

**Government Competition
with Private Enterprise:
Some Thoughts on Pricing the Mails**

Mitchell Knisbacher

Program on Information Resources Policy

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GOVERNMENT COMPETITION WITH PRIVATE ENTERPRISE: SOME THOUGHTS ON
PRICING THE MAILS

Mitchell Knisbacher
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Foreword

This paper is one of a continuing series of studies on postal policy sponsored by the Program on Information Resources Policy.

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EXECUTIVE SUMMARY

Mitchell Knisbacher, "Government Competition with Private Enterprise: Some Thoughts on Pricing the Mails."

. Competition between the United States Postal Service (USPS) and the private sector has increased in substance and complexity in recent years, creating a need to reevaluate the postal pricing process and the effect of rates on competition.

. USPS, created in 1970 as an independent establishment of the executive branch of the U.S. government, assumed the powers and functions of the former Post Office Department. To oversee the Postal Service, Congress concurrently established the independent Postal Rate Commission with authority for reviewing USPS requests for rate and classification changes.

. A decade of postal pricing experience, which saw an appeals court rejection of the demand-pricing Inverse Elasticity Rule, finds the Postal Service in need of a sound methodology to prevent the current discretionary approach to pricing from yielding anticompetitive results.

. Consideration of competition issues in postal rate proceedings has frequently been superficial and inconsistent as the PRC and participants in its proceedings have failed to develop an agreed approach to balancing the divergent public and private interests.

. Competition issues arise with increased frequency as a result of the expansion of USPS's service offerings into areas such as electronic communications, previously served by the private sector.

. Because the Postal Service is an arm of the government, many aspects of its operations are determined by law, resulting in both advantages and disadvantages to USPS. The advantages include:

- . savings from tax exemptions
- . low-cost borrowing;
- . the initial equity USPS received as successor to the Post Office Dept.; and
- . Congressional appropriations.

Disadvantages include:

- . personnel restrictions which may lead to higher labor costs;
- . laws governing federal contracting, property, employment, etc.
- . the nation-wide service requirement.

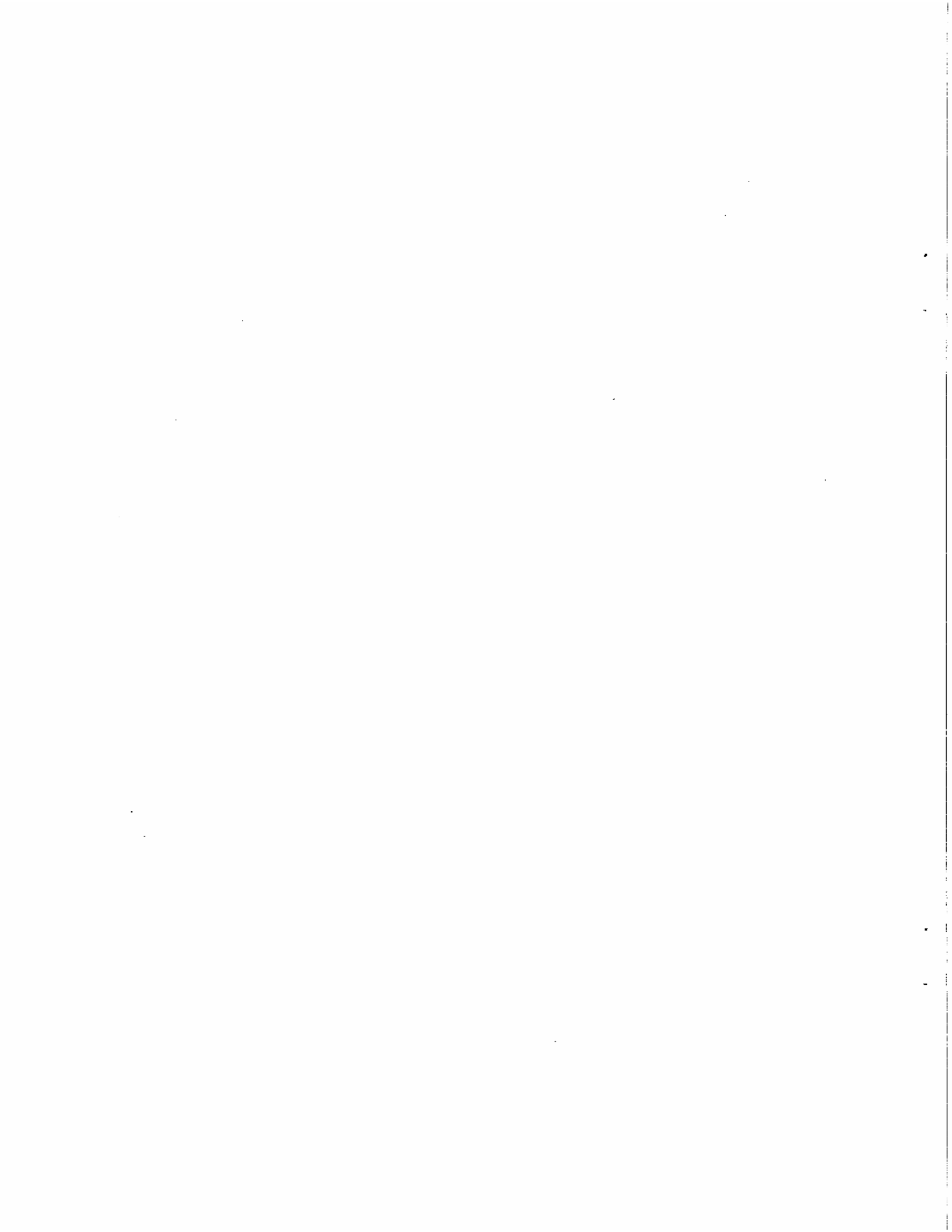
A sound economic basis exists for using a pricing policy to offset these advantages and disadvantages in order to assure against unfair competition by the Postal Service and to prevent the USPS competitive posture from being adversely affected. The issues are complex, yet preliminary analysis indicates that there also exist adequate policy and legal grounds for such a step.

Attention should also be focused on several other matters which can have important effects on competition, including:

- . separate subsidiaries for competitive USPS services;
- . the self-enforced Private Express monopoly;
- . cream-skimming;
- . timing of rate increases.

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GOVERNMENT COMPETITION WITH PRIVATE ENTERPRISE:
SOME THOUGHTS ON PRICING THE MAILS

I. Introduction

A. The Statutory Framework of Postal Reorganization

The United States Postal Service (USPS) was established in 1970, under the Postal Reorganization Act, as an "independent establishment of the executive branch of the Government of the United States." Transferring the powers and functions of the former Post Office Department to the new Postal Service, Congress directed that it "plan, develop, promote, and provide adequate and efficient postal services."¹ Rates and fees must be fair and reasonable, and

...sufficient to enable the Postal Service under honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service.²

To oversee the independent Postal Service, Congress concurrently established the Postal Rate Commission (PRC) and endowed it with limited authority over the ratemaking and classification process. USPS is required to go to the PRC with requests for recommended decisions on changes in postal rates or in the Domestic Mail Classification Schedule. The PRC is then obligated to hold hearings under the Administrative Procedure Act,³

¹ 39 U.S.C. §403.

² 39 U.S.C. §3621.

³ The Administrative Procedure Act specifies procedures governing, inter alia, proceedings in which federal agencies adjudicate matters affecting the rights of interests of private parties. See 5 U.S.C. §§551-59, 701-06.

basing its decisions on standards specified in Title 39.¹ PRC recommended decisions go to the Postal Service Governors, who may either accept, reject, remand for reconsideration, or, by unanimous vote, modify them.² Final responsibility for implementing changes in rates and classifications rests with the Governors; it is their decisions—not those of the PRC—which can be appealed to the courts.³

B. Private Competitors of the Postal Service

Since the eighteenth century, the Postal Service has enjoyed a statutory monopoly over the carriage of "letters,"⁴ with the result that private sector competition was largely limited to second-, third-, and fourth-class mail matter.⁵ United Parcel Service (UPS), Railway Express Agency, and other smaller carriers have competed for fourth-class traffic; local delivery services deliver circulars as an alternative to third-class

¹ 39 U.S.C. §§ 3601, 3621-23.

² The Governors can only modify after a decision has previously been returned to the PRC for reconsideration.

³ The only exception is that the Governors may accept a PRC decision under protest, appealing it to the courts.

⁴ In the enforcement of the Private Express Statutes (PES), the Postal Service has defined a "letter" as "a message directed to a specific person or address and recorded in or on a tangible object," including paper, recording disks, and magnetic tapes. The term "messages" refers to "any information or intelligence that can be recorded [in a manner having a predetermined significance]." 39 C.F.R. §310.1.

⁵ There has also been competition for the carriage of time-sensitive "letters," but until 1979, when the Postal Service suspended the PES for "extremely urgent letters," private carriers could carry time-sensitive materials only if postage was affixed to the outside of the envelope/package and if certain other requirements were met. 39 C.F.R. §§ 310.2, 320-6. These requirements placed a burden on private carriers, but did not prevent them from developing competitive services because first-class postage (required for letters) generally did not represent a substantial portion of their costs.

mail; and paper boys have presented an alternative to postal delivery of second-class newspapers. Indirect competition has also arisen in many areas, such as telephone calls and telegrams as substitutes for letters and media advertising for third-class mail.¹

In the 1980s questions surrounding Postal Service competition with the private sector are taking on increased importance because the Postal Service is reaching into new areas, such as Express Mail and electronically transmitted messages. Furthermore, increases in second- and third-class postal rates have, at times in recent years, made private sector delivery of newspapers, magazines and circulars a more viable proposition than it had been previously.

One of the factors which 39 U.S.C. §3622 requires be given consideration in setting postage rates is "the effect upon private enterprises engaged in the carriage of mail matter other than letters." While there is no analogous provision in §3623, which governs mail classifications, the rate-setting criteria are relevant in classification proceedings involving rates, including those cases in which the Postal Service seeks to offer new services in competition with the private sector. Competitors of the Postal Service have always appeared in Postal Rate Commission proceedings, but their number and the extent of their participation has increased dramatically in recent years.² The existence

¹ See generally, Coopers and Lybrand, Study on Competition and Demand in Component Markets of the Mailstream: Final Report, Vol. II (1980) (USPS Contract No. 104230-78-D-0265).

² UPS, the principal contender for fourth-class mail matter, has participated actively in every general postal rate case, as well as classification cases involving fourth-class; in Docket No. MC78-3, the E-COM proceeding, fourteen communications companies intervened, as well as two industry associations; in Docket No. MC79-2, Express Mail Metro Service, ten courier services intervened, vigorously opposing the Postal Service's proposal to offer an intra-city Express Mail service.

of substantial competition to the Postal Service has further complicated the labyrinthian ratesetting and classification processes, creating a need for an analytical framework to help systematize the process by which competition is considered.

C. The Ratesetting Process

Since the passage of the Postal Reorganization Act, the derivation of postage rates has involved a four-step computational process: (1) determination of the USPS revenue requirement; (2) allocation, pursuant to 39 U.S.C. §3622(b)(3), of all costs directly or indirectly attributable or reasonably assignable to a class of mail; (3) discretionary assignment of the residual portion of the revenue requirement, on the basis of the non-cost criteria of §3622¹; and (4) the design of rates for the different rate categories once the allocations of costs have been completed.² The second step is generally referred to as costing; the third as pricing because it results in the determination of the average revenue per piece, or price; and the fourth as rate design.

This analysis focuses on pricing, which can also be thought of as the allocation of that portion of the revenue requirement which exceeds attributable and assignable costs. The reason for concentrating on pricing, rather than on costing the revenue requirement or rate design, is twofold. First, this important stage in setting rates has been, to date,

¹ See p. 12, *infra*.

² The PRC has interpreted section 3622(b)(5) as requiring the collection of separate cost data and independent application of the ratesetting criteria only when a separate subclass is involved. The design of rates for different rate categories within a subclass or class need not be founded strictly upon section 3622. PRC Opinion and Recommended Decision [hereinafter Op. & Rec. Dec.], Docket No. R77-1, at 240-49 (1978).

largely discretionary. On the one hand, the discretionary nature of the process allows the Postal Service to engage in anticompetitive behavior (although no assumption is made that this has been the case); on the other, it creates an opportunity, at least theoretically, for the distribution of residual costs in a manner that will provide a safeguard against unfair competition. Second, although specific statutory criteria govern postal pricing, the competition issues surrounding revenue requirement, costing, and rate design are not unique to the Postal Service; traditional techniques for analyzing regulated industries can be applied in these areas in an effort to ensure against unfair competition with the private sector. For example, regulatory bodies frequently rely on cost analyses to assure that public utilities do not engage in cross-subsidization between monopoly and non-monopoly services.

Unlike the costing of telephone services, which are based on policy-oriented separations and settlements,¹ postal costing, since reorganization, has been based on the identification of causal relationships. As is discussed below, the Postal Service and the Rate Commission originally adopted volume variability as the criterion for establishing causality. But the Court of Appeals for the D.C. Circuit, in National Association of Greeting Card Publishers v. United States Postal Service (NAGCP I),² required the extension of the definition of "attributable and reasonably assignable costs to include those which can be identified through "reasonable inferences" of causation. To the extent the definition

¹ See, Oettinger, "Players, Stakes and Politics of Regulated Competition in the Communications Infrastructure of the Information Industry" (Program on Information Resources Policy, Harvard University, Cambridge, MA, 1981).

