TOWARD STABILIZING

THE SINGLE-PIECE RATE

IN FIRST-CLASS MAIL

by

James F. Callow
and
Ted Gerarden

Office of the Consumer Advocate

Postal Rate Commission

MAY 2001

TABLE OF CONTENTS

INTRODUCTION

The U.S. Postal Service's Board of Governors has recently directed that postal management prepare a new rate request.[1] According to news reports, that request could be filed sometime this summer.[2] If recommended by the independent Postal Rate Commission,[3] the new rates could take effect in 2002.

The Postal Service's preparations for a new rate request reflect a deteriorating financial picture. The slowing economy is limiting the volume growth of household and business mail. The effect could be a loss of up to $3 billion in fiscal year 2001.[4] As a result, the Postal Service's rate request could seek up to a 10 percent increase in the price for the First-Class postage stamp,[5] most commonly used by households on single-piece mail. Rate increases upwards of 20 percent are possible for Periodicals and other classes of mail used by businesses.[6]

---

1 *See* Statement, Robert F. Rider, Chairman of the U.S. Postal Service Board of Governors, February 6, 2001, San Antonio, Texas. It should be noted that the Board of Governor's directive for preparation of a new rate request is separate from its implementation of selected rate increases previously requested but rejected by the Postal Rate Commission in Docket No. R2000-1. Those selected rate increases will take effect on July 1, 2001. *See* Statement, Robert F. Rider, Chairman of the U.S. Postal Service Board of Governors, May 8, 2001, Washington, DC.

2 Davidson, Dan. "USPS Delivers One-Two Punch on Rate Hike," *Federal Times*, March 12, 2001, at 8.

3 The Postal Rate Commission was created by the Postal Reorganization Act (herein "the Act") of 1970, 39 USC §101 *et. seq.*, as an independent establishment of the executive branch of government. The Commission is composed of five commissioners. The President, with the advice and consent of the Senate, appoints each commissioner to a staggered six-year term of office. Pursuant to the Act, the Commission is directed to issue a "recommended decision" on any Postal Service request for a change in rates.

4 Association for Postal Commerce, *PostCom Bulletin,* 10-01, March 9, 2001, at 2.

5 Davidson, Dan. "USPS Delivers One-Two Punch on Rate Hike," *Federal Times*, March 12, 2001, at 8.

6 *Id.*

The prospect of another change in the First-Class rate for single-piece mail, coming so soon after the most recent rate increase, is problematic for household mailers. Unlike business mailers, household mailers generally purchase stamps in small quantities and visit retail post offices more frequently. The increasing frequency of rate changes is therefore inconvenient (and possibly confusing) for many household mailers.

The Postal Service should fashion a policy for setting rates to minimize the inconvenience associated with rate changes. Toward that end, this paper suggests a new approach for setting the First-Class rate for single-piece mail that would provide a longer period of rate stability for household mailers while accommodating business mailers' desire for rate adjustments that are more manageable.

I. HOUSEHOLD AND BUSINESS MAILERS HAVE DIFFERENT INTERESTS WITH RESPECT TO CHANGES IN THE FIRST-CLASS RATE

Households rely on First-Class Mail more so than any other class of mail. Virtually all First-Class Mail sent by households is mailed at the single-piece rate, currently 34 cents. The average household mails approximately eleven pieces of First-Class Mail per month.[7] In percentage terms, however, households mailed only 16.1 percent of the 101.4 billion pieces of First-Class Mail in 1999.[8] Moreover, annual household expenditures on First-Class postage are relatively small.[9]

7 1999 Household Diary Study, at I-8.

8 Docket No. R2000-1, Testimony of Postal Service Witness Tolley (USPS-T-6) at 25-26.

9 Assuming households mailed an average of 11 First-Class letters per month in 1999, annual household expenditures on First-Class postage would total $43.56 ((11 * 12 months) * $0.33).

By contrast, business mailers sent 82.7 percent of all First-Class Mail pieces in 1999,[10] a substantial portion of which were mailed at discounted rates that require entry in minimum quantities. The postage for such business mail is generally purchased in large amounts, and often applied via postage meters or indicated by a permit "imprint," rather than stamps.[11] Consequently, for many business mailers, rates paid for First-Class Mail represent a major item of cost and, as a result, occupy considerable management attention.

Not surprisingly, therefore, household and business mailers have different interests related to the amount and timing of rate changes related to First-Class Mail.

A. Households Prefer Longer Periods of a Stable Single-Piece First-Class Rate

As less frequent users of First-Class Mail, households have an interest in preserving the single-piece First-Class ("SPFC") rate as long as possible.[12] Maintaining a stable SPFC rate is a matter of convenience and economy, and can minimize confusion, for household mailers.

