Commission believes that the postal monopoly should be only as broad as needed to satisfy the statutory requirement of universal service, Congress may wish to postpone any decisions to refine the postal monopoly until Congress and the PRC have had the benefit of the PRC's comprehensive study on the universal service obligation and the postal and mailbox monopolies, including an examination of the "benefits of the current postal monopoly to the ability of the Postal Service to sustain the current scope and standards of universal service."[374]

E. Corporatization of the Competitive Products Division

Corporatization of the assets of the USPS associated with production of competitive products – either in private hands or to be owned by the USPS – would create another private express carrier. As a corporate entity, the new company would be subject to the same federal, state, and local legal requirements as its private competitors and would also would be free from the current legal and political constraints on USPS's operations.[375] The FTC received several comments on this particular issue in response to its FRN. Federal Express suggested a framework for establishing the USPS's competitive services as a separate corporate entity that is

[373] *See* PRES. COMM'N REP., *supra* note 197, at 17.

[374] PAEA § 702(b)(2)(B). The PRC study will report on the "scope and standards of universal service and the postal monopoly likely to be required in the future" to meet U.S. consumers' expectations. *Id.* § 702(a)(2)(D). The PRC will also offer any recommendations it deems appropriate to change the current universal service obligation and postal monopoly. *Id.* § 702(b)(1).

[375] We understand that Congress considered a proposal to establish a separate competitive products division in the early stages of developing the PAEA, but decided not to include it in the final bill. *See* Federal Express, Comment 9, at 3; USPS, Comment 18, at 31-32.

owned by the USPS.[376] Under this plan, the USPS would establish a new competitive products company under normal corporate law.[377] Another option suggested would be to have the USPS sell its competitive products assets to an existing or new entrant.[378] Either approach would leave the USPS's competitive products division a corporate entity and thus free of the advantages and burdens associated with being a government entity. As one commenter pointed out, however, divesting competitive assets to a private entity rather than retaining ultimate USPS control may create more efficiencies.[379]

Two related issues that corporatization of a separate competitive products division raises are sacrifice of economies of scope and network access. As discussed in Chapter III, the USPS likely enjoys economies of scope between competitive and market-dominant products because some Postal Service assets and personnel deliver both competitive and market-dominant products.[380] Some commenters contend that these scope economies would be lost if Congress were to establish the USPS's competitive products business as a separate corporate entity.[381] As a leading textbook on regulated industries explains:

> [T]he primary cost of separation is the elimination of a potential competitor (the regulated monopolist) from the market. If there is free entry into the market and the regulated monopolist offers no advantages over other firms, then there is little lost from

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[376]Federal Express, Comment 9, at 3.

[377]*Id.* at 4. The choice to purchase its own assets or utilize the exiting USPS assets would be based on business considerations: "For example, in some areas CompCo might wish to operate dedicated delivery trucks from the Parcel Post and Priority Mail business. . . . If CompCo did not want to assume the cost of operating its own delivery fleet, it could contract with USPS to use its network and pay the relevant costs." *Id.*

[378]*See* IRET, *supra* note 242, at 41.

[379] For example, the lack of independence between the USPS and the new company might lead to too many assets being allocated to the market-dominant division and too many costs being allocated to the competitive products division. Further, because the USPS would be the ultimate owner of the new corporation, incentives to reduce costs, raise productivity, and satisfy consumer demand are likely to be muted compared to a privately owned business. Finally, the private company likely still would enjoy lower borrowing costs than its competitors due to an implicit guarantee from the government. *See id.*, at 43.

[380] *See* USPS, Comment 18, at 6-7.

[381]*See id.* at 31-32; IRET, *supra* note 242, at 42. Further, because the assets and employees transferred to the new entity would have been built and trained to perform work on both competitive and market-dominant products, they may operate inefficiently, at least initially. *See id.*

> preventing it from competing. Suppose, however, that the regulated monopolist does possess an advantage. One plausible source of advantage is that it can produce the unregulated product at lower cost because of economies of scope between the regulated and unregulated products. By prohibiting the regulated monopolist from supplying the unregulated product, the most efficient firm is then eliminated from the market.[382]

Of course, economies of scope could be realized through production joint ventures between a new competitive products company and the USPS, much in the same way that the current workshare programs allow private carriers to combine their assets with the postal network to deliver competitive products. For example, one commenter explains that some scope economies could be recovered if the new company were allowed to contract at arms' length with the USPS to use its network, as other carriers do now via workshare programs: "The new company would not necessarily have to establish an entirely separate network. It could instead take advantage of the economies of scale and scope of the USPS's market dominant network by purchasing services from the USPS."[383] Another commenter also suggested some of these economies would likely be recaptured if the USPS's divested competitive products were combined with an existing set of products that the acquiring firm offers.[384]

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[382] VISCUSI, *supra* note 245, at 549.