² 569 F.2d 570 (1976), vacated as to other issues, 434 U.S. 884 (1977).

changes, the line between costing and pricing is porous. But once a definition of causality is agreed upon¹, it is possible to proceed with empirical analysis to determine which costs are attributable and which should be placed in the residual pool for allocation on the basis of pricing theory.²

One reason pricing can have such an important impact on postal rates is that the level of the Postal Service's attributable and assignable costs has never exceeded 71.4 percent.³ In its 1981 Recommended Decision in Docket No. R80-1, the last rate case, the PRC cut over \$1 billion from the Postal Service's requested revenue requirement and was still left with \$4.4 billion to distribute on the basis of pricing criteria. Nevertheless, pricing analysis is frequently ignored or subordinated in the evidentiary presentations of intervenors, who tend to concentrate on the approximately 50 to 70 percent of costs that are attributed or assigned.⁴ That strategy

¹ To the extent the definition differs from volume variability one could also argue that it is political rather than empirical. Moreover, the determination of the period over which volume variability is to be measured may be a political decision.

² There is no guarantee that empirical analysis will produce identical results every time, for improvements in the analytical techniques are likely to lead to costs moving back and forth between the attributable and residual cost pools.

³ That level was reached in Docket No. R77-1, the \$.15 rate case.

⁴ Intervenors have repeatedly pointed to the impact of pricing on rates, but they have not offered analytical alternatives to the present approach. Instead, their efforts have largely focused on arguments for reducing the shares of residual costs assigned to particular rate categories. Given the limited litigation resources of most of the intervenors, the emphasis on reducing residual cost assignments--as opposed to the development of new methodologies--is understandable from the standpoint of cost-effectiveness. Aside from the relatively steep cost of development, it is difficult to estimate in advance the extent to which a new methodology will result in appreciable changes to existing cost assignments or the likelihood that it will ultimately be adopted by the Postal Rate Commission, the Postal Service, and the courts.

is understandable, inasmuch as changes in relative markups over attributable and assignable costs¹ have tended to be rather minimal during the first decade of postal reorganization. Yet the course could become suboptimal should the Commission or the Postal Service prove open to serious consideration of a pricing schedule in which relative markups differ significantly from those presently prevailing.²

The United States Court of Appeals for the District of Columbia Circuit, before which the appeals from the first four Postal Service general rate cases were heard, has looked askance on pricing, because the process has been characterized by discretionary allocations. Blind to the fact that excessive costing can be as discretionary, arbitrary and anticompetitive as pricing,³ the Court has concentrated its efforts on forcing USPS and the PRC to push up the level of attributable and

¹ Prices of Postal Services are frequently compared by computing a markup fraction, the numerator of which is the price, or average revenue per piece, of a given rate category and the denominator of which is equal to the sum of its attributable and assignable costs.

² To a degree, this already occurred in Docket No. R80-1 as the Commission, for the first time, recommended that the third-class markup be higher than that for first-class.

³ An excellent example in recent postal ratemaking is "service-related costs" (SRC). In response to the Court of Appeals decision discussed in the text (NAGCP I, *supra*, p. 4), the Postal Service, in its 1977 rate request, Docket No. R77-1, identified costs associated with six-day as opposed to three-day delivery, and assigned them to those classes whose service standards could only be met with six-day delivery. Although the PRC accepted the SRC concept, and it was upheld by the Court of Appeals, the Postal Service rejected it as theoretically invalid in its subsequent rate filing. The PRC refused to discard SRC, and relied on the concept in its decision in Docket No. R80-1. The Postal Service Governors disagreed with this aspect of the Commission's decision and requested reconsideration, but to no avail. See PRC Op. & Rec. Dec., Docket No. R80-1, at 145-57; Governors' Dec., at 14-15; PRC Op. & Rec. Dec. Upon Reconsideration, Docket No. 80-1, at 69-103. It could be argued that SRC had originally been employed to further anticompetitive objectives--although there is no evidence that this was the case--because most of the costs were allocated to monopoly, rather than competitive services.

assignable costs. The result has been that both the Postal Service and the PRC have tended to neglect the development of pricing theories, concentrating their efforts on meeting the Court's goal of making "costing" as large a segment of the USPS revenue requirement as possible. As mentioned above, to conform to the court's directives, volume variability, previously the sole criterion for costing, has been supplemented with "reasonable inferences of cost causation."¹

By focusing on postal pricing under the existing law, this study seeks to aid policy-makers and participants in the ratesetting process with a framework for analyzing the effect of prospective rates on competition in the private sector. No legislative proposals will be presented, although the text will identify areas which future Congressional action could address.

Two important assumptions underlie the study: first, that pricing will continue to govern the allocation of a substantial share of the Postal Service's costs²; second, that no change will be made to the Private Express Statutes (PES). While it is recognized that there is currently some sentiment favoring repeal of those laws, they constitute a subject unto themselves requiring in-depth treatment far beyond what is possible here.

¹ See p. 5, *supra*. Whether this will continue to be the case will depend on the outcome of the Supreme Court's decision in the appeal of the most recent rate decision. See p. _____, *infra*.

² Whereas the D.C. Court of Appeals has continually urged higher levels of attributions and assignments, the sentiment on Capitol Hill has often been in favor of capping the level of costs, thereby assuring a certain sum for discretionary allocation on pricing considerations. S. 3229, in the 95th Congress, second session, for example, called for a ceiling of 60 percent on attributable and assignable costs. The proposed cap appears to have been a response to the decisions of the D.C. Circuit, and particularly the finding that the attribution process required reliance on "reasonable inferences" of causation.

Instead, this analysis will focus on questions surrounding the application of 39 U.S.C. §3622(b)(4), and how to balance it against the other sections of the Postal Reorganization Act. In addition, the effect of postal pricing on competition will be examined in the context of other statutory provisions which require its consideration as part of a general PRC/USPS obligation to protect the "public interest."

II. PRICING UNDER THE REORGANIZATION ACT

A. Computational Process

Under the 1970 act, postage rates have been set on the basis of an interactive procedure. Volume projections at existing rates ("before rates") are used to estimate costs, which are then totalled to provide the revenue requirement. After those costs which are attributable or assignable have been allocated to the different classes of mail, the residual portion of the revenue requirement, less Congressional appropriations,¹ is allocated on the basis of the pricing criteria of ¶3622. Once the process is complete, volumes are projected at the new levels ("after rates"), leading to a second set of estimates of the revenue requirement, attributable and assignable costs, and discretionary allocations on the basis of pricing criteria. Iterations are continued until a set of rates

¹ The Postal Service currently receives two types of Congressional appropriations. A public service subsidy is granted to compensate USPS for "providing a maximum degree of effective and regular postal service nationwide, in communities where post offices may not be self-sustaining, as elsewhere." 39 U.S.C. ¶2401(b). In addition, USPS receives phasing appropriations to reimburse it for revenue foregone as a result of statutory rate preferences for certain categories of second, third and fourth class mail. "Revenue foregone" appropriations are of two types: phased and continuing. Phasing appropriations are the product of a Congressional decision to phase in compensatory rates for categories of mail which prior to the enactment of the Postal Reorganization Act were at noncompensatory levels. Continuing appropriations reimburse the Postal Service for the preferences granted non-profit users, whose rates do not include any portion of the residual costs of the Postal Service. Each year the Treasury reimburses the Postal Service for the loss in revenue resulting from the decision to set the rates for these classes at preferred levels rather than the levels which would be in effect absent revenue foregone appropriations. 39 U.S.C. §§2401(c), 3626.

Despite the statutory provisions for both public service and revenue foregone appropriations, budget-cutting pressures, particularly in recent years, have led to restrictions on the size and scope of the appropriations reaching the Postal Service. See, e.g., Omnibus Budget Reconciliation Act of 1981, 95 Stat. 357 (1981).

is obtained at which revenues equal costs, in satisfaction of the breakeven requirement of \$3621.

To date, the framework for evaluating the discretionary allocations has been relative cost coverages, the cost coverage representing the average price per piece (attributable and assignable costs plus discretionary allocations) expressed as a percentage of the attributable and reasonably assignable costs for the subclass. Typically, the analysis is based on a comparison of the cost coverage of a given subclass with that of others within the same class of mail and the systemwide average.

B. Ten Years of Experience

In each of the five general postal rate cases,¹ USPS and the PRC followed remarkably similar approaches to pricing. In Docket No. R71-1, the Postal Service offered a set of allocations based on "a ranking of prospective price sensitivities as one of several bases," the application of the approach being strictly judgmental. The Commission, the Governors, and the Court of Appeals found the approach satisfactory as a first-time effort.² Chief Judge Bazelon, however, in a concurring opinion in which the other two members of the panel joined, was sharply critical of the fact that a relatively low level of attributable costs (49 percent) had combined with the absence of a pricing methodology to permit the wholly

¹ PRC proceedings limited to a single class or subclass will not be examined here unless they raise special competition considerations, e.g., E-COM and Express Mail Metro Service.

² "Op. & Rec. Dec.", Docket No. R71-1, at 1-280; USPS, Action of the Governors under 39 U.S.C., Section 3625, in the matter of Postal Rate and Fee Increases, 1971: Docket No. R71-1, at 1-367 (1972); Association of American Publishers v. United States Postal Service, 485 F. 2d 768 (1973) [hereinafter "Publishers"].

discretionary assignment of five billion dollars of Postal Service costs.¹

In response to Judge Bazelon's criticisms, the Post Service's presentations in Dockets No. R74-1 and R76-1 sought to alleviate the problem by increasing the level of attributable and reasonably assignable costs (52.5 percent in the former and 60.4 percent in the latter), based principally on new studies of volume variability. In addition, the development of elasticity estimates made it possible to employ a demand pricing model based on the Inverse Elasticity Rule (IER).² The PRC accepted the USPS approach in both cases, expressing satisfaction with IER, particularly as it was modified and computerized in Docket No. R76-1.

While the principal argument supporting use of IER is that under proper conditions it results in economically efficient pricing, an additional advantage is that it provides a structure for postal pricing, permitting the transformation of subjective decisions into a mathematical formula which can subsequently be used to produce a set of prices. Previously, all the subjective, non-cost factors of section 3622 had been evaluated at one time and translated into one objective number--a cost coverage. IER relied upon econometric analysis in the estimation of elasticities and provided a structure for the pricing decision.

By separating the subjective decision-making process from the computation of the final price, IER made it much more difficult for

¹ Publishers, 485 F.2d, at 776.

² For an explanation of IER, see 1 A. Kahn, The Economics of Regulation, pp. 144-45 (1970). USPS had employed IER in developing its pricing proposals in Docket No. R71-1, but relied on a ranking of the major categories of mail by "price sensitivity" rather than empirical quantifications of elasticities. See Docket No. R71-1, at I-11 (Chief Examiner's Initial Decision); Exhibit PS-T-5, at 4-8 (testimony of Postal Service witness Eden).

managers, rate commissioners, or intervenors to abuse the process. If the Postmaster General (PMG) wanted to lower his staff's proposed third-class rates, he could not do so without introducing a constraint into the IER model or requiring his staff to go back and change their evaluation of the regression analysis which had produced the elasticity estimate. In either case, the lower rate would have been vulnerable to attack by intervenors—on the grounds that the constraint was improper or that a proper interpretation of the regression analysis produced a lower elasticity estimate and hence a higher rate. In contrast, discretionary pricing is nearly impossible to test, for there is no analytical means of countering a witness's judgment that "on the basis of the criteria of section 3622, I believe the cost coverage should be X."

A basic problem faced by USPS in the first application of IER was that the econometric analysis of postal elasticity was still in its infant stages. Aside from "constraints" considered necessary to comport with various requirements of the law, and policy considerations, staff members inserted several "stipulations" into the IER computer model to account for unusually shaped demand curves. USPS opponents sharply criticized these stipulations as invalidating the model and producing an approach which was scientific in appearance but wholly judgmental in fact. The estimation of elasticities steadily improved in subsequent proceedings because the estimates continued to be used in the projection of volumes, wholly apart from the requirements of pricing. But further development of the IER model ended after the D.C. Circuit rejected the approach in

NAGCP I.¹ It is, therefore, impossible to know whether the model could have been sufficiently refined to distinguish the use of IER from the totally discretionary approach to pricing.

Because of delays in the Court of Appeals calendar and a PRC decision to expedite proceedings to meet a ten-month statutory time limitation which was then being considered by Congress,² the third PRC rate case was concluded prior to the issuance of the court's decision in NAGCP I. As a result, the NAGCP I directives were not implemented until Dockets No. R77-1 and R80-1, the fourth and fifth rate cases. In those proceedings USPS and the PRC increased levels of attributable and assignable costs and shifted

¹ The Court rejected IER as inadequately incorporating the non-cost criteria of section 3622. Its plunge into the technical details of pricing methodologies was somewhat surprising given the policy of judicial deference to administrative expertise, as formulated in the Supreme Court's decision in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), and confirmed elsewhere in the Court's decision:

We wish to emphasize that our holding with regard both to attributable and assignable costs is narrow. Our duty is not to prescribe any one methodology, and nothing we say here should be taken as approving in advance any particular approach. The selection of one approach from among acceptable alternatives is a matter for agency expertise. [569 F.2d, at 592-93.]