---

10 Docket No. R2000-1, Testimony of Postal Service Witness Tolley (USPS-T-6) at 25.

11 Postage meters allow business mailers to "apply" the exact amount of postage on a mailpiece during high-speed preparation and processing. The amount of postage purchased is entered into the postage meter. When a mailpiece moves through the postage meter, the amount of postage printed on the mailpiece is deducted. The Postal Service also authorizes business mailers to print, at their own expense, a permit "imprint" on mailpieces. Each permit imprint displays an unique identifying number. Business mailers using a permit imprint may pay the applicable postage for mailpieces displaying the permit at the time of mailing, or establish an "advance deposit" account that allows the Postal Service to deduct the amount of postage.

12 There are some non-household mailers, such as small and home office businesses, whose volumes are too small to qualify for discounted rates, or whose volumes while sufficient, mail only infrequently. These mailers may also view a more stable single-piece First-Class rate favorably.

1. Longer periods of rate stability reduce inconvenience for household mailers

Frequent changes in the SPFC rate can be inconvenient to household mailers. A change in the single-piece rate is accompanied by new postage stamps related to First-Class. New stamps are issued for both the new single-piece rate and the difference between the old and new single-piece rates, *e.g.,* the "make-up" stamp.[13] The rate change requires the purchase of the new denomination of stamps that would otherwise be unnecessary in the absence of the rate change. Some retail post offices have often been crowded with household (and smaller-volume) mailers seeking to obtain the new denomination stamps at the time new rates become effective.[14] Moreover, to the extent that household mailers have "left over" stamps of older denominations at the time of implementation, a hidden cost is imposed on households when such stamps go unused.

2. Longer periods of rate stability minimize confusion to household mailers

The prospect of more frequent rate changes can create confusion for household mailers—at least for a time after implementation. Where household mailers have "left over" stamps of older denominations (some of which may be non-denominated), the purchase of the new or make-up stamps create separate First-Class stamp "inventories." If the wrong denomination or non-denominated stamp is chosen, there is

[13] Traditionally, the Postal Service has issued new First-Class stamps bearing alphabetic letters rather than numeric denominations for distribution immediately following the implementation of new rates. Such stamps have included the "G" stamp and the "H" stamp, issued after the implementation of new rates in January 1995 and January 1999, respectively. Several months after implementation, stamps displaying the proper numeric denomination were issued. This practice has been discontinued. Docket No. R2000-1, OCA/USPS-62. Beginning with implementation of the new rates in January of this year (and thereafter), the Postal Service issued stamps bearing a "First-Class Mail" endorsement followed by stamps displaying the new 34-cent First-Class rate for single-piece mail.

[14] Wilson, Scott. "In For A Penny (Stamp), In For A Long Wait," *Washington Post*, January 12, 1999, at B1.

the possibility of inadvertent over or underpayment of postage. Longer periods of rate stability would minimize the need to purchase new stamps and therefore minimize confusion over the then-effective rate, at least in the period immediately following a rate change.

B. To the Extent Higher Rates Are Necessary, Smaller, More Frequent and Predictable Rate Adjustments Are Preferred by Business Mailers

Rate increases pose a different set of problems for business mailers compared to households. In particular, large rate increases can be disruptive to business management, customer relationships, and planning.

1. More frequent rate increases minimize the likelihood of sharp increases in mailers' costs

Postal rates represent a fundamental cost of doing business to business mailers. For some business mailers, large rate increases can mean sharply increased costs. Generally, such increases cannot be absorbed without affecting other aspects of business, including investments and prices charged to customers, among others. By contrast, smaller rate increases minimize the likelihood of sharp increases in mailers' costs and, consequently, the likelihood of price increases or other adjustments related directly to large increases in postage costs. To the extent postal prices are expected to increase, the possibility of larger rate increases exists as the duration between rate proceedings is extended. In the alternative, increases in smaller increments would require more frequent rate adjustments. Smaller, more frequent rate increases could avoid steeper general increases that might otherwise be necessary if rates were adjusted on a less frequent basis.

2. More predictable rate increases facilitate business planning

Uncertainty with respect to the timing of rate changes compounds concern about the amount of any rate change. As a result, business planning can be adversely affected. Where rate increases are larger as a consequence of an extended period between rate proceedings, planning for offsetting cost reductions, estimating the return on new investments, and planning the "best time" to raise prices on products or services (rather than immediately in response to a large rate increase) is made more difficult. More predictable rate increases can aid orderly business planning.