[383] *See* Federal Express, Comment 9, at 3. *See also id.* at 4-5 ("Competitors have products that use the USPS system for the 'last mile' or even the 'last few miles.' . . . What we are proposing is not just that competitors have access to the system, but that all competitive products – including what are now USPS competitive products – be charged on an arms' length basis for the same access, rather than the preferential system for USPS competitive products that exists now."). Although the Postal Service and the spin-off could achieve some scope economies by using contractual mechanisms to interconnect their systems, achieving other scope economies would likely require common ownership. For a discussion of why some efficiency benefits can only be realized within a firm, see PATRICK BOLTON & MATHIAS DEWATRIPONT, CONTRACT THEORY (2005). Another possible inefficiency attendant to separation is that the USPS may charge the competitive products spin-off a price greater than marginal costs for network access. Profit-maximizing integrated firms internally price inputs at marginal cost, which results in an efficient production mix and lower downstream prices. An unintegrated input producer, however, typically will charge prices above marginal cost for inputs, which a downstream firm will further mark up. This "double marginalization" can lead to higher downstream prices, lower output, and an inefficient production mix. *See* VISCUSI, *supra* note 245, at 549. The USPS, however, is not a profit-maximizing firm, but a governmental entity. Thus, it is uncertain whether competitive products currently receive network access at marginal cost or whether the efficiencies from separation would outstrip any inefficiencies due to double marginalization.

[384] *See* IRET, *supra* note 242, at 42 ("diseconomies of scale and scope would be a smaller problem for the economy as a whole than it would seem from looking at the Postal Service in isolation").

If a new competitive products corporation were allowed to contract with the USPS to use its network, however, competition could be threatened if private competitors are not allowed similar network access.[385] Federal Express suggests that if Congress were to create a new competitive products division, the USPS should be required to offer access to all private competitors on the same terms as it would the new USPS competitive products corporation.[386] It is also important to note that denials of network access that threaten competition in the competitive products market would be subject to antitrust scrutiny by the appropriate state and federal agencies and private parties.

Another important issue involved in creating a separate company to provide competitive products would be the difficult practical job of untangling USPS's competitive products assets and workers from those devoted to market-dominant products. The USPS enjoys economies of scope precisely because many assets and employees are used for both competitive and market dominant services. To spin off a competitive products company, these assets and personnel would need to be allocated between the Postal Service and the spin-off.[387] Relatedly, the compensation (i.e., salary, benefits, working conditions) received by the postal workers at any spin off would likely differ from the compensation received by postal workers at the Postal Service. This raises equity issues associated with how employees would be allocated between the spin-off and the Postal Service.

Foreign experiences in postal liberalization do not appear to offer a direct analogy to creating a separate entity to provide competitive products. The closest analog is the experience of Deutsche Post AG, Germany's postal service provider. In 2001, the EC found Deutsche Post guilty of predatory pricing by subsidizing its parcel business with revenue from its reserved monopoly business.[388] The EC ordered Deutsche Post to separate its parcel delivery business and to engage the new company only on an arms' length basis.[389] However, unlike the USPS,

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[385]*See supra* pages 51-52 for a discussion of network access issues in the context of a regulated monopolist.

[386]*See* Federal Express, Comment 9, at 3.

[387]*See* APWU, Comment 1, at 7 (noting that establishing a separate private entity to provide competitive products would be "impractical," "destructive of universal service," and "would be completely unworkable if done in substance and not just in form"); IRET, *supra* note 242, at 42 ("Because most of the Postal Service's facilities, equipment, and workers help process both market-dominant and competitive products, it is not clear how many production assets and skilled employees could be transferred to a spin-off.").

[388]Case COMP/35.141, *Deutsche Post AG*, 2001 O.J. (L 125).