In defense of the D.C. Circuit one could argue that the NAGCP I decision only prohibited use of IER as the sole basis for pricing, and the reason its use was completely terminated is that its theoretical foundations are faulty if it is not used as such. See, Kahn, at 69-70 (1971), and sources cited therein. That, however, is not the case, for as the ensuing discussion in the text indicates, the court has subsequently delved even deeper into the arguments underlying inverse elasticity pricing and issued what amounts to a blanket prohibition on its use in postal rate-making. See National Association of Greeting Card Publishers v. United States Postal Service, 607 F.2d 392 (1979), at 402-04 [hereinafter NAGCP III]. The Second Circuit, however, has specifically cited these findings as exceeding the proper scope of judicial review, relying, *inter alia*, on Publishers to support its position, Newsweek v. United States Postal Service, 663 F.2d 1186, at 1196-97 (2d. Cir. 1981) [hereinafter "Newsweek"].

² The provision was subsequently enacted into law. P.L. 94-421, 5(a), 90 Stat. 1306, codified in 39 U.S.C. § 3624(c).

back to discretionary allocations of the residual. Because of the increased level of attributions and assignments, pricing theory was employed to allocate a smaller employed to allocate a smaller piece of the pie (17.6 percent in Docket No. R77-1 and 20.0 percent in Docket No. R80-1), but the dollars allocated dropped only slightly in R77-1, and rose in R80-1, because of sharp increases in the Postal Service's total revenue requirement.¹

In its review of Docket No. R77-1 the D.C. Court of Appeals expressed satisfaction with the increases in attributions and assignments. While the court did not address the discretionary allocations to which USPS and the PRC had returned, it devoted several pages of its opinion to a discussion of the compatibility of marginal cost pricing with the Postal Reorganization Act. The panel concluded that in the setting of postal rates and fees, Congress intended that the "prevention of discrimination among the mail classes" take precedence over the application of economic principles such as marginal cost pricing.² Again, the Court refused to recognize that there is nothing magical in the allocations identified as "costing," and it failed to appreciate that there may be as much room for discrimination in assignments based on "reasonable inferences" of causation as in allocations inversely proportionate to elasticity.

¹ The amount of residual costs allocated on the basis of pricing considerations was as follows for the first five rate cases:

<u>Docket No.</u>	<u>Amount (millions)</u>	<u>Percentage</u>
R71-1	\$4006.7	41.2
R74-1	4405.0	36.7
R76-1	3843.1	27.1
R77-1	3096.2	17.6
R80-1	4409.1	20.0

² NAGCP III, 607 F.2d, at 402-04.

In its review of the latest rate decision, Docket No. R80-1, the Second Circuit has differed sharply with the D.C. Circuit, finding that the NAGCP I and NAGCP III panels "failed to give sufficient deference to [the PRC's] own interpretation of the statute, misread the plain language of 3622(b) and misconstrued the legislative history of that section."¹ The court in Newsweek specifically rejected the D.C. Circuit's rulings that §3622 requires attribution and assignment of costs "to the maximum extent possible" on cost-of-service principles, with only the residual being allocated on the basis of the non-cost factors of the statute. The panel stated its conviction that Congress intended for the PRC to enjoy "much more discretion and greater latitude in its rate-setting determinations," and noted that "[t]here is nothing in the legislative history to suggest that attribution of fifty percent of postal costs is adequate."² The Supreme Court granted certiorari in Newsweek, and the differences between the D.C. and Second Circuits should be resolved in the October 1982 term.

To summarize, the approach of the D.C. Court of Appeals has been to interpret the statute as prohibiting inverse elasticity pricing and to reduce the impact of pricing by expanding the definition of attributable and reasonably assignable costs to take account of "reasonable inferences" of causation. In the process, both costing and pricing have become more arbitrary and susceptible to abuse. The Court has provided no pricing theory to take the place of IER, and presently billions of dollars of USPS costs are being allocated on the basis of an unstructured, judgmental application of the section 3622 criteria. The Second Circuit's approach has been to reduce the emphasis on attributions and assignments based on

¹ 663 F.2d, at 1196.

² Id., at 1200.

cost-of-service principles and to increase the scope of the PRC's discretion. Should its interpretation of the statute be adopted by the Supreme Court, pricing is likely to become the foremost issue in postal ratemaking, as the door will be open for the annual distribution of ten billion dollars or more of postal costs on the basis of pricing criteria.

It is not suggested that IER be revived, because it has never been shown to be capable of encompassing all of the non-cost criteria of 39 U.S.C. §3622 without the employment of constraints and stipulations which can undermine its theoretical foundations. However, there is still a need for a structured, systematic pricing system which lessens the impact of unrestrained judgments. The totally discretionary approach to pricing presently used is open to arbitrary and capricious manipulation by any of the actors with responsibility for the pricing decision, and may well become a target of the courts in future cases.

Development of an alternative approach to pricing is beyond the scope of this paper, which is limited to the pricing of competitive services. The discussion of methodology in the ensuing section thus concentrates on preventing the existing discretionary approach from resulting in anticompetitive USPS behavior, either intentional or unintentional.

III. LEGAL AND POLICY CONSIDERATIONS IN PRICING COMPETITIVE SERVICES

A. Statutory Criteria

The criteria for setting postage rates and fees are contained in 39 U.S.C. §3622(b):

Upon receiving a request [from the Postal Service], the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors:

- (1) the establishment and maintenance of a fair and equitable schedule;
- (2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation and priority of delivery;
- (3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
- (4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
- (5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
- (6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
- (7) simplicity of structure for the entire schedule and simple identifiable relationship between the rates or fees charged the various classes of mail for postal services;
- (8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and
- (9) such other factors as the Commission deems appropriate.

B. Competition Issues in Past Proceedings

Competition issues have arisen in several different postal rate proceedings. Yet, as the ensuing discussion indicates, the PRC's consideration of competition has tended to be rather superficial, and related inconsistencies appear in its interpretations of some of the provisions of the Reorganization Act.

1. Docket No. R71-1 (June 1972)

In Docket No. R71-1 the hearing examiner¹ found that parcel post rates should be set at levels adequate to recover long-run costs, and that failure to do so would be unfair to competing carriers such as UPS.² The Commission, however, rejected the approach, comparing it to the fully distributed costing methodology used for postal ratemaking before the 1970 Act. According to the PRC, section 3622(b)(4) served as a substitute for-- rather than as a reaffirmation of--the old methodology.³ In adopting the provision, Congress left the decision to employ a fully allocated costing methodology with the Commission.

The PRC had also been urged to raise parcel post rates to conform to the policies of the antitrust laws, but it refused to do so, finding there was no evidence on the record that parcel post was unfairly priced in any

¹ The first two general rate cases were heard before a hearing examiner, now called an administrative law judge; in subsequent proceedings the Commission sat en banc.

² Docket No. R71-1, Initial Decision, at 149.

³ PRC Op. & Rec. Dec., Docket No. R71-1, at 198 (1-316). See Hearings on the Reorganization of the Postal Establishment before the Senate Committee on Post Office and Civil Service, 91st Cong., 1st sess., 689, 716-17 (1969); Hearings on Various Proposals to Reform the Postal Establishment before the House Committee on Post Office and Civil Service, 91st Cong., 1st sess., 551-59, 946-56 (1969); S. Rep. No. 912, 91st Cong., 1st sess., 17 (1970).

respect.¹ The focus of the PRC's examination was on the "'effect' of proposed rates on private carriers." Once it found no evidence of adverse impact, it concluded its task was over, stating section 3622(b)(4) was not directed to "theoretical costing arguments."²

2. Docket No. R74-1 (August, 1975)

In the second general rate proceeding, Docket No. R74-1, the PRC's attention was directed to competition for second and third class, as well as fourth. Interestingly, users of the mails—and not competitors—raised the issue of alternate delivery of magazines and newspapers. Dow Jones, Inc., and the Magazine Publishers Association (MPA) argued that higher rates would result in a shift of volume from the postal system,³ but the PRC found that the recommended rates would not cause any appreciable diversion. The Commission similarly rejected analogous claims regarding third class, concluding the record was insufficient to prove the proposed rates would result in substantial diversion.⁴

With respect to fourth class, the PRC found that the existence of alternate means of delivery required "a relatively low cost coverage,"⁵ interpreting section 3622(b)(5) as an authorization to facilitate USPS competition with the private sector. The Commission did not have to balance that interpretation of subsection (b)(5) against the "effect on

¹ Op. & Rec. Dec., Docket No. R71-1, at 199.

² The Commission noted that UPS appeared to be principally concerned with the principles involved and not the effect of the rates actually proposed. Id., at 200-01.

³ See PRC Op. & Rec. Dec., Docket No. R74-1, at 233, 245.

⁴ Id., at 277-79.

⁵ Id., at 288-89.

competitors" provision of subsection (b)(5) because UPS did not contend that it would be adversely affected by the proposed rates.

3. Docket No. R76-1 (June, 1976)

In Docket No. R76-1, the PRC repeated its interpretation of section 3622(b)(5) as requiring lower rates when the Postal Service is presented with competition. Citing the provision, the Commission stated that "the basic issue concerning the rates for second-class regular rate publications is whether, and to what extent, private delivery is a viable alternative to the Postal Service."¹ The Commission based its rate on an economic model developed by USPS to analyze the likelihood of private sector competition and thereby aid in the estimation of elasticity. While the PRC concluded that the section 3622(b)(5) standard could not be quantified into a precise elasticity estimate for input into the IER model, it relied upon the USPS alternative delivery model is deciding to "exercise caution" in raising the rate for second-class regular rate because the subclass was "approaching a range of increasing elasticity."²

In its analysis of parcel post rates, the Commission accepted a USPS proposal for a stipulated 10 percent increase in place of the rates produced by the IER model. That decision was based on a USPS analysis of the likelihood of increases in UPS rates. Concluding that a UPS rate increase of more than 15 percent could not be expected, the Commission found that a substantial increase in the price of parcel post relative to UPS prices "would be catastrophic...in the sense that it might not yield the intended net revenue and might even lose net revenue because of

¹ PRC Op. & Rec. Dec., Docket No. R76-1, at 193.

² Id., at 200.

diversion to UPS."¹ The pricing decision for parcel post appears to have been based more on value of service considerations (subsection (b)(2)), as reflected in the elasticity of the service, than on subsection (b)(5). There was no need to balance those provisions with a subsection (b)(4) consideration of the effect on competitors because UPS chose not to argue that the proposed rates would affect it adversely.²

The Commission did rely upon section 3622(b)(5), however, to support a three-tiered rate for special-rate fourth-class mail (books and records). According to the PRC, the rate design was an "appropriate response to market factors," "designed to compete with the rates charged by other parcel carriers for heavier pieces."³

4. Docket No. R77-1 (May 1978)

In Docket No. R77-1 competitive pricing issues extended to first-class mail for the first time. The Postal Service and the Officer of the Commission (OOC)⁴ proposed decreases in priority rates, which UPS claimed were based on competitive considerations and not on costs. The PRC did not address the competition issue but decided to increase priority rates anyway, grounding its decision on the "fairness and equity" requirement of section 3622(b)(1).⁵

¹ Id., at 245.

² Id., at 248.

³ Id., at 257.

⁴ The Officer of the Commission is appointed by the Commission at the onset of a proceeding to represent the interests of the general public. 39 U.S.C. § 3624(a).

⁵ Op. & Rec. Dec., Docket No. R77-1, at 270-76. " [F]airness and equity" apparently precluded reducing or leaving some rates unchanged when most were being raised substantially.

Alternative means of delivery were again a focus of second-class pricing, as USPS improved its economic model, and several second-class mailers presented evidence as to the viability of alternatives. The Commission concluded that the record was not sufficient to draw conclusions as to the feasibility of alternate delivery, but still found that the availability of alternatives decreased the value of service. In setting the rate, it stated that "the interests of all will be best served by recommending that regular rate mail make only a very modest contribution to institutional costs."¹

Addressing third-class rates, the Commission also relied on the existence of competition as grounds for lowering the rate, citing the availability of television, radio, newspaper, and magazine advertising.²

Fourth class was the subject of the first strictly competition-related testimony to be presented in the PRC proceeding. UPS witness Wyckoff urged to PRC to increase the fourth-class markup over attributable and assignable costs to provide a "margin of safety against the risks of operating at rates which will damage private sector competitors." In addition, he advocated movement in the direction of distributing residual costs in proportion to "consequential" costs, i.e., attributable and assignable costs, when it is necessary to take into account the effect of rate changes on private firms.³

The Postal Service rebutted the UPS analysis on the grounds that predatory pricing requires pricing below marginal (or average variable)

¹ Id., at 292-94, 300-02. One can only assume that the Commission did not intend in its statement that "all" would benefit to include private firms engaged in alternate delivery.

² Id., at 389.

³ PRC Docket No. R77-2, UPS-T-18, Tr. 25/5897-98.

costs. Citing the fact that the level of attributable and assignable costs had been sharply increased in Docket No. R77-1, pursuant to the Court of Appeals decision in NAGCP I, USPS witness Kolin maintained the USPS rates were far above its marginal costs and therefore not predatory.¹

USPS also argued on brief that it was necessary to offset the competitive edge enjoyed by the Postal Service because it receives appropriations, does not pay taxes, and does not have to borrow on the open market.² The Commission, however, failed to address these arguments, instead satisfying itself--if not its detractors--with a finding that its 35 percent recommended rate increase was sufficiently close to UPS's proposed 39 percent to avoid anticompetitive effects. The Commission further found that its low cost coverage of 102.8 percent would further fair competition by the Postal Service, citing section 3622(b)(5).

