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The views expressed in this paper are those of the author and do not necessarily represent the opinions of the Postal Rate Commission.

The U.S. Congress set postal rates and classifications from the earliest days of the republic. It should not be surprising then that since the nation's beginning, business interests continually lobbied Congress for favorable rate and classification treatment. At first newspapers lobbied for and won free or nominal postage rates. Later advertising mailers lobbied for better rates while newspapers opposed them. Mail order firms lobbied for low priced parcel post and package delivery companies opposed them. Bulk mailers and nonprofit organizations lobbied for lower rates while First-Class mailers lobbied not to be stuck with the bill. Throughout the history of the post office, large and important political forces opposed each other and battled for influence. Congress was forced to make difficult and painful choices. It did so reluctantly. Every time Congress made a decision, it either cost the treasury money or it alienated powerful constituencies. A recent example occurred in the mid 1950s when the post office inaugurated unaddressed advertising mail. Although it would have generated much needed revenue which Congress dearly wanted and it would have benefited advertising mailers, newspapers mounted such furious opposition that Congress made the post office back down.

Since postal rates have involved large sums of money, bribery of congressmen was always a potential problem. And, just before postal reorganization, a senator who sat on the Post Office Committee was convicted of taking bribes to set favorable rates for catalogs.

Postal reorganization was enacted at the end of the 1960s, with the intention of eliminating taxpayer subsidies to mailers. Congress took the opportunity to extricate

itself from postal ratesetting. It set up an independent regulatory agency, the Postal Rate Commission.

Why did Congress do this? First of all, the U.S. has a tradition of regulating monopolies with independent regulatory commissions. For example, the Interstate Commerce Commission was set up in 1887 to regulate the railroads, the Federal Communications Commission was set up in 1934 to regulate broadcasting and telephone, and every state in the U.S. has a regulatory body which regulates local monopolies in electricity, telephone and natural gas. These regulatory bodies are thought necessary to protect captive customers and competitors for nonreserved services.

The Postal Rate Commission must be seen in the context of the continuing postal letter mail monopoly which to this day accounts for well over 80 percent of postal revenue. Congress wanted to prevent the abuse of monopoly power by postal management, so it set up checks and balances. Most of all, Congress feared that the Postal Service, if unregulated, might abuse its monopoly to exploit First-Class mailers and in particular, household mailers. Congress feared that large mailers with much at stake in postal rates would seek and receive special treatment from the Postal Service. Therefore, Congress decided that rates and classifications should be set by an independent regulatory agency with commissioners and staff who had no material interest in the outcome. In addition, Congress wanted an open ratesetting process which allowed those interested in postal rates to participate. Congress even wanted ordinary consumers to be represented in rate proceedings with a special representative paid for by the government.

The Senate Post Office Committee Report on the legislation stated:

"Most of the money in the postal system comes from first-class mail. A 100-percent increase in the rates for all second-class mail would not produce as much revenue as a 5-percent increase in the first-class rate. The temptation to resolve the financial problems of the Post Office by

charging the lion's share of the operational costs to first class is strong; that's where the money is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management."

Congress was also concerned that the Postal Service might use its monopoly to finance unfair competition. It wrote the legislation in such a way that the Commission was required to set rates high enough for each class of mail to recover all costs caused by that class of mail. It also required that the rates for each class of mail contribute a reasonable amount for overhead. Congress of course was most concerned with fair competition in parcel delivery.

Finally, Congress required the Commission to develop a public record for its decisions. It did not want rates to be set in private meetings between commissioners and influential mailers. It required the Commission to follow the Administrative Procedures Act, a set of rules designed to insure that any party with an interest may participate in its proceedings and receive due process. Congress knew that this would require fairly lengthy proceedings each time there was opposition to a Postal Service proposal. But Congress felt that due process, and meaningful public participation, was worth the time it took. By law, an omnibus rate proceeding in the U.S. takes at most ten months. I should add that it takes the Postal Service about five to six months to prepare its evidence prior to filing with the Commission.

Due process in the U.S. regulatory context means that all decisions must be made on a public record. The proponents of change (usually the Postal Service in our case) must present evidence in the form of testimony and supporting workpapers which are frequently complex computer spreadsheets or other computer based data and models. This evidence may be cross examined in writing and orally by any participant. Opponents may then present their own testimony which in turn can be cross examined. Rebuttal testimony is allowed for all participants and finally briefs summarizing each party's position are submitted. All of this constitutes the record of a

proceeding. It is available to all participants and interested observers. The Postal Rate Commission makes it available on the Internet. The Commission must decide all issues based on this record and only on this record. Parties that participate include large mailers, associations of mail users, other mailers with relatively narrow concerns and competitors which include newspapers and United Parcel Service. Newspapers are both users of the mail and competitors with advertising mail. Large newspapers are primarily interested in competitive issues, while small newspapers are primarily interested in issues involving their use of the mails. Finally, our statute requires that the Commission have a consumer advocate who participates in our proceedings as a party representing the general public.