C. The Postal Service Recognizes the Value of Smaller, More Frequent and Predictable Rate Adjustments for Business Mailers and for Itself

In determining when to seek new rates, the Postal Service maintains that its objective is to extend the time between rate increases for as long as possible.[15] Nevertheless, rate increases are becoming more frequent and the Postal Service appears to be planning future rate adjustments on a more frequent and predictable basis.[16]

As recently as last year, the Postal Service revealed that it was planning for rate requests approximately every two years. In May 2000, Deputy Postmaster General John Nolan stated in a speech to the Direct Marketing Association that postal management was beginning to plan for the next two rate cases in 2003 and 2005.[17]

---

15 Docket No. R2000-1, OCA/USPS-55(c).

16 During the past 20 years, new rates have been implemented approximately every three to four years, e.g., November 1981, February 1985, April 1988, February 1991, January 1995, January 1999, and January 2001. A new rate case filed during the summer of 2001 could result in new rates becoming effective in 2002.

17 Odell, Patricia. "USPS to Cut Jobs and Reevaluate Property," *DirectNewsLine*, May 3, 2000. *See also* Association for Postal Commerce, *PostCom Bulletin,* 21-00, May 5, 2000; and, Alliance of

Previously, in estimating volumes in response to a request from the General Accounting Office (GAO), the Postal Service assumed rate increases would become effective beginning in January 2001, and every two years thereafter, *e.g.,* January 2003, 2005 and 2007.[18] Moreover, the January 2001 implementation of the rate changes from Docket No. R2000-1, the most recent rate request, is consistent with a two-year rate cycle, as the increases resulting from the previous rate request took effect in January 1999.

Business mailers expect the Postal Service to propose smaller, more frequent and predictable rate increases in the future. For several years, business mailers have pressed the Postal Service to seek smaller rate increases, even if they come more frequently, since smaller increases are more easily managed than larger increases.[19] Consequently, the Postal Service's proposals in Docket No. R97-1 were considered by some mailers to be responsive to the "longstanding desire of business mailers" for smaller, more predicable rate increases.[20] One association of business mailers considers smaller, more frequent rate increases to be postal "policy."[21]

The prospect of substantially higher business mail rates, on a timetable more rapid than every two years, is prompting renewed calls for "phasing-in" new postal

---

Nonprofit Mailers, *Alliance Report*, 00/14, May 10, 2000. Deputy Postmaster General Nolan's comments occurred during the pendency of Docket No. R2000-1, the most recent rate request that resulted in new rates that became effective January 7, 2001.

18 *See* "Challenges to Sustaining Performance Improvement Remains Formidable on the Brink of the 21st Century, GAO Report T-GGD-00-2, (October 21, 1999), at 5; *see also* Docket No. R2000-1, Library Reference USPS-LR-I-179.

19 Association for Postal Commerce, *PostCom Bulletin,* 09-01, March 1, 2001, at 3.

20 Letter of Time, Inc. to the USPS Board of Governors, May 21, 1998.

21 Letter of American Mail Marketing Association to the USPS Board of Governors, October 4, 1999.

rates—an approach also consistent with the notion of smaller, more frequent rate increases.[22] Although details are not specified, "phasing" would permit the Postal Service to implement a single (and possibly larger) rate increase in smaller and more regularly scheduled increments over several years, rather than at one time. This would provide the Postal Service with some pricing flexibility (at least with respect to timing) to raise the revenue it needs on a timely basis, while minimizing the impact on business mailers.[23]

II. THE DIFFERING INTERESTS OF HOUSEHOLD AND BUSINESS MAILERS CAN BE ACCOMMODATED BY ADJUSTING THE SINGLE-PIECE FIRST-CLASS RATE EVERY OTHER RATE PROCEEDING

Household mailers would benefit from convenience and simplicity if the single-piece First-Class rate were maintained for longer periods. That business mailers prefer smaller, more predictable rate increases (when necessary), however, suggests that rate adjustments will occur on a more frequent basis. To date, the Postal Service has responded to the desires of business mailers in this regard.

However, the differing interests of households and business mailers with respect to rate adjustments need not be viewed as irreconcilable. There is a way to accommodate the interests of households for a longer period of stable rates with business mailers' desire for smaller, more predictable adjustments. This could be achieved by adjusting the single-piece First-Class rate every other rate proceeding.[24]

---

22 Association for Postal Commerce, *PostCom Bulletin,* 09-01, March 1, 2001, at 3.

23 *Id.*

24 Under the Postal Reorganization Act, a change in postal rates may be made only at the request of the Postal Service. The Postal Service is required to formally request such a change by submitting its request to the Postal Rate Commission. The Commission must issue a recommended decision on the Postal Service's request within 10 months. For purposes of this paper, the 10-month period during which

A. Adjusting the Single-Piece Rate Every Other Rate Proceeding Would Involve Maintaining the "Whole Cent" Integer Rate for Households and Establishing Workshare Discounts Based upon a Non-Integer Rate

A longstanding policy in postal ratemaking is setting the First-Class rate for single-piece mail in whole cents. Commonly referred to as the *integer constraint*, such a policy is intended to promote convenience and simplicity for households and other smaller-volume mailers.[25] Rates for presort and automation compatible (e.g., "pre-barcoded) mail, collectively known as "workshare" mail,[26] represent discounts from the whole-cent single-piece rate. These rates, expressed in tenths of a cent, are paid for large-volume mailings by businesses.