Finally, USPS pricing was questioned with regard to the pricing of Express Mail when intervenors presented an analysis by Professors Posner and Landes which contained allegations that USPS had engaged in anti-competitive practices. Because the analysis was presented as a supplement to a brief, and not as testimony, the record was without evidence to support most of its conclusions.³ Nevertheless, after finding that the national policy in favor of competition, as well as section 3622(b)(4), justified examination of properly-raised competition issues, the Commission addressed the three major arguments presented by Messrs. Posner and Landes: (1) that USPS was cream-skimming by not offering Express Mail in all areas;

¹ Docket No. R77-1, USPSRT-7, at 14.; see also, Areeda and Turner, "Predatory Pricing and Related Practices under Section 2 of the Sherman Act," 88 Harv. L. Rev. 697, at 716 (1975).

² UPS Hearing Brief, at 14-16.

³ Op. & Rec. Dec., at 409.

(2) that the money-back guarantee constituted unfair competition because the ICC prohibited common carriers from making such an offer; and (3) that USPS was engaged in predatory competition to extend its private express monopoly.¹

On each of these issues the Commission found the record to be inadequate to support the claims of anticompetitive conduct. The standard it employed in applying 3622(b)(4) was to require "some demonstration of an actual effect, or at least a potential effect whose realization is shown by probative evidence to be probable."² By not recommending any change in the existing rates, the Commission implied that this standard was higher than that which would normally be required.³

The PRC's decision also suggests that, even had the service guarantee been found to be anticompetitive, it would not have been disallowed out-of-hand:

[W]e would have to weigh possible countervailing benefits flowing to the public in the form of increased quality of service where delivery guarantees (1) establish standards of reliability and (2) function as an integral management tool to maintain those standards.

Viewing its primary responsibility as enabling USPS to operate efficiently, the Commission apparently believed usefulness as an internal

¹ Id., at 420.

² Id., at 422.

³ One could question the logic of that approach on the grounds that postal costs had risen significantly, as reflected in the sharply increased revenue requirement. While Express Mail rates may have been adequate to cover marginal costs at the time of the previous mail case, its marginal costs could have increased sufficiently in the interim to render its existing rates predatory.

⁴ Id., at 428.

management tool could properly justify anticompetitive behavior in the marketplace.

5. Docket No. MC78-3, Electronic Computer-Originated Mail (E-COM) (December 1979)

The first phase of the E-COM proceeding, Docket No. MC78-3, was less concerned with questions of rates for postal services provided in competition with private enterprise than with the overall issues of the propriety of USPS competition¹ and the need for the Commission to consider the effect of a USPS proposal on competition in a non-postal market. As will be discussed below, the Commission found it had an obligation to consider such impact, and it gave that factor great weight in rejecting the Postal Service's E-COM proposal and accepting an alternative proposed by the OOC.²

6. Docket No. MC79-2, Express Mail Metro Service (EMMS) (April 1980)

Docket No. R77-1 served as a preliminary round for the Postal Service's Express Mail Metro Service Proposal presented to the PRC in Docket No. MC79-2. An intra-city Express Mail service, with either same day or next day delivery, the proposal was viewed as a direct threat by private courier services, several of which intervened and participated actively in the proceeding.

¹ In the second phase of the proceeding, recently commenced following the remand by the Court of Appeals, it appears that the impact of rates on competition will be a major issue. See Presiding Officer's Notice of Prehearing Conference Agenda and Proposed Special Rules of Practice, Sept. 3, 1981.

² See, PRC Op. & Rec. Dec., Docket No. MC78-3, at 150-59.

The PRC found that the proposed rates were not predatory because the level was sufficient to recover attributable and assignable costs and make a contribution to institutional costs.¹ Nevertheless, citing its decision in Docket No. MC78-3, supra, the Commission emphasized the importance of considering the effect on competition as part of its consideration of the impact on the general public pursuant to 3622(b)(4).² It interpreted subsection (b)(4) as applying to actual and "potential" anticompetitive impact, but indicated that consideration of competition policies was secondary to its primary responsibility of better enabling USPS to provide efficient postal services.³ No effort was made to reconcile that conclusion with the fact that in rate setting section 3622 requires consideration of the impact on competitors and that, with the exception of the subsection (b)(3) "requirement,"⁴ there is no indication that one of the criteria of 3622 is to be preferred over another.

Intervenors in the proceeding contended the Postal Service's exemption from taxes and its operation without profit constituted unfair competition, but the PRC was not persuaded. The Commission reasoned that Congress could have required USPS to return imputed taxes and profits to the Treasury as is sometimes done when public utilities compete with private ones. Congress, however, did not include any such provision in the Postal Reorganization Act, despite a 1969 proposal which would have required the pricing of parcel post along those lines.⁵

¹ PRC Op. & Rec. Dec., Docket No. MC79-2, at 4.

² Id., at 22-25.

³ Id., at 28.

⁴ See, NAGCP I, 569 F.2d, at 585-89.

⁵ Id., at 31-32.

Rather than deal directly with section 3622(b)(4)'s reference to impact on competitors, the PRC emphasized that it is unfair competition which is prohibited, and that the "[a]ntitrust laws exist to protect consumers and not competitors within the free market."¹ The Commission then applied antitrust standards to support its finding that "a much greater showing of anticompetitiveness" was necessary to prove that the offering of EMMS would violate public policy because there had been no showing that USPS had sought an unlawful purpose or used unlawful means.²

That finding and the accompanying cite to the Standard Oil case,³ however, are unpersuasive. Both involve application of a test formulated for the purpose of determining whether particular conduct is unlawful under a statute which imposes criminal and civil sanctions to a determination of whether the rate set for a service is consistent with public policy. In applying section 3622 there is no apparent reason for placing such a heavy burden on a party seeking to show anticompetitive behavior.

The PRC's decision also raises other questions. On the one hand, the Commission found that the burden of going forward on the issue of anticompetitiveness was on the Postal Service, but that the burden of proof, i.e., demonstrating by a preponderance of the evidence, was on the intervenors, the issue being analogous to an affirmative defense.⁴ On the other hand, even though USPS failed to meet its burden of going forward, the Commission approved the service, on an experimental basis, citing the

¹ Id., at 35-36.

² Id., at 38.

³ United States v. Standard Oil Co. of New Jersey, 47 F.2d 288 (10th Cir. 1931).

⁴ Id., at 28-31.

intervenor's failure to show "injury to them that has been proximately caused by the operation of EMMS."¹ One can only assume that the standard evolved from an application of antitrust principles to the section 3622(b)(4) consideration of the effect on the general public and private enterprises engaged in the delivery of non-letter mail. Again, the Commission failed to explain why such a strict standard should be applied in the subsection (b)(4) evaluation of public policy.

The PRC's conclusion that the burden of showing anticompetitive behavior lies with the intervenors in its proceedings was not adequately supported, and an examination of the law suggests it may have been improper. As the proponent in all rate cases, USPS has the burden of proving its proposed rates are in accordance with the statutory policies,² and specifically the factors of section 3622(b). One would, therefore, expect that USPS would be required to show that its rates are consistent with each of the factors, and that proof of consistency with the effect on competitors criterion of subsection (b)(4) would involve a demonstration that no anticompetitive behavior is involved.

Lastly, in Docket No. MC79-2 the PRC attached a new interpretation to section 3622(b)(5) by finding that EMMS satisfied the provision because "there are no postal alternatives to EMMS that can guarantee delivery by a

¹ Id., at 46. The Court of Appeals decision in the E-COM case found the Commission's solution--approving EMMS on an experimental basis because of inadequate evidence to support a permanent service--to be an improper exercise of its powers. United States Postal Service v. Postal Rate Commission, 654 F.2d 108 (D.C. Cir. 1981).

² 5 U.S.C. §556(d), applicable to postal rate and classification proceedings pursuant to 39 U.S.C. 3624(a), provides "Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof."

time certain, within a metropolitan area."¹ That provision had previously been interpreted as referring to private sector alternatives and permitting USPS to engage in fair competition. In Docket No. MC79-2, however, the existence of private sector alternatives was not mentioned in the discussion of subsection 3622(b)(5).

7. Docket No. R80-1 (February, 1981)

In its most recent general rate decision, Docket No. R80-1, the PRC gave considerably less attention to competition issues than in Docket No. R77-1. After considering evidence on the potential for alternate delivery of second-class mail, the Commission decided not to lower the rates, noting that the consideration of 3622(b)(5) paralleled consideration of value of service pursuant to subsection (b)(2).² In other words, to the extent alternatives exist, value of service would be lower and rates would be kept down by a low cost coverage.³

The Commission also addressed the effect on competition in its discussion of parcel post rates. There it emphasized that section

¹ See, PRC Op. & Rec. Dec. Docket No. MC78-3, at 150-59.

² Op. & Rec. Dec., Docket No. R80-1, at 371.

³ Subsection (b)(5) was also cited by the PRC in a discussion of third-class bulk rates:

...we find that the difference between the available alternative means of sending or receiving letters and other mail at reasonable costs (§3622(b)(5)) is not substantially different between third-class and first-class. Both are impacted by the Private Express Statutes. Further, although third-class bulk mailers are subject to competition, from newspapers, door-to-door distributions, etc.; conversely, the availability of these forms of competition affords advertisers who use third-class mail, alternatives to the Postal Service. (Footnote omitted).

Id., at 453. The Commission did not explain why the existence of competitors to bulk third and the availability of alternatives to advertisers who use it were apparently viewed as offsetting considerations.

3622(b)(4) also referred to the effect on users (i.e., the general public and businesses) and found that that section of the provision also had to be given consideration. It concluded that the rates it was recommending would not have an "adverse effect" on UPS or other competitors, noting the USPS projected volume under the new rates was 172 million, as compared to 196 million in FY 1980, and 1,437 million for UPS in 1979.¹

In another apparent twist on the application of subsection (b)(5), the Commission stated that the "effect" of its proposed parcel post rate schedule on available alternatives did not call for a higher cost coverage.² No rationale was given for why the "effect" on alternatives, as opposed to their availability, was being considered under section 3622(b)(5); nor was there an explanation of why (b)(5) was considered potential grounds for raising cost coverages in the face of alternatives when it had previously been cited as the basis for lower coverages.³

C. Problems Encountered in Applying the Statutory Criteria

The criteria of section 3622 are difficult to apply and require balancing, as is evident from the review of postal rate proceedings contained in the previous section. Subsection 3622(b)(4) requires consideration of the effect of rate increases on the general public, business mail users, and private sector competitors of USPS. These interests will generally diverge, for users will want to see the lowest possible rates with the highest possible standard of service, while

¹ Id., at 490-92.

² Id., at 493.

³ See, e.g., discussion of Dockets No. R74-1 and R76-1, pp. 19-21, supra.

competitors can be expected to oppose improvements in service quality and seek to raise USPS rates. Past experience with fourth-class mail amply demonstrates the point, as UPS and fourth-class mail users have repeatedly intervened in PRC proceedings and taken diametrically opposed positions, particularly with respect to the revenue requirement and pricing issues.

Another example of intrinsic conflict is subsections (b)(4) and (b)(5). The latter requires consideration of alternative means of sending and receiving mail at reasonable costs. When there is effective competition to USPS, (b)(5) has frequently been interpreted as requiring moderation in setting rates, the purpose being to permit USPS to compete with the private sector providers of similar services. But the result of the Postal Service's rate moderation is likely to be an adverse impact on private sector competitors, which would appear to be contrary to the intent of the §3622(b)(4) instruction to take into account, inter alia, the effect on competitors.

Consideration of "value of service" pursuant to subsection (b)(2) also tends to offset the impact of subsection (b)(4)'s reference to the effect on competitors. When competitors offer similar services, the value of the USPS service will be limited to the rate charged by its competitors. Consideration of "value of service" could then be interpreted as requiring the USPS rate to be set at a competitive level, whereas the "effect on competitors" would weigh against any moderation.

In short, the difficulty in applying section 3622 is that the different criteria frequently push rates in opposite directions. Congress has given no guidance as to when one factor is to be preferred over another and, if so, by how much. Thus, other factors can offset the competition considerations of subsections (b)(4) and (b)(5), with the result being

prices which adversely impact upon competition.

D. Section 3622 (b)(4) and Competition Analysis

A basic question in the examination of the role of competition analysis in postal pricing is whether subsection (b)(4) requires consideration of the effect on postal competitors or the effect on competition. The wording of the statute, effect upon "enterprises in the private sector of the economy," supports the interpretation that the effect on competitors, as opposed to competition, is key. This approach is suggested by the Senate Report on the Postal Reorganization Act, which makes references to subsection (b)(4) in a discussion of private sector requests that special costing principles be applied to parcel post.¹ If this is the correct interpretation, the effect will nearly always to be drive postal rates higher, for then the position of competitors will be improved, assuming (1) there are enough similarities between the USPS and private sector services to permit substitution between the two, and (2) rates are at a level where the changes are of sufficient magnitude to induce crossover.²

On the other hand, such an approach may not be consistent with the nation's competition policy, as embodied in the antitrust laws. Section 7 of the Clayton Act is the clearest example of concern for competition per se, as the Supreme Court emphasized in Brown Shoe Co. v. United States:³

¹ S. Rept. No. 91-912, 91st Cong., 2d Sess., at 17.

² It must not be forgotten, however, that consideration of the rest of subsection (b)(4), the effect on the general public and business mail users, could have an offsetting effect.