The Rate Commission has five Presidentially appointed commissioners who are confirmed by the Senate and who serve for six-year terms and they can be reappointed. The Commission's professional staff includes five attorneys and nine technical staff advising the Commission, and a consumer advocate assisted by three lawyers and three technical staff. Consultants, especially academics, are used to supplement staff when necessary. The budget of the Rate Commission is 6 million dollars.

The Postal Rate Commission is not a regulator in the European sense. The Commission's role is limited to setting rates and classifications, approving the closing of small post offices, hearing complaints from the public, and giving advisory opinions about proposed changes in the level of service.

The Commission cannot disallow legitimate expenses of the Postal Service; the Commission can only disallow overestimates of expenses. On occasion it has even added to the revenue requirement when it found that the Postal Service has underestimated its expenses. The Commission establishes costing methodology used in ratesetting. It determines the cost of each product and the overhead contribution of each product. The Commission sets all worksharing discounts or as you might say, upstream and downstream access prices. It approves new products and the

elimination of existing products. It also has authority over eligibility for all products which it largely delegates to the Postal Service to meet its operational concerns.

To my mind, the most important features of the Commission are its independence and its open proceedings. While the Commission does not wish to preside over the demise of our Postal Service, the Commission recognizes that what is good for the Postal Service or what postal management might want is not necessarily in the best interest of the United States. I think it is safe to say that the Commission has avoided regulatory capture. The Postal Service knows the Commission may alter or deny its proposals or accept the proposals of mailers or competitors over its protests. This forces the Postal Service to be careful that its positions are reasoned and supported by good evidence.

The Commission's open procedures ensure transparency. The data and analyses supporting Postal Service proposals or the proposals of mailers and competitors is subject to scrutiny by all the parties and by Commission staff. The Commission must rule on each contraverted issue and issue a written opinion which explains its decision on each and every such issue. The Commission's decisions can be appealed to the courts on many grounds including lack of substantial evidence, failing to rely exclusively on the public record, arbitrariness and going beyond its authority.

I believe the open process I have described has made all of the parties including the Postal Service confident that their views are considered fairly and respectfully. I am not saying the Commission is perfect and that it does not make mistakes. Far from it. But the Commission's process helps to ensure fairness and leads to fewer errors than would be the case in a closed proceeding where the evidence was not subject to scrutiny.

If there was a Postal Service representative here, I am sure that he or she would complain about the burdens of regulation including the resources the Postal Service must devote and the time it takes to get its proposals accepted (or rejected). The

Postal Service must spend scores of millions of dollars to maintain five major statistical sampling systems which measure and assign costs to the classes of mail. These include in-office costs, city carrier out-of-office costs, rural carrier costs and transportation costs. Another system measures the volume, revenue and weight of each class of mail. The Postal Service has a thousand full time data collectors supporting the statistical data systems and a couple of thousand more employees who spend part of their time collecting data. In addition, the Postal Service must spend several million dollars more each year to conduct special cost studies designed to supplement the statistical data systems. It must also maintain a staff to deal with rate issues.

Furthermore, it usually takes the Postal Service five to six months to prepare its evidence for a proceeding and the Commission takes ten months to finish a major proceeding. This is frustrating to the Postal Service which feels it needs to act more quickly to meet increasing competition.

It is clear that regulation is not without costs. The burdens of regulation should be put into context, however. The U.S. Postal Service is a huge monopoly processing 200 billion items per year with a revenue of 60 billion dollars per annum. It employs 850 thousand workers. With over 600 pieces of mail per capita, it has the largest per capita volume in the world. Direct mail in the U.S. accounts for over 20 percent of all advertising expenditures in the U.S. This has increased from 13 percent in 1977. The Postal Service also competes vigorously in the competitive small parcel market. A great many mailers care a great deal about postal rates. Over seven thousand people attend the semi-annual postal convention called the Postal Forum. They all want the lowest possible rate for their mail.

The cost of regulation is a small fraction of one percent of postal revenue. Much of the data that the Service collects and uses for regulatory purposes is also used by management for its own purposes. Moreover, the Postal Service could not set rates in an information vacuum. So much of the data the Service collects would be needed

even if the Service were to set rates unilaterally. Perhaps it could get by with less data or lower quality data. But I submit, even a 100 million dollars a year is not too much for a 60 billion dollar monopoly to spend to make sure that its captive customers and competitors are treated fairly.