To achieve the twin goals of longer periods of rate stability for household mailers and smaller, more frequent adjustments for business mailers, the relationship between the single-piece First-Class integer rate and the discounted rates for workshare mail must be changed.

1. The single-piece First-Class rate should be changed every other rate proceeding

As envisioned here, the single-piece First-Class ("SPFC") rate for letters would be established in a two step process. During an initial or first rate proceeding (rate case

---

the Commission is considering the Postal Service's request is referred to as the "rate case proceeding," or simply "rate proceeding." The time period during which the rates recommended by the Commission is in effect is referred to as the "rate period."

25 *See* PRC Op. R94-1 at ¶5005.

26 The term "workshare" is used to describe mail that has undergone certain preparation or processing by the mailer prior to entry with the Postal Service. In First-Class, workshare mail must be entered in minimum quantities of 500 or more pieces. Common workshare activities include *presorting* and *pre-barcoding*. Presorted mail is mail that has been sorted into groups by ZIP Code (5- or 3-digit) area. Pre-barcoding involves mailer application of barcodes on the mail, permitting more efficient sorting on automated mail processing equipment by the Postal Service. Such workshare activities performed by mailers reduce mail processing costs to the Postal Service for which mailers are "paid" through lower (discounted) rates.

1), an "actual" rate (AR1) would be determined in the same manner as in past proceedings[27]—with one exception. That is, the "actual" rate would be set without regard to the integer constraint. The second step would involve using the "actual" rate (AR1) as the basis for establishing a SPFC "recommended" rate (RR), conforming to the integer constraint. Thus, *the recommended rate for single-piece First-Class Mail would continue to be set at a whole cent.* At the next rate proceeding (rate case 2), a new "actual" rate (AR2) would be determined, again without regard to the integer constraint. The recommended SPFC integer rate (RR) would remain the same for two rate periods, a duration of approximately four years, assuming rate cases are filed every two years. The determination of First-Class rates for mail other than single-piece would be based on the actual non-integer rate (AR1, AR2) in both rate proceedings.

2. The revenue generated by the difference between the recommended SPFC rate and the actual non-integer rate would be used to maintain a stable single-piece rate

At the time of the first rate proceeding, the recommended SPFC integer rate (RR) would be set so as to generate revenues greater than if the actual non-integer rate (AR1) were used for single-piece mail. The additional revenues generated would permit maintenance of the recommended SPFC integer rate (RR) through two rate periods. A positive balance would be created during the first rate period and recorded in a "SPFC

[27] The Postal Reorganization Act requires that the Postal Rate Commission issue a recommended decision on a Postal Service rate request within 10 months. The Commission's recommended decision must be based on evidentiary records developed in administrative hearings that are quasi-judicial and adversarial in nature. The decision must also comport with the policies of the Act. Some of the more significant policies include determining that the Postal Service's request will raise sufficient revenues to "break-even" over time; requiring that revenues generated from rates for one class of mail do not subsidize the rates of any other class; and, recovering the "institutional" (e.g., overhead) costs of the Postal Service through an appropriate mark-up of rates based upon nine ratemaking criteria in the Act. These ratemaking criteria involve considerations of the fairness and equity of the requested rates, the relationship of the rates to value of service, and the effect of rate increases on the "general public" and business mailers, among others.

Reserve Account" on the books of the Postal Service. This amount would be the difference between the actual non-integer rate (AR1) and the recommended SPFC rate (RR), multiplied by the volume of single-piece letters.

If, during the second rate period, maintaining the recommended SPFC integer rate (RR) caused a revenue "deficiency," the positive balance in the SPFC Reserve Account would be used to make up the difference. The deficiency would be the difference between the new actual non-integer rate (AR2) established in the second rate proceeding and the recommended SPFC integer rate (RR), multiplied by the volume of single-piece letters.

At the time of the third rate proceeding, when it would again be time to change the recommended rate, the balance in the SPFC Reserve Account, positive or negative, would be taken into account in setting the new recommended SPFC integer rate.