[389] *See Antitrust Proceedings in Postal Sector Result in Deutsche Post Separating Competitive Parcel Services from Letter Monopoly* (Mar. 20, 2001), *at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/01/419&format=HTML&aged=0&l

Deutsche Post is privately owned. Further, in the EU, where postal liberalization has been vibrant, most reform has involved converting governmental postal agencies into either government or privately-owned corporations that provide competitive products directly or through owned subsidiaries.[390] For example, as of 2006, only seven member states' postal operators were state enterprises,[391] with the remaining postal operators either private or state-owned corporations.[392] Further, the USPS notes that liberalization in these countries typically has included postal providers being permitted to expand their economies of scale and scope by diversifying into related businesses.[393] That liberalization in the EU has proceeded with full, rather than partial, corporatization, may suggest that conversion of the entire postal service into either a government or privately-owned corporation is more efficient than partial corporatization for the reasons discussed in the preceding paragraphs.

Conclusions:

- Corporatization – either with USPS or private ownership – of the USPS competitive products business arguably would eliminate many of the remaining major legal differences between the USPS and its private competitors. This approach to leveling the competitive environment, however, raises a host of issues that are beyond the scope of the FTC's assignment. Accordingly, the FTC believes that Congress and the PRC would be well served to reserve any decisions regarding corporatization until they have the

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anguage=EN&guiLanguage=en; UPS, Comment 18, at 21; Federal Express, Comment 9, at 4-5.

[390]For example, an EU report finds that 71 percent of EU letter post is handled by corporatized public postal operators and 29 percent is carried by operators who are partially privatized. WIK-CONSULT, *supra* note 371, at 3. The German government has reduced its stake in Deutsche Post from 63 percent to 42 percent, and the Dutch government has reduced its share of TNT from 35 percent to 10 percent. *Id.* at 42. *See also* UPS, Comment 19, at 20-21 (noting that several EU postal operators either have established private entities to provide competitive products or have expanded into competitive products directly); Federal Express, Comment 9, at 5 (noting that there are "few direct foreign precedents" for such an approach because other industrialized countries have moved substantially beyond the need for such a legal device").

[391]Cyprus, Czech Republic, Spain, France, Greece, Luxembourg, and Poland. Only Cyprus' postal operator is a government department. *See* WIK-CONSULT, *supra* note 371, at 159.

[392]The majority of shares in the German and Dutch postal operators are privately held, and the private investors have substantial stakes in the postal operations of Austria, Belgium, Denmark, and Malta. *Id.*

[393]USPS, Comment 18, at 32.

benefit of analysis provided by the GAO's study of options for restructuring the USPS.[394]

[394] PAEA § 710.

Appendix: Pricing Comparisons

Table A1
Cost of Shipping from Washington DC to Pasadena, California: Letter[1]

Overnight Delivery	Rate($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	16.25
UPS Next Day Air Saver (typically by 3:00 p.m.)	31.80
FedEx Standard Overnight (by 3:00 p.m.)	29.88
DHL Next Day 3:00 p.m.	29.98
Federal Government GSA Schedule - UPS Next Day Air Saver	5.17
Federal Government GSA Schedule - FedEx Standard Overnight*	4.91
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	4.60
UPS 3 Day Select (Letter: UPS 2nd Day Air)	24.35
FedEx Express Saver (3rd business day by 4:30 to most areas)	20.21
DHL 2nd Day Service	22.75
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	12.46
FedEx Home Delivery (4 business days)	7.83
DHL Ground Service (1-6 business days)	11.56
Federal Government GSA Schedule - UPS Ground	4.05
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

[1] Data for all prices retrieved from company websites on November 15, 2007 for residential deliveries. For UPS, FedEx, and DHL, prices reflect additional charges for package pick-up and delivery to residential addresses.

Table A2
Cost of Shipping from Washington DC to Pasadena, California: 1 lb. Package

Overnight Delivery	**Rate ($)**
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	19.50
UPS Next Day Air Saver (typically by 3:00 p.m.)	45.90
FedEx Standard Overnight (by 3:00 p.m.)	43.63
DHL Next Day 3:00 p.m.	41.00
Federal Government GSA Schedule - UPS Next Day Air Saver	5.60
Federal Government GSA Schedule - FedEx Standard Overnight*	5.31
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 4.60**
UPS 3 Day Select (Letter: UPS 2nd Day Air)	20.39
FedEx Express Saver (3rd business day by 4:30 to most areas)	20.21
DHL 2nd Day Service	20.15
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	12.46
FedEx Home Delivery (4 business days)	7.83
DHL Ground Service (1-6 business days)	9.25
Federal Government GSA Schedule - UPS Ground	4.05
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter; DHL - Volume discounts depending on how much shipped per month.