³ 370 U.S. 294, at 320 (1962). See also, United States v. Manufacturers' Hanover Trust Co., 240 F.Supp. 867, at 934 (S.D.N.Y. 1965). The proposition has also been asserted in Sherman Act cases. Checker Motor Corp. v. Chrysler Corp., 283 F.Supp. 876 (S.D.N.Y. 1968), aff'd 405 F.2d 319, cert. den. 394 U.S. 999.

Taken as a whole, the legislative history illuminates congressional concern with the protection of competition, not competitors, and its desire to restrain may tend to lessen competition. (Emphasis in the original.)

This overriding concern with competition--as opposed to competitors--has been characterized by Professors Areeda and Turner as one of the basic propositions to be culled from the large body of judicial decisions interpreting the antitrust laws.¹

Were section (b)(4) to be construed, consistent with the policy of the antitrust laws, as requiring consideration of the effect upon competition rather than competitors, its impact could be substantially different. For example, taking the hypothetical case of a single private firm controlling 95 percent of the market for overnight delivery of parcels within the continental United States, at rates which are three times its costs, USPS's entry into the market at rates which demonstrably covered its marginal costs,² but were markedly lower than those of the private firm, would likely have a positive impact on competition. The impact on USPS competitors, however, i.e., the private enterprise, would likely be adverse.

Another question which arises is whether, under section 3622(b)(4), the effect on private enterprises must be substantial. Several types of activity, such as price fixing, have been found to constitute per se violations of the Sherman Act,³ meaning no adverse effect on competition need be shown to prove a violation of the law.⁴ On the other hand, the

¹ P. Areeda and D. Turner, I Antitrust Law ¶ 104 (1978).

² The need for markups over costs to compensate for tax, capital, and other advantages is discussed in Chapter IV, infra.

³ 15 U.S.C. ¶ 1.

⁴ See, e.g., Northern Pac. R. Co. v. United States, 356 U.S. 1 (1958).

"prevailing standard of analysis" has been the rule of reason, which requires that the factfinder weigh all of the circumstances to determine whether a restrictive practice results in an unreasonable restraint on competition.¹

In the interpretation of section 3622, logic seems to dictate application of a rule-of-reason test. Subsection (b)(4) specifically speaks of "the effect of rate increases upon the general public...and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters." The PRC and USPS are, therefore, not precluded from arriving at the conclusion that the impact on the general public or business mail users outweighs the effect on competitors. Moreover, the effect on competitors or competition is but one of a list of factors contained in §3622(b), strongly suggesting Congress intended for it to be weighed against the other criteria, with its impact on rates dependent upon the magnitude of the effect and the relevance of the other criteria in the particular case.

E. Other Bases for Engaging in Competition Analysis

Also relevant to a competition analysis of postal pricing is the policy statement of 39 U.S.C. §101(f):

In selecting modes of transportation, the Postal Service shall give highest consideration to the prompt and economical delivery of all mail and shall make a fair and equitable distribution of mail business to carriers providing similar modes of transportation services to the Postal Service.

¹ Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977); Chicago Board of Trade v. United States, 246 U.S. 231 (1918).

The PRC cited this provision in its E-COM decision as an expression of the Congressional intent that competition be promoted wherever possible in the implementation of the Postal Reorganization Act.¹

It has also been argued that the PRC should look to national competition policy as one of the "other factors appropriate" for consideration under §3622(b)(9), or as part of its broader obligation to safeguard the interests of the public. This position was taken by the Antitrust Division of the Department of Justice and the Officer of the Commission in the E-COM proceeding,² and it was accepted by the PRC, which concluded that there was "an obligation to consider competition issues..., and to attempt to promote competition so far as consistent with regulatory requirements."³ The Commission considered itself bound by the standards which apply to other regulatory agencies operating under "public interest" statutes, and cited the antitrust laws as evidence of the incompatibility of unreasonable restraints of trade with the "public interest."⁴

¹ Op. & Rec. Dec., Docket No. MC78-3, at 59.

² Comments of the United States Department of Justice, December 6, 1978; Response of the Officer of the Commission to the Presiding Officer's Request for Legal Memoranda, Nov. 21, 1978. Cases relied upon included United States v. Philadelphia Nat. Bank, 374 U.S. 321, 350-51 (1963); FMC v. Aktiebolaget Svenska Amerika Linien, 390 U.S. 328, 244 (1968); Gulf States Utilities Co. v. FPC, 411 U.S. 747, 758-59 (1973); Northern Natural Gas Co. v. FPC, 399 F.2d 953, 959 (D.C. Cir. 1968); United States v. CAB, 511 F.2d 1315, 1326 (D.C. Cir. 1975); Hawaiian Teleph. Co. v. FCC, 498 F.2d 771, 778 (D.C. Cir. 1974); and Pillai v. CAB, 485 F.2d 1018, 1027 (D.C. Cir. 1973).

³ Op. & Rec. Dec., Docket No. MC78-3, at 51. Compare that statement with the more qualified approach taken by the Commission in Docket No. R71-1:

Insofar as the concepts of fair pricing, included in § 3622(b)(4), and the antitrust policy against unfair competition overlap, the Commission does consider such matters in establishing postal rates.

Op. & Rec. Dec., at 198-99, I-316.

⁴ Id., at 54-55.

Finally, in hearings before the House Post Office and Civil Service Committee on the various postal reform bills, then Postmaster General Blount, an ardent supporter of reorganization, testified that the Postal Service would be prevented from competing unfairly with private carriers of parcels by virtue of the provision now incorporated in 39 U.S.C. §403 requiring rates to be "fair and reasonable"; the requirement that rates cover costs; and the complaint procedure.¹ It would, thus, seem fair and reasonable to interpret the "fair and reasonable" provision of §403 as allowing, if not requiring, examination of competition considerations.

F. The Free Enterprise Economy

The obligation to safeguard the public interest can also be interpreted as extending to consideration of the national policy of promoting a free enterprise economy and limiting government involvement when the private sector is willing and able to provide a given service. The policy of the Reagan administration in particular has been to decrease government's involvement in the economy and to increase incentives for private enterprise.

By statute the Postal Service is to be operated as:

...a basic and fundamental service to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people. The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons₂ in all areas and shall render postal services to all communities.²

¹ Hearings before the House Committee on Post Office and Civil Service on various proposals to reform the postal establishment, Serial No. 91-4(a), 91st Cong., 1st sess., at 1234 (GPO, 1969).

² 39 U.S.C. 101(a).

As a public service, a strong argument could be made that USPS should operate only in those areas in which either it has a specific statutory obligation or there is an identifiable need for the provision of a "postal service."

In recent years USPS has been expanding its service offerings into areas previously served only by the private sector. Express Mail, for example, first introduced in 1970, competes with Purolator and other inter-city express delivery services. In 1979 USPS sought to expand Express Mail to the intra-city delivery market with Express Mail Metro Service (EMMS). Offered on a temporary basis while a request for the necessary change in the classification schedule was before the PRC, the new service produced strong opposition from private couriers who leveled allegations of past anticompetitive conduct by Postal Service officials in connection with Express Mail and argued there was no need for USPS involvement in the market. The PRC approved the request on an experimental basis, but the rates USPS had proposed were too high to attract customers, and the Governors allowed the temporary authority to expire without implementing EMMS on a permanent basis.¹

On the electronic side, at least three different services, E-COM, Intelpost, and Electronic Mail Service System (EMSS) are in various stages of planning or development.² But the proper role for USPS in the provision of electronic mail services is a subject of sharp controversy. Communications interests are quick to argue that electronic communications services

¹ PRC Op. & Rec. Dec., Docket No. MC79-2. The Governors made the decision at a meeting held on May 5, 1980, but did not issue a written decision on the matter.

² E-COM is planned as an alpha-numeric service limited to computer-generated input; the latter two are facsimile services, the first international and the second domestic.

should be offered solely by the private sector, with the Postal Service's participation, if any, limited to the physical processing and delivery of messages which are not electronically transmitted directly to the recipient. Any USPS involvement in electronic transmission is sharply opposed, and the desirability of Postal Service conversion of electronically transmitted messages to hard copy has been questioned by some communications companies, the Department of Justice, and the National Telecommunications and Information Administration (NTIA).¹

In July 1979, the Carter Administration with the concurrence of PMG Bolger, issued a Presidential Review Memorandum (PRM) endorsing USPS involvement in Generation II services,² but opposing entry into Generation III. USPS has since proceeded with planning for a \$1.8 billion (1979 estimate) system for EMSS, which would be a Generation II facsimile service. However, should Generation II services prove to be no more than a stopgap measure on the way to Generation III,³ there is unlikely to be a long-term demand for EMSS. Communications interests fear that should that happen, the Postal Service would seek to avoid heavy losses by seeking authority for the relatively easy step of turning its EMSS computer and communications equipment into a Generation III system capable of

¹ See, e.g., Joint Comments of the United States Department of Justice and the National Telecommunications and Information Administration of the United States Department of Commerce, PRC Docket No. MC78-3, July 27, 1981.

² USPS electronic mail services are often identified as Generations I, II, and III. Generation I involved hard copy input and output to the postal system, but electronic transmission within that system. Generation II involves electronic input to the Postal Service and hard copy output. Generation III assumes electronic input and output, no hard copy being involved.

³ According to one body of thought, computers with communications capability will become household items in the foreseeable future and produce a sharp drop in the demand for Generation II services as Generation III services become widespread.

transmitting messages electronically from sender to recipient. According to the private sector, that result would be inconsistent with the 1979 PRM and could result in unfair competition.

The PRM also listed Postal Service purchase of electronic transmission services from communications carriers, rather than construction of a separate system, as a condition to USPS entry into the market.¹ The consistency of the multibillion dollar EMSS system with that condition is open to question, which may be one of the reasons why EMSS currently appears to be on the back burner at USPS. Meanwhile, it remains undecided whether or how to implement in the field of electronic mail the policy of discouraging government involvement in economic sectors served by private enterprise.

In other areas Congress has generally limited government involvement in the provision of services traditionally offered by the private sector. The Tennessee Valley Authority is subject to statutory restrictions on its service area to avoid competition with neighboring power companies.² Unfair competition resulting from Federal Reserve Board activity is one target of the Monetary Control Act of 1980, which requires the Board to set fees taking into account imputed taxes and financing costs which would have been incurred had the services been provided by a private firm.³ OMB has issued detailed guidelines for the evaluation of indirect government costs

¹ Not only was the condition accepted by PMG Bolger at the time the PRM was issued, but the Postal Service Governors independently adopted a policy decision on electronic mail, renouncing any intention of becoming a telecommunications common carrier. "Board Reiterates Position on Electronics," USPS General Release No. 40, June 7, 1979.

² 16 U.S.C. § 831n-4. See, Hardin v. Kentucky Utilities Co., 390 U.S. 1 (1968).

³ P.O. 96-221, 94 Stat. 132. See also, Federal Reserve Board Press Release, December 31, 1980.

and benefits in considering whether the government should undertake a particular project on its own or contract with a private firm.¹ The feasibility of taking such approaches in the postal arena is discussed in the next chapter.

G. Need for a Viable Postal Service

In evaluating whether Postal Service competition with the private sector is desirable, one must weigh the potential for anticompetitive effects and the national policy of avoiding government involvement in sectors which are adequately served by private enterprise against those policies of the Postal Reorganization Act which swing the other way. The balancing must take into account that USPS is directed to utilize modern methods of transporting mail; provide prompt, reliable, and efficient services; and achieve a fair and equitable apportionment of the costs of postal operations to all users.² Moreover, the very existence of a government-operated postal system, for over two hundred years, evidences the fundamental policy of government involvement in this particular sphere of the economy.

Politically, there is little willingness to permit a substantial deterioration in the quality of postal services. Although the USPS public service subsidy was recently slashed, the same law prevents the Postal Service from reducing regular mail delivery from six to five days per week.³ Other Congressional moves have restricted the flexibility of the

¹ OMB Circular No. A-76: Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government (1979).

² 39 U.S.C. § 101.

³ Omnibus Budget Reconciliation Act of 1981, §§1722, 1726.

Postal Service to close small post offices.¹ As long as mail volume remains strong, such actions are likely to have a relatively minor impact on USPS. But if the widely held projections of future declines in volume prove true, as businesses and then consumers shift to electronic communications, the impact on USPS could be substantial.² In the years ahead the technological revolution in communications could undermine the economic viability of physical mail delivery.

In Europe, postal services are typically provided by a Ministry of Posts, Telephone and Telegraph (PTT). The communications revolution may divert revenues from one department within the ministry to another, but overall financial stability should not be affected. In the United States, however, cross-subsidization is not possible as long as mail services are offered by one firm (USPS) and electronic communications services by others. USPS, in an effort to change the status quo, appears to be following a strategy of expanding into new areas which hold promise for the future, engendering opposition from private enterprise, which has little to gain and much to lose from USPS involvement. Even if effective assurances against unfair competition were secured, the private sector could still be expected to raise the "competition"/"competitors" issue, for even fair competition is likely to have an adverse impact on USPS competitors.

The central policy issue is whether to permit USPS to expand its services to preserve or improve upon its present position, or to require a

¹ See, e.g., Pub. L. 94-421, §2; 90 Stat. 1303 (1976).