3. De-linking the discounts for workshare mail from the whole cent integer rate would more accurately reflect costs

Currently, the single-piece rate is the reference point for determining rates for workshare mail. Rates for workshare mail represent discounts from the whole cent integer rate. The discounts are based upon estimated cost savings and the percentage of those savings "passed-through" to create discounts, in tenths of cents, from the single-piece rate.[28]

[28] The size of workshare discounts is based upon the costs saved by the Postal Service when mailers perform worksharing activities that avoid certain postal processing operations. The cost savings are determined from engineering studies of mail processing operations conducted by the Postal Service. In general, because of uncertainties associated with the engineering studies, only a portion of the total cost savings are "passed-through" to the mailers in discounted rates. Consequently, if the uncertainties were such that a 75 percent "pass-through" was warranted, it would mean that 75 percent of the cost savings were recognized in discounted rates. By contrast, a well-understood postal operation bypassed by mailer worksharing might warrant a 100 percent "pass-through." Thus, the entire amount of the cost savings is recognized in discounted rates.

Under this proposal, however, rates for workshare mail would be established by reference to the actual non-integer rate (AR1, AR2) in each rate case, rather than the whole cent recommended SPFC integer rate (RR). Consequently, rates for workshare mail, set at one (or more) decimal places, would more accurately reflect costs.[29]

It should be noted that during the period rates from the first rate case are in effect, there would be larger discounts for workshare mail compared to the recommended SPFC integer rate (RR). At the time of second rate proceeding, presuming postal costs rose during the first rate period, the new actual non-integer rate (AR2) would likely rise as well. If the amount of the discount remains the same, the rates for workshare mail will increase because they are set according to the new actual non-integer rate (AR2). At the same time, the recommended SPFC integer rate paid by single-piece mailers remains unchanged. In effect, workshare discounts would shrink vis-à-vis the recommended SPFC integer rate (RR) during the second rate period.

B. The Effect of Separating the Timing of Rate Adjustments for Household and Business Mailers Can Be Illustrated

Changing the recommended SPFC rate every other rate proceeding while rates for workshare mail change in each rate case will affect First-Class revenues and

29 The integer constraint also has a substantial effect on postal revenues. The Postal Service processes more than 100 billion pieces of First-Class Mail annually. Consequently, a one-cent change in the First-Class rate for single-piece mail effectively generates about $1 billion in revenues. By adhering to the integer constraint, the Postal Rate Commission must round the single-piece rate up or down to a whole cent from rates that otherwise might be based upon tenths of a cent, thereby increasing or decreasing First-Class revenues by several hundred million dollars. With respect to workshare mail, the discounted rates also carry with them the "rounding" effect of setting the First-Class rate at a whole cent.

volumes. In particular, the changes in workshare discounts will vary workshare volumes, affecting certain business mailers. These changes can be illustrated.[30]

1. First-Class revenues will vary, and volume will shift between single-piece and workshare

Table 1 illustrates the operation of this proposal and its effect on revenues. In the first rate proceeding, the actual non-integer rate (based upon the litigated revenue requirement, costing and pricing, etc.) is assumed for purposes of illustration to be 34.9 cents. After determining the actual non-integer rate, a SPFC integer rate of 36 cents might be recommended and then held constant through two rate periods (Years 2002 – 2003, and Years 2004 – 2005). The difference between the recommend SPFC rate and the actual non-integer rate, a positive 1.1 cents, would be multiplied by the SPFC mail volume each "accounting period" to determine the amount of revenues credited to the SPFC Reserve Account for that accounting period.[31]

The second and third columns in Table 1 show the annual and cumulative total revenue credited to the SPFC Reserve Account for Years 2002 and 2003, the period during which rates from the first rate case are in effect. In Year 2002, $558 million is generated for the SPFC Reserve Account. In Year 2003, another $539 million is generated, for a total of $1.097 billion in the SPFC Reserve Account at the end of the two years.

---

[30] Electronic versions of Tables 1, 2 and 3, discussed below, can be found on the Commission's website, www. prc.gov.

[31] The Postal Service's fiscal year is divided into 13 "accounting periods" for reporting purposes. Each period is four weeks long. At the end of each accounting period, the financial and operating results during the period are reported to postal management and the Commission.

Based upon a two-year rate cycle,[32] rates established in the second rate proceeding would become effective in Year 2004 in this example. While the recommended SPFC rate paid by single-piece mailers would remain at 36 cents, litigation in the second rate proceeding might result in a new actual non-integer rate of 36.8 cents. The difference, now a negative 0.8 cents, is multiplied by the SPFC volume in each accounting period to determine the amount deducted from the SPFC Reserve Account for that accounting period. In effect, the positive balance in the SPFC Reserve Account generated during the first rate period is used to "make-up" the expected revenue deficiency during the second rate period.

This effect is also shown in Table 1. For the Years 2004 and 2005, the total balance in the SPFC Reserve Account is reduced by $406 million and $388 million, respectively.