Table A3
Cost of Shipping from Washington DC to Pasadena, California: 5 lb. Package

Overnight Delivery	Rate($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	30.70
UPS Next Day Air Saver (typically by 3:00 p.m.)	63.38
FedEx Standard Overnight (by 3:00 p.m.)	59.71
DHL Next Day 3:00 p.m.	57.00
Federal Government GSA Schedule - UPS Next Day Air Saver	6.67
Federal Government GSA Schedule - FedEx Standard Overnight*	6.31
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 15.85**
UPS 3 Day Select (Letter: UPS 2nd Day Air)	25.59
FedEx Express Saver (3rd business day by 4:30 to most areas)	29.13
DHL 2nd Day Service	31.88
Federal Government GSA Schedule - UPS 3 Day Select	5.56
Federal Government GSA Schedule - FedEx 3 Day	5.28
Ground Service	
USPS Parcel Post	10.50
UPS Ground (1-5 days)	15.83
FedEx Home Delivery (4 business days)	9.30
DHL Ground Service (1-6 business days)	11.56
Federal Government GSA Schedule - UPS Ground	5.55
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A4
Cost of Shipping from Washington DC to Pasadena, California: 30 lb. Package

Overnight Delivery	Rate ($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	88.25
UPS Next Day Air Saver (typically by 3:00 p.m.)	149.12
FedEx Standard Overnight (by 3:00 p.m.)	142.01
DHL Next Day 3:00 p.m.	140.42
Federal Government GSA Schedule - UPS Next Day Air Saver	35.57
Federal Government GSA Schedule - FedEx Standard Overnight*	33.76
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 45.15**
UPS 3 Day Select (Letter: UPS 2nd Day Air)	86.33
FedEx Express Saver (3rd business day by 4:30 to most areas)	87.32
DHL 2nd Day Service	102.98
Federal Government GSA Schedule - UPS 3 Day Select	30.00
Federal Government GSA Schedule - FedEx 3 Day	28.44
Ground Service	
USPS Parcel Post	29.90
UPS Ground (1-5 days)	40.68
FedEx Home Delivery (4 business days)	26.31
DHL Ground Service (1-6 business days)	28.57
Federal Government GSA Schedule - UPS Ground	17.58
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A5
Cost of Shipping from Minneapolis, MN to New Orleans, LA: Letter

Overnight Delivery	Rate ($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	16.25
UPS Next Day Air Saver (typically by 3:00 p.m.)	30.06
FedEx Standard Overnight (by 3:00 p.m.)	28.37
DHL Next Day 3:00 p.m.	25.83
Federal Government GSA Schedule - UPS Next Day Air Saver	5.17
Federal Government GSA Schedule - FedEx Standard Overnight*	4.91
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	4.60
UPS 3 Day Select	18.64
FedEx Express Saver (3rd business day by 4:30 to most areas)	18.70
DHL 2nd Day Service	19.32
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	12.18
FedEx Home Delivery (4 business days)	6.79
DHL Ground Service (1-6 business days)	9.05
Federal Government GSA Schedule - UPS Ground	4.04
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A6
Cost of Shipping from Minneapolis, MN to New Orleans, LA: 1 lb. Package

Overnight Delivery	Rate ($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	19.50
UPS Next Day Air Saver (typically by 3:00 p.m.)	43.22
FedEx Standard Overnight (by 3:00 p.m.)	41.24
DHL Next Day 3:00 p.m.	38.63
Federal Government GSA Schedule - UPS Next Day Air Saver	5.60
Federal Government GSA Schedule - FedEx Standard Overnight*	4.91
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 4.60**
UPS 3 Day Select	18.64
FedEx Express Saver (3rd business day by 4:30 to most areas)	18.70
DHL 2nd Day Service	19.32
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	12.18
FedEx Home Delivery (4 business days)	6.79
DHL Ground Service (1-6 business days)	9.05
Federal Government GSA Schedule - UPS Ground	4.04
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A7
Cost of Shipping from Minneapolis, MN to New Orleans, LA: 5 lb. Package