There are great benefits from setting cost based rates. It is a truism to say price signals which are based on costs help allocate societies' resources efficiently. It could be argued that the ensuing benefits of cost based rates are much greater than the limited cost of regulation. For example, a lack of adequate cost data and regulation might have allowed the U.S. Postal Service to under price the United Parcel Service and stifle its growth. The Postal Service could have protected its market share with below cost rates. While the Postal Service would have been better off, surely the United States would have been worse off. The real cost to the United States of the 20 billion dollars domestic ground service small parcel business would have been higher by perhaps five percent or more percent. Five percent is one billion dollars a year. This possible result dwarfs the cost of regulating the U.S. Postal Service.

With regard to the Service's complaint about the length of Commission proceedings and the resulting lack of flexibility, it should be pointed out that the preponderance of revenue comes from monopoly services for which there is no competition. To give due process to participants in a complex rate proceeding takes time. The Commission has, however, adopted special rules for new products and other limited proceedings so that they can be completed in about 100 days. These rules appear to be working.

I was asked to speak about liberalization of the monopoly in the United States. An urgent letter exemption was adopted by the Postal Service in the 1970s under pressure from Congress and the overnight delivery industry. With pressure from President Reagan, the Postal Service gave up the monopoly on outbound international letters in the 1980s. Beyond that, there has been no reduction in the scope of the letter monopoly in the United States. This would require action by the

Congress or a unilateral decision by the Postal Service. The Rate Commission lacks authority to limit the scope of the monopoly. Legislation has been proposed in Congress to limit the monopoly to letters priced at less than six times the basic letter rate. But that is all.

The U.S. Postal Service has, however, extensively liberalized upstream and downstream access. This is called worksharing in the U.S. The goal is to allow the mailer, the Postal Service or third parties, whoever has the lowest cost, to collect, sort, barcode and transport mail.

The U.S. Postal Service, the Rate Commission and the mailers have all cooperated in what I am certain is the most extensive worksharing program of any postal administration. The Commission uses what is known in regulatory parlance as efficient component pricing to set these discounts. The discount is set at the Postal Service avoided cost so that the lowest cost provider, be it the Postal Service, third party or mailer, performs that activity. Efficient component prices mean that workshared mail makes the same overhead contribution per piece as nonworkshared mail. Consequently, the discount is set so that the Postal Service and nonparticipating mailers are indifferent to who does the work.

The effects of worksharing on the Postal Service have been profound. Of the 100 billion pieces of First-Class Mail, 44 billion pieces are workshared. This means they are presorted and barcoded. All barcoded pieces must have had their mailing list reviewed regularly by special software to remove poor addresses and to update addresses of people who have recently moved. The discounts depend on the depth of presort. The savings to the Postal Service from First-Class worksharing is 3.4 billion dollars.

The savings from advertising mail worksharing are even greater. Advertising mailers not only presort and barcode their mail, mail presorted to the carrier route level is sorted into carrier walk sequence by the mailer. Advertising mail is also trunked or

dropshipped to locations near their destination. Sixty-one billion of the 67 billion advertising mail pieces are workshared. The savings to the Postal Service is nearly 9 billion dollars annually. To facilitate cost based worksharing for advertising mail, the rate schedule contains over 60 different discounts.

Extensive worksharing also takes place in publications mail and parcel post. The total cost savings from all worksharing discounts for all classes of mail is nearly 13 billion dollars. This is more than one-fifth of the 60 billion dollar total operating expenses of the Postal Service.

Today mailers and the Postal Service enthusiastically support worksharing. All state that the goal of the program is to provide the lowest cost of mail to society. The effect of lower real prices stimulates volume. The Commission has conducted analyses which show that volume increases are the invariable consequence of new worksharing discounts. In particular, much of the growth of advertising mail has been due to the extensive worksharing discounts and the resulting opportunity for mailers to reduce the real cost of postage.

The U.S. Postal Service was not always a supporter of worksharing discounts. It resisted suggestions by large mailers in the late 1960s and the early 1970s. Realizing that the Commission could act without the Postal Service's support, however, drove the Service to the bargaining table. It reluctantly agreed to support a First-Class presort discount of one-half cent. The Commission approved a one-cent discount in 1976. Later, the statistical data systems found the cost difference between presort and single piece mail to be five cents. Worksharing soon spread to all classes of mail. Today, well over half the postal volume of 200 billion pieces receives worksharing discounts.