Table 1
ILLUSTRATIVE ANNUAL AND TOTAL CHANGE IN ESTIMATED REVENUES IN SPFC RESERVE ACCOUNT DURING TWO RATE CASES
(volumes and amounts in millions, except rates)

	Year 2001	*Year 2002*	Year 2003	*Year 2004*	Year 2005
Recommended SPFC Rate [1]	$0.34	$0.360	$0.360	$0.360	$0.360
Actual Single-Piece Rate [2]	$0.34	$0.349	$0.349	$0.368	$0.368
Difference [3]		$0.011	$0.011	-$0.008	-$0.008
SPFC Volume [4]	52,829	50,732	48,979	50,751	48,480
SPFC Reserve Acct - Annual [5]		$558	$539	-$406	-$388
SPFC Reserve Acct - Total [6]		$558	$1,097	$691	$303

32 A two-year rate cycle, or the period between implementation of new rates, is used here for purposes of illustration. However, it must be emphasized that this proposal does not require a two-year period between implementation of new rates, or any other interval. As is the case now, the Postal Service would determine when new rates are to be made effective.

In the third rate case, when the recommended SPFC rate is expected to change, the balance in the SPFC Reserve Account, positive or negative, would be considered in deciding the new recommended SPFC rate.

During two rate periods, some volume will shift to and from single-piece and workshare mail. By holding the recommended SPFC rate constant through two rate periods as proposed, the workshare discount "rises and falls" compared to the recommended SPFC rate with each rate case (although the amount of the discount relative to the actual non-integer rate is assumed not to change).[33] In the first rate case proceeding, when the recommended SPFC rate is set higher than the actual non-integer rate (AR1), the workshare discount is larger. In theory, this should generate more workshare mail. The opposite effect results after the second rate case, when the recommended SPFC rate is less than the actual non-integer rate (AR2), creating a smaller discount relative to the recommended SPFC rate.

Table 2 illustrates the changing SPFC and workshare volume during the two rate periods. For purposes of Table 2, a workshare discount of 6.2 cents, representing the difference between the actual non-integer rate and the workshare rate, is assumed.[34] It is also assumed that the discount vis-à-vis the actual non-integer rate (AR1, AR2) remains constant at 6.2 cents during the entire four-year period.

Part A of Table 2 shows the recommended SPFC integer rate of 36 cents and resulting volumes, and assumes that rate is unchanged for the duration of two rate

[33] To isolate the effects of changes in SPFC and workshare volume based upon a static recommended SPFC rate and a changing actual non-integer rate, it is assumed that the amount of the discount relative to the actual non-integer rate (AR1, AR2) in both rate proceedings is the same.

[34] A 6.2 cent discount is assumed in this illustration as it represents the difference between the current 34 cent single-piece rate and the current Automation Basic rate of 27.8 cents. In practice, the amount of the discount would be subject to review and change in each rate proceeding.

periods, or four years in this example. Workshare rates and volumes at the recommended SPFC rate of 36 cents are also shown. Part B shows the single-piece non-integer rates and volumes and the workshare rates and volumes. The actual non-integer rate is assumed to change from 34.9 cents in Year 2002 to 36.8 cents in Year 2004 for purposes of this illustration. In both Parts A and B, the workshare rate is also assumed to change from 28.7 cents in Year 2002 to 30.6 in Year 2004.

In Year 2002, when the recommended SPFC rate is 1.1 cent (36.0 – 34.9 cents) greater than the actual non-integer rate, the workshare discount is effectively 7.3 cents, representing the difference between the 36.0 cent recommended SPFC rate and the 28.7 cent workshare rate. SPFC volume is estimated to decline by 3.4 percent while workshare volume is estimated to increase by 3.7 percent. Total First-Class volume increases by 68 million pieces in Year 2002, and increases again by 176 million in Year 2003. In Year 2004, when the recommended SPFC rate is 0.8 cents (36.0 – 36.8 cents) less than the actual non-integer rate, the effective workshare discount becomes 5.4 cents (36.0 cents – 30.6 cents). The result is an estimated 1.6 percent increase in SPFC volume, and an estimated 2.0 percent decrease in workshare volume. Total First-Class volume declines by 126 million in Year 2004 and by 146 million in Year 2005. During the entire four year period (Year 2002 through Year 2005), total First-Class volume decreases by 28 million. The resulting changes in SPFC, workshare and total First-Class volume can be seen in Part C of Table 2.