Overnight Delivery	Rate ($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	30.70
UPS Next Day Air Saver (typically by 3:00 p.m.)	60.23
FedEx Standard Overnight (by 3:00 p.m.)	56.79
DHL Next Day 3:00 p.m.	54.15
Federal Government GSA Schedule - UPS Next Day Air Saver	6.67
Federal Government GSA Schedule - FedEx Standard Overnight*	6.31
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 12.90**
UPS 3 Day Select	26.56
FedEx Express Saver (3rd business day by 4:30 to most areas)	25.05
DHL 2nd Day Service	28.44
Federal Government GSA Schedule - UPS 3 Day Select	5.56
Federal Government GSA Schedule - FedEx 3 Day	5.28
Ground Service	
USPS Parcel Post	8.98
UPS Ground (1-5 days)	14.43
FedEx Home Delivery (4 business days)	8.33
DHL Ground Service (1-6 business days)	10.59
Federal Government GSA Schedule - UPS Ground	5.34
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A8
Cost of Shipping from Minneapolis, MN to New Orleans, LA: 30 lb. Package

Overnight Delivery	Rate ($)
USPS Express Mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	88.25
UPS Next Day Air Saver (typically by 3:00 p.m.)	140.03
FedEx Standard Overnight (by 3:00 p.m.)	131.88
DHL Next Day 3:00 p.m.	130.23
Federal Government GSA Schedule - UPS Next Day Air Saver	35.57
Federal Government GSA Schedule - FedEx Standard Overnight*	33.76
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 32.55**
UPS 3 Day Select	72.00
FedEx Express Saver (3rd business day by 4:30 to most areas)	72.64
DHL 2nd Day Service	93.50
Federal Government GSA Schedule - UPS 3 Day Select	30.00
Federal Government GSA Schedule - FedEx 3 Day	28.44
Ground Service	
USPS Parcel Post	23.23
UPS Ground (1-5 days)	30.02
FedEx Home Delivery (4 business days)	19.01
DHL Ground Service (1-6 business days)	21.27
Federal Government GSA Schedule - UPS Ground	12.33
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A9
Cost of Shipping from Cumberland, MD to Highmore, SD: Letter

Overnight Delivery	**Rate ($)**
USPS Express mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	16.25
UPS Next Day Air	35.82
FedEx Priority Overnight	33.73**
DHL Next Day 3:00 p.m.	31.05***
Federal Government GSA Schedule - UPS Next Day Air Saver	5.17
Federal Government GSA Schedule - FedEx Standard Overnight*	4.91
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	4.60
UPS 3 Day Select (Letter: 2nd Day Air)	25.69
FedEx Express Saver (3rd business day by 4:30 to most areas)	21.26**
DHL 2nd Day Service	21.92****
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	14.65
FedEx Home Delivery (4 business days)	9.10
DHL Ground Service (1-6 business days)	11.36
Federal Government GSA Schedule - UPS Ground	4.04
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The FedEx website does not identify the estimated date and time of delivery for this location.
*** Next day service delivers by 5 p.m. of second day
**** 2nd Day Service delivers by 5 p.m. of third day
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A10
Cost of Shipping from Cumberland, MD to Highmore, SD: 1 lb. Package

Overnight Delivery	Rate ($)
USPS Express mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	19.50
UPS Next Day Air	49.69
FedEx Priority Overnight	48.17***
DHL Next Day 3:00 p.m.	45.50****
Federal Government GSA Schedule - UPS Next Day Air Saver	5.60
Federal Government GSA Schedule - FedEx Standard Overnight*	4.91
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	4.60 or 8.95**
UPS 3 Day Select (Letter: 2nd Day Air)	21.38
FedEx Express Saver (3rd business day by 4:30 to most areas)	21.26***
DHL 2nd Day Service	21.92*****
Federal Government GSA Schedule - UPS 3 Day Select	4.78
Federal Government GSA Schedule - FedEx 3 Day	4.54
Ground Service	
USPS Parcel Post	4.50
UPS Ground (1-5 days)	14.65
FedEx Home Delivery (4 business days)	9.10
DHL Ground Service (1-6 business days)	11.36
Federal Government GSA Schedule - UPS Ground	4.04
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
*** The FedEx website does not identify the estimated date and time of delivery for this location.
**** Next day service delivers by 5 p.m. of second day
***** 2nd Day Service delivers by 5 p.m. of third day
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A11
Cost of Shipping from Cumberland, MD to Highmore, SD: 5 lb. Package