² Total mail volume is still on the rise, despite past predictions by senior USPS officials that an all-time high would have been reached by this time. Nevertheless, the latest forecasts available envision the diversion of billions of pieces of first-class mail by the end of the decade. See, e.g., Arthur d. Little, Inc., The Impact of Electronic Communications Systems on First Class Mail Volume in 1980-1990, final report to U.S. Postal Service, Task 5, Contract No. 104230-76-2-0335 (1978).

reassessment of the role of the Postal Service in the American economy. If the decision is made to limit USPS expansion, immediate planning should be undertaken to develop an effective long-term strategy for enabling the Postal Service to maintain operations at acceptable cost and service levels. On the other hand, if USPS is to be permitted to expand into areas currently served by private enterprise, careful attention should be devoted to the design¹ and pricing of new services to assure against or minimize anticompetitive impact, even if adverse effects upon competitors cannot be avoided.

¹ See, e.g., PRC Op. & Rec. Dec., Docket No. MC78-3 (1978), at 159-59.

IV. ASSURING FAIR POSTAL SERVICE COMPETITION

This section explores the basis for using pricing to prevent USPS statutory advantages or disadvantages from creating unfair competition with the private sector or adversely affecting the Postal Service's competitive position in the marketplace. The discussion will address the economic, legal and policy issues involved.

A. Introduction

To the extent Postal Service operations are governed by the Postal Reorganization Act rather than business considerations, USPS stands in a competitive position different from that of its private sector counterparts. On the one hand, it enjoys a host of advantages—tax exemptions, initial capital which it received from the Post Office Department, access to low-cost capital, and Congressional appropriations. On the other, it is subjected to statutory requirements which tend to result in competitive disadvantages: (1) Postal reorganization has led to labor costs which are said to exceed those in the private sector; (2) various requirements governing property, works, contracting, etc., apply to USPS; and (3) the Postal Service is obligated to provide nationwide service with certain classes offered at uniform rates.¹

The requirements imposed on USPS can affect its costs, and thus its ability to compete with the private sector. With respect to some, the effect could be substantial; as to others, it is likely to be inconsequential. The scope of this study does not permit a comprehensive effort to quantify, or even to identify, all the cases in which the statute

¹ 39 U.S.D. §§403(a), 3623(d).

bestows a competitive advantage upon USPS or imposes a competitive advantage upon USPS or imposes a competitive disadvantage upon it. Instead, the focus will be on examining several of the most apparent factors, discussing the legal and policy grounds for offsetting them, and suggesting methods by which their effects could be measured. Should a thorough competition analysis of the Postal Service be undertaken at a later time, one task should be a section-by-section analysis of the statute with a view toward identifying and quantifying all provisions affecting the Postal Service's competitive position.

B. General, Legal, Economic and Policy Considerations

The central question is whether USPS should be permitted to obtain a competitive edge on the basis of the advantages it enjoys as a governmental establishment or be impeded in competing because of disadvantages. Perhaps the most persuasive argument against offsetting the statutory advantages enjoyed by USPS is that the Congressional intent was to permit the Postal Service to benefit from the cited provisions of the law. One could reasonably contend that the section 3622(b)(4) policy of considering the effect upon competitors is overridden by specific statutory pronouncements granting USPS appropriations, tax exemptions, favorable access to capital, and other advantages over the private sector.

Moreover, the legislative history shows that Congress had considered and discarded the idea of imputing taxes and carrying charges on capital. One of the key House bills in the postal reform effort, H.R. 11750 in the first session of the 91st Congress, contained the following provision:

§ 1203. Parcel post rates.

The Postal Service, in setting rates for services involving parcels, shall recover the carrying charges on all capital employed in providing such service and shall recover an imputed charge for the Federal, State, and local taxes which it would have to pay if it were privately owned, and providing such service."

That section was not included in H.R. 17070, which was reported out of committee, but the reason is not clear. The omission might have been part of a package deal struck between PMG Blount and the postal unions in the spring of 1970,¹ or the PMG's testimony that other sections provided adequate safeguards for fair competition, rendering inclusion of the specific provision cited above unnecessary.² In any event, there is no indication that the omission signified Congressional opposition to the imputation of interest, taxes, and other expenses incurred by the private sector as a means of protecting against unfair USPS competition.

Congress, however, has since demonstrated a readiness to take direct action to protect USPS competitors in the parcel market. Specifically, one of the USPS advantages, the public service subsidy, was required to be partially offset by the 1976 amendments to the Act:

The rates established under chapter 36 of this title for zone-rated parcels [parcel post]...shall not be more than 10 percent less than the rates for such mail would be if the [public service subsidy] funds...were not appropriated.³

¹ As a consequence of that deal, substantial changes were made to the proposals then being considered by the House Post Office and Civil Service Committee. Through adept procedural maneuvering, supporters of the package succeeded in railroading the revised proposals through committee and reporting H.R. 17070 out to the floor of the House. See "Postal Reform and Salary Adjustment Act of 1970," House of Reps. Committee on Post Office and Civil Service, Rept. No. 91-988, 91st Cong., 2d sess., at 83-89, 100-02 (GPO, 1969).

² See page 37, supra.

³ Pub. L. 94-421, §2(b), 90 Stat. 1303 (1976), 39 U.S.C. §2401(1).

According to the House report,¹ the limitation of the benefit parcel post enjoys from the public service appropriation was "fair to...those private enterprises who compete with the Postal Service."² The argument could be made that the inclusion of a specific provision specifying a test for offsetting the effect of the public service subsidy on the parcel post rates implies a Congressional intent that the effect of the subsidy on other rates not be offset. Further, it could be maintained that the absence of any provision specifying a method for offsetting any of the other advantages enjoyed by USPS as a governmental establishment indicates Congress's intent that only the public service subsidy should be so treated.

On the other hand, given the pre-1970 statutory protection accorded competitors of parcel post,⁴ fourth class must be viewed as the exception and not the rule. Congress appears to have been willing to provide a special safeguard for parcel post competitors without even considering the applicability of the approach to other classes of mail or to USPS advantages other than the public service subsidy. The absence of any

¹ H. Rept. No. 94-391, 94th Cong., 1st sess. (1975).

² Id., at 48. On this item the final law reflects the provisions of the House bill.

³ See also p. 26, supra.

⁴ For example, section 106 of the Postal Policy Act of 1958 stated:

The provisions of this title shall not require any downward adjustment in rates of postage on fourth-class mail existing on the date of enactment of this Act.

reference in the legislative history¹ to statutory advantages affecting the rates of other classes which compete with the private sector strongly suggests that this was the case. If so, section 3622(b)(1), which requires consideration of the effect of rates on competitors in the private sector, could still be used as a basis for offsetting the effects of the public service subsidy on rates other than fourth class or of other advantages on rates for any of the classes of mail. Moreover, the general regulatory obligation to consider effects upon competition could be employed for the same purpose.

Assuming the law permits implementation of ratesetting methodologies which offset some or all of the advantages the Postal Service enjoys as a result of its governmental status, there remains the question of whether such a course is sound. Most economists could be expected to favor offsets because they are likely to lead to a more efficient allocation of resources.

For example, assume USPS can offer non-profit second-class delivery of Magazine X at a rate of \$.07 per copy, the rate representing \$.10 of attributable and assignable costs and a \$.02 contribution to institutional costs, less \$.05 in phasing appropriations, while the marginal cost to USPS is only \$.08.² Assume that a private firm is willing to offer identical

¹ See, H.R.8603, Postal Reorganization on Act Amendments of 1976: Legislative History, Committee Print No. 94-20, 94th Cong., 2d sess. (1976).

² When attributable costs represented estimates of costs which varied with volume over the short run, they were often employed as a surrogate for marginal costs. Since NAGCP I, however, assignments have also been based on cost-of-service principles, incorporating "reasonable inferences" of causation. Volume variability is now only one criterion for attribution and assignment. Insofar as higher levels of attribution have been attained by reliance on other criteria, attributable and assignable costs can no longer be used as a substitute for marginal costs.

service at a rate of \$.08 per copy, representing \$.05 in marginal costs, \$.015 in contribution to non-variable costs and profits, and \$.015 in federal income taxes. The private firm is a more efficient provider of the service—\$.05 marginal cost versus \$.08 for USPS, but eligible customers will prefer to use non-profit second-class mail because its rate is lower. USPS could draw business because of its phasing subsidy and tax exemption, and not because it is delivering magazines more efficiently than its competitors. Moreover, while the ratepayer saves \$.01 by using USPS, the Treasury loses \$.065—\$.05 in the phasing subsidy and \$.015 in tax revenue which would have been realized had the private enterprise delivered the magazines. Strictly from the standpoint of economics, it would be desirable to offset the Postal Service's advantages in this case, for they would be leading to an inefficient allocation of resources. From a policy perspective, however, one would have to consider whether to nullify or weaken the effect of the phasing appropriations, given the statutory policy of easing the effect of rate increases on those classes of mail which are entitled to benefit from the funds.¹

The numbers would change from case to case if the different USPS advantages were examined in the same manner, but one could always postulate cases in which the particular USPS advantage resulted in a competitive edge. moreover, even if an advantage does not give the Postal Service an edge in the market, its competitive position will always be improved by the resulting reduction in rates. Economic theory will, thus, nearly always favor offsetting Postal Service advantages, but the countervailing considerations must be examined in each case to determine whether the economic arguments should prevail.

¹ See pp. 54-56, infra.

There is ample precedent for requiring cost savings realized by the Postal Service by virtue of its governmental status to be taken into account in the ratemaking process. Publicly owned electric companies competing with private ones are frequently required to set rates at levels which include an adjustment to offset the government's lower costs of money.

A recent example of Congress's continuing commitment to such approaches is the Monetary Control Act of 1980,¹ which requires taxes and interest savings to be imputed in the setting of Federal Reserve Board fees:

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.

Pursuant to the statute, the Board issues a set of pricing principles which included a "Private Sector Adjustment Factor" calculated on the basis of estimates of the private sector's tax and financing costs.²

One complication incident to the offsetting of advantages is that the additional revenue produced by increased (offset) rates for competitive services would have to be taken into account in the iterations performed to satisfy the breakeven requirement of 39 U.S.C. #3621.³ The result would be lower rates for monopoly services as a result of the increased contributions to residual costs made by the competitive services. That, however, is unlikely to result in cross-subsidization of monopoly services

¹ P.L. 96-221, 94 Stat. 132 (1980).

² See, Federal Reserve press release, Dec. 31, 1980.

³ See p. 9, supra.

by competitive ones because the markups on the monopoly services are, in most instances, relatively high. In addition, §3622(b)(3) would still require each class or type of mail to bear its attributable and reasonably assignable costs.

An economic argument can also be made for offsetting statutory disadvantages imposed by USPS, but law and policy problems arise. For example, take the hypothetical case in which USPS can offer third-class delivery of Circular Y at a rate of \$.07 per piece, the rate representing \$.06 in attributable and assignable costs and a \$.01 contribution to institutional costs, while the marginal cost is only \$.055. Assume further that \$.02 of the attributable and assignable costs, as well as of the marginal costs, are the direct result of a statutory requirement that the service be offered nationwide. Finally, assume a private sector delivery firm with flexibility to choose the markets it enters, and marginal costs of \$.04, offering the same circular delivery service at \$.06, the \$.02 differential being split evenly between profit and income taxes.

Were USPS to offset the disadvantage (the nationwide service requirement) by reducing the third-class rate by \$.02—the amount attributable to the disadvantage—it would be offering the service below marginal cost: Financially, the Postal Service would do better not offering the service at all. On first glance, such action would appear to lead to an inefficient allocation of resources, because consumers would switch from the private firm to USPS, even though the private firm's marginal costs would be lower. That, however, may not be the case, for the \$.02 of USPS costs attributable to the offering of the service nationwide need not be viewed as an opportunity cost. Instead, it could be regarded as a transfer payment in the form of the provision of a public service to

persons who could not otherwise receive mail service. Because the nationwide service requirement would then amount to a subsidy of such service recipients, strong argument could be made that its costs should be paid by the taxpayer rather than by the Postal Service.¹ Moreover, there would not be any adverse impact on competition were the Postal Service to offset the effect of the disadvantage in the pricing of its competitive services, because the USPS marginal cost would only be \$.035 (\$.055 less the \$.02 transfer payment) and the rate would exceed that amount.

As noted above, the more formidable barriers to the offsetting of disadvantages lie in the statute and considerations of policy rather than economics. Returning to our example, the third class rate would be below attributable and assignable costs, in violation of the requirement of 39 U.S.C. #3622(b)(3). The rate could be defended on the grounds that the \$.02 of public service costs resulting from the nationwide service requirement would not be "attributable" or "reasonably assignable" to the classes of mail. That argument, however, would not be consistent with the current reliance on volume variability as the foundation for postal costing.

Moreover, a potential barrier to a rate schedule which reflects reductions in the rates for competitive services to offset the cost effects

¹ It is in respect of such costs that USPS receives its annual public service subsidy. See fn. 1, p. 9, *supra*. Were the public service subsidy calculated on the basis of the cost to USPS of providing "public services" and imputed to the classes of mail in the same proportions as the costs of "public service" are incurred, there would be no need to offset the disadvantage (providing "public services") or the advantage (appropriations) to USPS. However, because (1) the size of the "public service" appropriation has been based on political considerations rather than on an estimate of the actual cost of providing such services, and (2) there is no evidence that the distribution of the appropriations tracks the incurrence of the public service costs, the two must currently be analyzed separately.

of a statutory disadvantage would be the "fair and equitable" criterion of § 3622(b)(1). Because the revenue foregone by virtue of any such reductions is unlikely to be reimbursed by Congressional appropriations,¹ it would have to be recovered in the rates for monopoly services, meaning higher rates for the latter.