Table 2
ILLUSTRATIVE CHANGE IN ESTIMATED SINGLE-PIECE AND WORKSHARE VOLUME DURING TWO RATE CASES
(volumes and amounts in millions, except rates)

PART A: RECOMMENDED SPFC INTEGER RATE

Recommended	Year 2001		*Year 2002*		Year 2003		*Year 2004*		Year 2005		2002-2005
Integer Rate	Rate	Volume	Rate	Volume	Rate	Volume	Rate	Volume	Rate	Volume	Total Volume
SPFC	$0.340	52,829	$0.360	50,732	$0.360	48,979	$0.360	50,751	$0.360	48,480	198,942
Workshare	$0.278	47,320	$0.287	48,734	$0.287	50,034	$0.306	46,437	$0.306	45,590	190,796

PART B: ACTUAL SINGLE-PIECE NON-INTEGER RATE

Actual Non-	Year 2001		*Year 2002*		Year 2003		*Year 2004*		Year 2005		2002-2005
Integer Rate	Rate	Volume	Rate	Volume	Rate	Volume	Rate	Volume	Rate	Volume	Total Volume
Single-Piece	$0.340	52,829	$0.349	52,463	$0.349	50,650	$0.368	49,928	$0.368	47,693	200,733
Workshare	$0.278	47,320	$0.287	46,936	$0.287	48,188	$0.306	47,387	$0.306	46,523	189,033

PART C: CHANGE IN VOLUME AND PERCENT BETWEEN SPFC AND WORKSHARE

	Year 2001		*Year 2002*		Year 2003		*Year 2004*		Year 2005		2002-2005	
	Volume	Percent	Volume	Percent	Volume	Percent	Volume	Percent	Volume	Percent	Volume	Percent
SPFC			(1,731)	-3.4%	(1,671)	-3.4%	824	1.6%	787	1.6%	(1,791)	-0.90%
Workshare			1,799	3.7%	1,847	3.7%	(950)	-2.0%	(933)	-2.0%	1,762	0.92%
Total Volume			68		176		(126)		(146)		(28)	

2. The shifting volumes between single-piece and workshare results from changes in the actual non-integer rate and the size of the workshare discount

As shown above, mail volumes shifting between SPFC and workshare will alternately increase and decrease with changes in the workshare rate relative to the recommended SPFC rate. In the first rate period, where the discount is "large" relative to the recommended SPFC rate, workshare volume increases. The higher recommended SPFC rate reduces SPFC volume, and offsets most of the increase in workshare volume. During the second rate period, when the recommended SPFC rate is held constant and the actual non-integer rate (AR2) rises, the rate for single-piece mail is declining on a real basis, causing SPFC volume to increase. At the same time, the workshare discount is smaller vis-à-vis the recommended SPFC rate, producing a decline in workshare volume caused in part by workshare mail shifting to single-piece because of the smaller discount.

Table 3 shows the magnitude of the change in SPFC and workshare volumes as the difference between the recommended SPFC rate and the actual non-integer rate changes, and the effective size of the workshare discount changes. More specifically, Table 3, column 1 shows the effect on volumes of varying the recommended SPFC rate by plus/minus 2 cents, in one-cent increments, from the actual non-integer rate (AR1). Again, the illustrated workshare discount (for Automation Basic), calculated from the actual non-integer rate, is assumed to remain constant at 6.2 cents (34.9 cents – 28.7 cents). However, the workshare discount increases and decreases compared to the recommend SPFC rate, as shown in column 2.

In Table 3, when it is assumed the recommended SPFC integer rate is 2 cents more than the actual non-integer rate of 34.9 cents, the effective discount rate expands to 8.2 cents. The maximum reduction in SPFC volume is 3.13 billion, while workshare volume increases by 3.27 billion. Similarly, when it is assumed the recommended SPFC integer rate is 2 cents less than the actual non-integer rate of 34.9 cents, the effective discount rate drops to 4.2 cents. The result: SPFC and workshare volumes shift in opposite directions, with SPFC volume increasing by a total of 3.203 billion and workshare volume decreasing by 3.27 billion. Overall, however, total First-Class Mail volume does not vary by more than 140 million pieces per year.

Table 3
ILLUSTRATIVE EFFECT OF CHANGE IN RECOMMENDED SPFC RATE ON SHIFT IN ESTIMATED SINGLE-PIECE AND WORKSHARE VOLUME
(volumes in millions)

Rate Difference [1]	Effective Workshare Discount [2]	SPFC Volume Change [3]	Workshare Volume Change [4]	Net Volume Change [5]	SPFC Volume % Change [6]	Workshare Volume % Change [7]	Net Volume % Change [8]
-$0.02	$0.042	3,203	(3,270)	(67)	6.1%	-7.0%	-0.068%
-$0.01	$0.052	1,592	(1,635)	(43)	3.0%	-3.5%	-0.043%
$0.00	$0.062	0	0	0	0.0%	0.0%	0.000%
$0.01	$0.072	(1,574)	1,635	61	-3.0%	3.5%	0.061%
$0.02	$0.082	(3,130)	3,270	140	-6.0%	7.0%	0.141%

The changing rates for workshare mail as the recommended SPFC rate is held constant will increase and decrease the volume of SPFC and workshare mail at different times. Consequently, presort mailers, and to a lesser extent, pre-barcode mailers, will be impacted, as well as the Postal Service.