Overnight Delivery	**Rate ($)**
USPS Express mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	30.70
UPS Next Day Air	68.56
FedEx Priority Overnight	66.99***
DHL Next Day 3:00 p.m.	64.23****
Federal Government GSA Schedule - UPS Next Day Air Saver	6.67
Federal Government GSA Schedule - FedEx Standard Overnight*	6.31
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 11.90**
UPS 3 Day Select (Letter: 2nd Day Air)	29.30
FedEx Express Saver (3rd business day by 4:30 to most areas)	27.61***
DHL 2nd Day Service	31.05*****
Federal Government GSA Schedule - UPS 3 Day Select	5.56
Federal Government GSA Schedule - FedEx 3 Day	5.28
Ground Service	
USPS Parcel Post	8.59
UPS Ground (1-5 days)	16.89
FedEx Home Delivery (4 business days)	10.64
DHL Ground Service (1-6 business days)	12.90
Federal Government GSA Schedule - UPS Ground	5.34
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
*** The FedEx website does not identify the estimated date and time of delivery for this location.
**** Next day service delivers by 5 p.m. of second day
***** 2nd Day Service delivers by 5 p.m. of third day
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A12
Cost of Shipping from Cumberland, MD to Highmore, SD: 30 lb. Package

Overnight Delivery	Rate ($)
USPS Express mail (Overnight guaranteed to most areas, by noon or 3 p.m.)	88.25
UPS Next Day Air	153.49
FedEx Priority Overnight	148.48***
DHL Next Day 3:00 p.m.	147.77****
Federal Government GSA Schedule - UPS Next Day Air Saver	35.57
Federal Government GSA Schedule - FedEx Standard Overnight*	33.76
Two-Three Day Delivery	
USPS Priority Mail (Average delivery 2-3 days)	8.95 or 28.30**
UPS 3 Day Select (Letter: 2nd Day Air)	74.73
FedEx Express Saver (3rd business day by 4:30 to most areas)	75.20***
DHL 2nd Day Service	96.10*****
Federal Government GSA Schedule - UPS 3 Day Select	30.00
Federal Government GSA Schedule - FedEx 3 Day	28.44
Ground Service	
USPS Parcel Post	22.24
UPS Ground (1-5 days)	32.49
FedEx Home Delivery (4 business days)	21.32
DHL Ground Service (1-6 business days)	23.58
Federal Government GSA Schedule - UPS Ground	12.33
Federal Government GSA Schedule - FedEx Ground	N/A

* A fuel surcharge is allowed to be added to all FedEx Express shipments. In November 2007, the fuel surcharge for express deliveries was 16.5%, or an additional charge of at least $2.26, not to exceed $2.30.
** The USPS has flat rate envelopes and boxes for Express Mail and Priority Mail. Express Mail flat-rate envelopes (11.625" x 15.125" or 12.5" x 9.5") can be shipped for $16.25 for packages up to 70 pounds, regardless of destination. Priority Mail flat-rate envelopes and boxes (11-7/8" x 3-3/8" x 13-5/8" or 11 x 8-1/2" x 5-12") can be shipped at a rate of $4.60 for envelopes and $8.95 for packages up to 70 pounds, regardless of destination.
*** The FedEx website does not identify the estimated date and time of delivery for this location.
**** Next day service delivers by 5 p.m. of second day
***** 2nd Day Service delivers by 5 p.m. of third day
Business Discounts: FedEx - Small Business Discounts: 15% discount for first four months, 10% thereafter;
DHL - Volume discounts depending on how much shipped per month.

Table A13
FedEx Rates Under the Federal Strategic Sourcing Initiative Tier 3 Rates[2] - FOR GOVERNMENT USE ONLY

	Letter	5 lb. Package	30 lb. Package
FedEx Standard Overnight	4.02	5.14	27.69
FedEx 3Day	3.70	4.30	23.24
FedEx Standard Ground Rates:			
Washington, DC to Pasadena, CA	3.75	5.47	18.07
Minneapolis, MN to New Orleans, LA	3.61	4.75	12.65
Cumberland, MD to Highmore, SD	3.61	4.75	12.65

[2]Under the Federal Strategic Sourcing Initiative (FSSI), FedEx was awarded a Blanket Purchase Agreement for express and ground domestic delivery service. This award provides for savings below the current GSA schedule and waives the fuel surcharge.