The legal basis for offsetting disadvantages is also weaker than the basis for offsetting advantages because of the absence of § 3622 support. Grounds for offsetting advantages can be found in § 3622(b)(4), which has been interpreted as pertaining to competition considerations. The argument for offsetting disadvantages would have to rest on the general policy of maintaining a viable Postal Service and be based primarily on provisions other than § 3622.²

In addition, the arguments for not offsetting advantages can also be applied to disadvantages. Congress intentionally included that statutory provisions on nationwide service and the other "disadvantages" when it enacted the Reorganization Act. In the absence of specific directives permitting their effects to be offset in the setting of rates for competitive services, one cannot assume such a Congressional intent. On the other hand, because the cost consequences of the disadvantages are generally indirect--the cost of complying with various statutes pertaining to government operations, for example--offsetting their impact would not directly counter the policy of the law. In this regard, the disadvantages

¹ The likelihood of additional appropriations to cover the offsets discussed here is de minimis given the current policy of reducing the level of appropriations even where the desirability of reimbursement has previously been recognized--e.g., the public service subsidy.

² Subsection (b)(4), the effect on competitors, should not be interpreted as calling for lower USPS rates. Subsection (b)(5), on the other hand, was so interpreted in some earlier PRC decisions, but recent decisions have tended to move away from this view. See pages 18-30, supra.

are distinguishable from some of the statutory advantages, such as revenue foregone appropriations, which are specifically intended to benefit certain classes of mail.

C. Factor-by-Factor Analysis

1. Advantages

a. Tax Exemptions

An "independent establishment of the executive branch of the Government of the United States," USPS is exempt from state and local income, property, sales, and gasoline taxes; its obligations are exempt from state taxes (except estate, inheritance, and gift taxes) both as to principal and interest;¹ and it is not subject to federal income taxes should it report a profit. By calculating what would otherwise have been the USPS tax liability, it is possible to evaluate the impact of the exemptions on the Postal Service's competitive position.

The initial effort to examine the real estate exemption could require appraisal of USPS properties.² That process could be time consuming and costly, but it should not be very difficult and would also be useful in examining the financial position of USPS. One important factor decreasing the effect of the exemption is that most USPS facilities are rented, in which case the landlord is liable for real estate taxes. Thus, USPS pays the taxes as a portion of its rent.

¹ 39 U.S.C. § 2005

² While there would be valuations on the books for all properties, they are not likely to be at the amount required for tax purposes-- frequently fair market value.

Sales tax savings should be calculable from records of purchases, and estimating gasoline taxes should be a simple matter, using the detailed figures USPS has been maintaining in recent years for energy conservation purposes.

Difficulties could arise with estimates of federal, state, and local income tax savings. For example, one can never know whether state income tax authorities or the IRS would challenge USPS accounting practices, with the result that the USPS budget, which is viewed as break-even for ratemaking purposes, would be considered profitable should it be subjected to a tax audit.¹

Two approaches could be taken to offset the competitive edge USPS enjoys from income tax exemptions. First, taxes could be imputed and rates on any given service raised to take account of USPS "profits." Second, an estimate could be made of the taxes paid by a representative private sector enterprise providing the same volume of service.

The first approach has the attraction that USPS would only be "taxed" on its actual "profits" on the service. Yet it also has drawbacks, the major one being the difficulty of determining what constitutes "profits." For purposes of the calculation, one would expect attributable and reasonably assignable costs to be included in the calculation of costs, but a strong argument could be made that they should be excluded to the extent they exceed average variable costs. Similarly, one would expect a contribution to be made to institutional costs, but should such a

¹ An example of an area in which a conflict could easily arise is the discount rate used in calculating the workers' compensation expense. Such a dispute arose between USPS and the PRC in Docket No. R80-1, as the former argued for a 7.5 percent discount rate, while the latter insisted upon 10 percent. The increased rate, which was subsequently implicitly overturned by the Court of Appeals in Newsweek, resulted in a \$326 million reduction in the Postal Service's test year revenue requirement.

contribution be permitted to exceed average non-variable costs? And what if the class has been assigned a very low cost coverage, e.g. 103 percent, on the basis of an application of the non-cost criteria of section 3622? Should the cost basis for the purpose of imputing taxes be raised above the actual allocation of institutional costs to some higher level, e.g., the systemwide average cost coverage? There are no clear answers to these questions, for which reason the second approach to imputing taxes would appear to be preferable.

The use of a representative private sector tax rate based on sales volume has the advantage of being much more readily ascertainable. Once the market in which USPS is competing is identified, OMB could be asked to develop a representative rate. The same procedures could be employed as are currently used to estimate the taxes to be imputed in the determination of whether commercial or industrial products and services needed by the government should be developed in-house or secured by outside contract.¹

However, the imputation of taxes based on representative rates may not seem preferable when firms in the private sector enjoy high profits and, as a result, pay large amounts of tax. In such a situation USPS would be required to impute a high tax rate, to the detriment of the mail user. But basic economics teaches that, in the absence of anticompetitive practices, firms are unlikely to earn high profits in a competitive industry for an extended period of time. It would, thus, seem reasonable to rely upon the antitrust laws to prevent the development of such a situation, provided private sector competition exists in the relevant market.

¹ See, OMB Circular No. A-76, at 74.

It must be noted that imputing taxes can cause a dichotomy of interests between the ratepayer and taxpayer. The ratepayer, of course, prefers not to impute taxes, because imputation results in lower USPS rates. The taxpayer, on the other hand, favors imputation of taxes so that USPS rates will be higher, and more traffic will be carried by the taxpaying private sector. Thus, even were the economic efficiency argument not sufficient to support the imputation of tax revenues, a separate public policy argument could be made to support the practice on the basis of the need to maintain tax revenues.

On the other hand, there could be situations in which imputation of tax revenues would impose added costs on the mail user without causing a more efficient allocation of resources. For example, assume (1) USPS rates for a given service are 40 percent below private sector rates for comparable services; (2) the imputed tax revenues would be less than 10 percent of the private sector rate; and (3) there is no willingness among users to substitute private sector services for the USPS service at the given rate levels. Imputation of taxes would raise USPS rates, increasing the cost to the ratepayer without any benefit to the taxpayer, and without any improvement in economic efficiency. USPS revenues would rise by virtue of the imputed taxes, providing additional income to reduce the level of residual costs and theoretically allowing USPS to lower rates across the board. Thus, other USPS customers would benefit from the imputed taxes

paid by the users of the competitive service, which could mean an unfair advantage to other competitive USPS services.¹

Similar arguments could be made with respect to the imputation of sales, gasoline, and real estate taxes. For each, an efficient allocation of resources would call for imputing taxes if USPS would otherwise enjoy a competitive edge. On the other hand, if a USPS competitive edge were great enough not to be significantly affected by the imputation of taxes, USPS rates might be raised, to the detriment of the mail user, without any corresponding increase in economic efficiency.

Issues surrounding the imputation of taxes are complex, as should be clear from the preceding discussion. Because the effects of imputation will vary from case to case, depending on such factors as relative marginal cost levels and the substitutability of the USPS service and private sector services, no single rule can be formulated. A proper competition analysis would have to examine these different factors in determining the extent, if any, to which taxes should be imputed.

b. Low-cost borrowing

The exemption from state and local taxation of the interest and principal on USPS obligations lowers the cost of borrowing. Savings attributable to the tax exemption and the "full faith and credit" clause

¹ Alternatively, USPS could be required to turn over to the Treasury any additional revenue raised as a result of imputed taxes. This would amount to a transfer payment, with no impact on economic efficiency. Nevertheless, whereas the imputation of taxes could be effected through an interpretation of section 3622(b)(4), the raising of additional revenue and its transfer to the Treasury would require an amendment to the break-even requirement of section 3622.

² For an illustration of the types of problems one should expect to encounter in the postal arena, see Federal Reserve press release, Dec. 31, 1980, Appendix I: The Private Sector Adjustment Factor (PSAF).

could be computed by comparing USPS borrowing costs with those of similar private sector enterprises. While there is no other organization in the country which has 650,000 employees, with labor accounting for over 85 percent of its costs, it should be possible to develop a reasonable cross-section of companies against which USPS could be compared.

Offsetting the state and local tax exemptions on the interest and principal on USPS obligations involves the additional consideration that Congress specifically decided to create such exemptions. Thus, imputation of taxes pursuant to the broader "competition" criteria of section 3622 would appear to be directly contrary to the goals of Congress. On the other hand, one could argue that the tax exemptions were not enacted with competitive services in mind, but rather to decrease the cost to the public of mail services for which private sector competition does not exist. Such a reading would be consistent with the consideration of "the available alternative means of sending and receiving letters and other mail matter at reasonable costs," pursuant to §3622(b)(5).¹

With no legislative history to the contrary, it is reasonable to assume Congress intended section 3622, which deals exclusively with the ratemaking process, to govern competition considerations in the pricing process. Even if the user of a "competitive" class of mail were to pay a higher rate as a result of imputation pursuant to 3622, the savings from low-cost borrowing would still accrue to USPS and would be available to lessen the institutional burden across the board.

¹ See, PRC Op. & Rec. Dec., Docket No. R71-1, at 1-281; Op. & Rec. Dec., Docket No. R76-1, at 1-160; Op. & Rec. Dec., Docket No. R77-1, at 233.

As mentioned previously, USPS also has access to low-cost capital as a result of the "full faith and credit" clause of 39 U.S.C. 2006(c).¹ To repeat the preceding analysis, providing the guarantee of the United States on its obligations permits the Postal Service to operate more efficiently, but that does not require that the effect on competition be ignored. Offsetting the effect of the "full faith and credit" clause in the pricing of competitive services would not reduce the benefits of the guarantee; it would simply preclude competitive classes from enjoying lower rates as a result thereof.

c. Initial equity

USPS also benefits from the initial equity it received as the successor to the Post Office Department. Unlike a private enterprise, it does not have to operate at a profit to pay a return on this equity, and it is also free to deplete its initial equity; for example, by maintaining insufficient reserves for depreciation, or by incurring operating losses, should management choose to do so. The amount of equity transferred in 1970 would be ascertainable from the first USPS balance sheets, although it may be necessary to review these figures to determine whether the book value of property reflected fair market value.² If not, the process of re-appraising, based on market considerations of ten years past, would not

¹ The "full faith and credit" of the United States government only applies if the Postal Service has made a request for it, and the Secretary of the Treasury "in his discretion, determines that it would be in the public interest" to make the guarantee. Since 1970 the pledge has been given on every USPS borrowing.

² Even fair market value may be an inadequate guide, particularly with respect to facilities in more remote areas. If the Postal Service has an identified need for a facility, replacement cost, and not fair market value, is the more appropriate measure of its worth.

be a simple task. Once completed, however, the benefit accruing to USPS from the initial equity could be estimated as the present cost had USPS obtained long-term equity financing when it was established in 1970.

The analysis required for deciding whether to impute the initial cost of equity is also analogous to that required for taxes. USPS succeeded to the former postal system, and its costs reflect the fact that its initial equity came free of obligation. Imputing equity costs to "competitive" classes of mail would not affect USPS's enjoyment of the legacy of the old Post Office Department.

d. Appropriations

Congressional appropriations have recently been reduced, but still remain a source of revenue for the Postal Service, and there is always the possibility that they could be increased in the future, particularly if steps are taken to amend or abolish the Private Express Statutes. Both the revenue-foregone appropriations and the public service subsidy are easily quantifiable.

The revenue-foregone appropriations have been intended to benefit non-profit users and to give certain mailers who enjoyed non-compensatory rates prior to postal reorganization a sufficient period of time to adjust to the impact of increases to compensatory levels. Since 1970 Congress has addressed the question of revenue-foregone appropriations on several occasions and sharply limited the subclasses of mail entitled to benefit from them. Thus, there is a definite Congressional policy of subsidizing only those few classes which continue to receive such appropriations.

¹ S. Rept. No. 91-912, 91st Cong., 2d sess., at 11 (1970); H. Rept. No. 91-1104, 91st Cong., 2d sess., at 17 (1970).

Indeed, unlike the advantages discussed previously, revenue-foregone appropriations are intended to benefit specific classes of mail. To impute the value of the appropriations to the classes of mail benefitting from them would directly counter the Congressional policy of imposing regular rates on subclasses which Congress had found it appropriate to favor with reduced rates. It must, therefore, be concluded that revenue-foregone appropriations should not be imputed to those classes of mail which benefit from them. The general obligation to consider the effect on competitors and/or competition cannot be read as overriding the very specific policy of favoring certain classes with reduced rates.

Public service subsidies are somewhat different. Public service costs are institutional in the sense that they are incurred as a result of policy decisions to provide service that would not be provided were the Postal Service to operate on the basis of strictly economic considerations.¹ For example, some low-volume rural post offices would undoubtedly be closed; at-door delivery service might be replaced with curbside or kiosk delivery; and six-day delivery in residential areas might be reduced to five or three days. Services which are provided by private enterprises competing with the Postal Service are, by definition, not public services, and thus there is no need for competitive services to benefit—through lower rates—from the public service appropriation. Because the public service appropriation is intended to benefit the postal service as a whole, and not specific classes of mail, it could be offset in the pricing of competitive classes

¹ The criterion could also be stated as services which would not be provided were the Postal Service not a governmental entity. In that case, however, to the extent services are provided because of regulatory requirements, they may still be public services, for they might not be provided were the decision made on the basis of strictly economic considerations.

without affecting the statutory policy or the direct financial benefits USPS reaps from the appropriations.