With respect to the Postal Service, the shift in volume to and from SPFC mail and workshare mail from one rate period to another is likely to have little effect on total First-Class volume. As shown in Table 3, when the price difference is plus 2 cents, the largest net percentage change in total First-Class volume is negligible at well under one percent, *i.e.,* 0.141 percent.

Nevertheless, the shift in volumes to and from SPFC and workshare would have a limited impact on Postal Service operations. As much as 3.3 billion pieces per year could shift between the two. However, such shifts can be anticipated, as the change in rates causing the shifts are known in advance. Moreover, the shifts in volume are generally smaller and likely to be more gradual than existing seasonal fluctuations in mail volume.

With respect to presort mailers, changes in the size of the workshare discount will create cycles causing volumes and revenues to rise and fall. When the difference between the recommended SPFC rate and the actual non-integer rate is positive, the discount for workshare mail is larger. As a result, presort mailers will see higher volumes and revenues, and potentially higher profits. When the difference between the recommended SPFC rate and actual non-integer rate is negative, however, they will operate with lower volumes and revenues and potentially lower profits.

As proposed here, the first cycle would occur during the first rate period when the difference between the recommended SPFC rate and actual non-integer rate is positive, resulting in higher workshare volumes and mailer revenues. This, in turn, should permit presort mailers to establish a financial base with which to offset lower volumes that would occur during the second rate period. Over the entire four year period, these cycles could induce greater efficiency, as firms invest in new capital equipment during the first rate period of higher volume in order to operate more efficiently during the second rate period of lower volumes.

III. ADJUSTING THE SINGLE-PIECE FIRST-CLASS RATE EVERY OTHER RATE PROCEEDING REQUIRES A CHANGE IN POSTAL SERVICE POLICY, AND THE CONCURRENCE OF THE RATE COMMISSION, NOT A CHANGE IN LAW

The possibility of rate stability for single-piece mailers is dependent, in the first instance, upon the Postal Service. The Board of Governors and postal management must simply decide whether a longer period of rate stability for household and other single-piece mailers is an appropriate policy goal.

To effectuate such a policy, no change in law is necessary. Under current law, postal management is able to file omnibus rate proceedings, and to select the implementation date of rate changes, at its discretion. Nothing in the proposal for a longer period of rate stability alters that prerogative of postal management. Consequently, the rate stability proposal outlined in this paper could be included in a future Postal Service rate request. The Postal Service could state its intention to maintain the single-piece First-Class rate for the duration of two rate periods, and propose a recommended SPFC rate and an actual non-integer rate to accomplish that goal.[35] If recommended by the Postal Rate Commission, the proposal and accompanying rates could be implemented by the Postal Service.

As with any proposal extending over a period of several years, circumstances may arise such that the recommended SPFC rate could not be maintained for two rate periods. Because the Postal Service may file a rate request at any time, postal management would be able to respond to the changing circumstances with a new rate request. This is the type of situation in which the Postal Service now finds itself, where changing economic circumstances are expected to prompt the filing of a new rate request earlier than previously anticipated by the Postal Service.

To implement the proposal for a longer period of rate stability, the Postal Service could establish under its own authority the SPFC Reserve Account. Neither a change in law nor approval of the Commission is required to establish the account. As proposed here, such an account is intended to be an entry in the book of accounts of the Postal Service, and need not be established as a segregated trust or similar fund. The SPFC

[35] It should be noted that a proposal to maintain the single-piece First-Class rate for two rate periods would be considered in a rate proceeding before the Postal Rate Commission in the same manner as any other Postal Service proposal. As is the case now, business mailers and other interested parties would have the opportunity to litigate all issues related to this (or any other) proposal, including the costs of service, the allocation of costs within and between the various mail classes, the estimated cost savings from worksharing activities, the percentage of cost savings to be passed-through in discounts, and the portion of the Postal Service's "institutional" costs to be borne by each class of mail.

Reserve Account would be established for the sole purpose of stabilizing the single-piece First-Class rate, according to Postal Service policy. Any revenues collected during the first rate period and "disbursed" during the second would be reported in a new line entitled "SPFC Reserve Account" in the Statement of Revenue and Expense. This treatment of reporting revenues in the SPFC Reserve Account would be similar to the treatment of revenues collected for the Recovery of Prior Years Losses ("RPYL"). This postal policy directs that additional revenues be obtained through rates to reduce a portion of the prior accumulated losses of the Postal Service. In the case of RPYL, the additional revenues are collected and reported each year on the "Operating Revenue" line of the Statement of Revenue and Expense, and used pursuant to postal policy for RPYL.