Offsetting the public service appropriation in the pricing of competitive services would have its difficulties, however, because the costs of public services are allocated to both competitive and monopoly services. Competitive services would thus still be burdened with a share of the costs of public services yet would not receive the benefits of appropriations designed to reimburse USPS for serving the public. To prevent the competitive classes from being unduly burdened, the costs of public services could be excluded in the allocation of attributable, assignable and residual costs, but that approach, as noted above,¹ would conflict with the principle of costing on the basis of volume variability.

2. Disadvantages

The disadvantages which accompany the Postal Service's governmental status are somewhat more difficult to quantify than the benefits, for their impact on the financial position of the organization is generally indirect. As noted above, disadvantages include:

- . personnel restrictions which may lead to higher labor costs;
- . statutory requirements applicable to property, contracts, budgets, etc.; and
- . the obligation to provide nationwide service.

a. Labor Costs

It has frequently been contended that the compensation of postal workers exceeds that of their counterparts in other sectors of the

¹ See page _____, supra.

economy,¹ and as a result the Postal Service incurs excessive labor costs. Such claims raise three questions relevant to the present study: (1) Are postal labor costs higher than those of other sectors? (2) If so, by how much? and (3) Can the difference be attributed to the statutory regime imposed upon USPS?

For obvious reasons, there has been much debate over the first question, with unions and management arguing opposing sides during wage negotiations.² Straight comparisons of Postal Service wages with those in other industries are met with union contentions that postal positions entail greater job responsibilities. Some outside observers have suggested that the issue has regional dimensions--whereas USPS employees in rural areas receive relatively high salaries, those in urban areas may not be any better off than their counterparts in the civil service or the private sector.³ The legislative history of the Postal Reorganization Act indicates that consideration was given to permitting the Postal Service to pay area wages, but no such provision worked its way into the final bill.⁴

Considerable controversy is likely to surround any attempt to quantify the difference, if any, between postal labor costs and those of other

¹ See, e.g. Douglas K. Adie, "How have Postal Workers Fared Since the 1970 Act?" in R. Sherman, Perspectives on Postal Service Issues 74 (1980); Adie, An Evaluation of Postal Service Wage Rates (American Enterprise Institute, 1977).

² For the position of the American Postal Workers Union and the National Association of Letter Carriers in the most recent wage negotiation, see Joel Popkin, "The History of Wages of U.S. Postal Workers" (July 7, 1981); for the Postal Service presentation, see Michael L. Wachter and Jeffrey M. Perloff, "An Evaluation of U.S. Postal Service Wages" (July 15, 1981).

³ See, Adie, in Sherman, supra. at 92-93; Sharon A. Smith, "Commentary," in Sherman, supra., at 96-97.

⁴ See, "Postal Reorganization," Conference Report to Accompany H.R. 17070, H Rept. No. 91-1363, 91st Cong., 2d sess., at 81 (1970).

sectors. Two areas of inevitable debate would be the selection of the industry or industries to be used as the basis for comparison and the method by which a particular wage package would be valued. Given the existence of non-monetary fringe benefits and intangible items such as job security, the latter would be a particularly difficult task.

Turning to the third question, the existence of higher labor costs--no matter how great the differential may be--is irrelevant to the present analysis if it can be shown that the differential is not an inevitable result of the statutory arrangement but rather a consequence of the manner in which postal management has exercised its responsibilities. There is no question that individual items such as USPS participation in the Civil Service Retirement and Disability Fund rather than the Social Security System result in higher costs,¹ or that the statute² and not a management decision leads to the incurrence of such costs. Yet that does not mean the total compensation package of postal workers need by any higher than that of workers in other sectors.

Postal wage agreements are negotiated through collective bargaining under Chapter 12 of Title 39. During the course of collective bargaining, postal management should attempt to offset expensive, statutorily-imposed benefits--such as participation in the Civil Service Retirement and Disability Fund--with concessions on other items such as wages. One would expect postal management to seek a package deal in which total compensation

¹ The higher costs may be offset, in whole or in part, by the additional contributions private firms frequently make to private pension funds. Participation in such plans, however--unlike the Social Security System--is not required by law. The decision is a business one, based on the economic benefit to be derived from improved employee/employer relations.

² 39 U.S.C. 1005(d).

is comparable to that paid for comparable work in other sectors. The same would also apply to the current policy of maintaining uniform wages nationwide--to the extent USPS is thereby burdened with excessive labor costs it should be able to obtain concessions from the postal unions.

There are also other grounds for questioning whether high postal labor costs can reasonably be attributed to the statutory provisions governing the Postal Service work force. First, wages for workers in other regulated industries such as airlines, railroads, and telecommunications have always been relatively high,¹ even though private, rather than governmental, entities are involved in those industries. To the extent higher wages reflect an effort to maintain worker satisfaction and thereby avoid the disproportionate damage to the national economy which can be caused by work slowdowns or strike in such essential industries, the postal situation is different because postal workers are prohibited by law from striking.² On the other hand, the possibility of an illegal, wildcat strike, such as occurred in 1970, always exists.

Second, the Postal Service's monopoly position in its most important markets must be considered in examining its labor costs. Because of the absence of alternatives, and the consequent inelasticity of a demand for first-class mail, USPS can afford somewhat higher labor costs without jeopardizing its financial stability. The breakeven requirement of 39 U.S.C. §3621 guarantees adequate revenues, and it is exceedingly difficult for the PRC to cut the USPS revenue requirement on any grounds, much less

¹ See, e.g., P. Garfield and W. Lovejoy, Public Utility Economics, Englewood Cliffs, N.J.: Prentice Hall, 1964, pp. 399-400.

² 39 U.S.C. §410; 5 U.S.C. §7311.

a finding that a wage agreement is inconsistent with honest, efficient, and economic management.¹

b. Statutory Requirements

Other disadvantages, and potential hindrances to the efficient operation of the Postal Service, are specific provisions of the Reorganization Act and a whole gamut of statutes pertaining generally to government contracts, property, officers, employees, and operations.² For example, in selecting modes of transportation, USPS is obligated to "make a fair and equitable distribution of mail business to carriers providing similar modes of transportation and services to the Postal Service."³ Private businesses, on the other hand, are free to negotiate with providers of similar modes of transportation or individual carriers to obtain discounts or preferential services in exchange for high volume usage.⁴

The Postal Service's freedom of operation is also restricted by the requirement that it provide nationwide service, even though it does not

¹ See Newsweek. The PRC has only occasionally reduced the revenue requirement upon a finding that the incurrence of a proposed expense would not be consistent with honest, efficient, and economical management. See, e.g., Op. & Rec. Dec., Docket No. R78-1, at 42-45.

² 39 U.S.C. §410. USPS is exempt from those not listed in the cited provision of the statute, but those which do apply are sufficiently wide-ranging to create potentially significant compliance costs.

³ 39 U.S.C. §101(f).

⁴ In practice, the Postal Service's competitors may not be in a significantly better position. Most, if not all, purchase transportation services from common carriers operating pursuant to CAB and ICC tariffs. It is thus unlikely that they would be able to obtain discounts, although it still may be possible for them to obtain preferential services. Moreover, Postal Service volume is sufficiently great that even with a distribution to carriers providing similar modest of transportation services USPS might be able to bargain for discounts or some form of preferred service.

enjoy the flexibility to reflect regional or local cost differentials in its most important rates.¹ A private enterprise would be able, through unilateral action, to close or consolidate post routes or offices which were not cost-effective; USPS must go through a statutory hearing process before it can make such changes,² and in arriving at its decision it is required to take into consideration such factors as the effects on the community served by the post office involved.³ Examples of other statutes which impose compliance burdens on USPS are the Freedom of Information Act and the Sunshine Act.

While Postal Service competitors are not subject to the operation of these laws, private enterprise incurs compliance costs with respect to a host of government regulations promulgated by agencies such as IRS, SEC, OSHA, and EPA. Any exemptions USPS enjoys from such regulations could be viewed as statutory advantages offsetting the disadvantage of complying with federal laws not applicable to the private sector.

The cost of complying with many of these statutory provisions is likely to be de minimis in relation to the total USPS revenue requirement. But that is not true with respect to others, such as the nationwide service requirement, for which reason a comprehensive competition analysis should include an estimate of the impact such requirements have on the Postal Service.

¹ See 39 U.S.C. §3623(d).

² See 39 U.S.C. §404(b).

³ See PRC, Opinion Remanding Determinations for Further Consideration, Dockets No. A79-10 thru 21 (1979); R. Margolis, At the Crossroads: An Inquiry into Rural Post Offices and the Communities They Serve (1980).

V. MISCELLANEOUS MATTERS

There are several other competition-related issues in postal ratemaking which will be addressed here very briefly. Because all are deserving of in-depth consideration, this discussion is only intended to aid in the identification of key issues.

A. Separate Subsidiaries

This study has focused on postal pricing as a means of avoiding unfair competition with the private sector. An alternative, which is often viewed as more effective, would be to require USPS to offer competitive services through a separate subsidiary. The degree of separation could vary from requiring different books of account to restrictions on the labor force, capital, facilities, research and development, etc. The FCC recently followed this approach with respect to AT&T in its Second Computer Inquiry decision and in the conditions imposed upon GTE when it acquired Telenet.¹ It is not a new means of protecting competition, and it can be effective if the degree of separation is adequate to meet the circumstances of the particular case.²

In the postal arena, the possibility of establishing subsidiaries was recently raised with respect to electronic mail offerings. The 1979 PRM called upon USPS to offer electronic mail services through an independent

¹ Re Second Computer Inquiry, 77 F.C.C. 2d 284, reconsid. 84 F.C.C. 2d 50 (1980); G.T.E.-Telenet Merger, 72 F.C.C. 2d 111, modified 72 F.C.C. 2d 516 (1979).

² Nonetheless, there have been cases in which the establishment of separate subsidiaries has not been considered adequate to protect competition, and such arrangements have not been permitted. One of the most prominent examples is the 1956 antitrust decree which prohibited AT&T or any of its subsidiaries from entering the data processing business.

subsidiary which would be separate for "accounting and ratemaking purposes."¹ One advantage of the PRM approach is that by using accounting principles as well as ratemaking theory, it would require costs to be analyzed on two levels, providing greater assurances against cross-subsidization. The major difficulty is that separation for accounting purposes is a complex, difficult task, with no greater assurances of accuracy than exist in the application of costing methodologies. Moreover, the application of accounting techniques may be no more than a fully distributed costing system in disguise.

Communications industry sources have frequently advocated the creation of a separate subsidiary, but, to date, USPS has given no indication that it contemplates taking such a step. Nevertheless, all of the competitive services offered or planned by USPS, the electronic ones are probably the strongest candidates for separate subsidiaries because they involve distinct functions, machinery, and possibly even facilities. It may be that a service such as E-COM could be offered as efficiently by a USPS subsidiary, with offices adjacent to the twenty-five serving post offices,

¹ A copy of the PRM is appended to the Notice of Inquiry Regarding Administration Policy Statement, PRC Docket No. MC78-3, July 23, 1977; see also 73 FCC 2d 283, Appendix, at 313.

² One argument against offering electronic services through separate subsidiaries is that such a structure would prevent optimal utilization of the Postal Service work force, which is already on duty around-the-clock at virtually every location where major electronic installations are likely to be placed. The argument is not compelling, however, inasmuch as the only functions performed by mail handlers would be the operation of the interface between the electronic communications segment and the mails, i.e. the conversion of messages to hard copy and their entry into the mailstream. In the E-COM proceeding such functions were shown to represent only a small fraction of the total cost of providing an electronic mail service once processing is fully automated, and thus the savings realizable through the exploitation of the USPS work force should not be significant.

as by the Postal Service itself.¹ As noted earlier, in the E-COM remand proceedings the National Telecommunications and Information Administration (NTIA) and the Department of Justice have raised the similar issue of whether private enterprise could offer E-COM service just as efficiently, precluding the need for government involvement.²

On the other hand, it is difficult to imagine establishment of a separate USPS subsidiary for the delivery of second class, fourth class, or Express Mail. The first two are moved as part of the regular mailstream, and it would be difficult--if not impossible--to achieve any real degree of separation without duplicating portions of, if not the entire, mail processing and delivery network.³ Express Mail receives special handling, but the Postal Service's ability to compete in the market stems largely from its use of an existing system complete with the necessary transportation connections and a nationwide delivery network. Should the Postal Service be required to offer Express Mail through a wholly separate subsidiary, none of the economies of scope realized through reliance on the existing system would be achievable, and there would be little reason to favor

¹ E-COM plans currently call for equipment to be installed and electronic messages converted into hard copy and entered into the mailstream at twenty-five serving post offices across the country.

Were the service to be offered by a separate subsidiary it would probably not include delivery. Instead, once messages were printed and inserted into envelopes they could be walked across the street and entered as regular or presorted first-class mail, the mail charge being added on to the fee the subsidiary would set for the services it would perform.

² Joint Comments of the United States Department of Justice and the National Telecommunications and Information Administration of the United States Department of Commerce, PRC Docket No. MC78-3, July 27, 1982.

³ It could be argued that the function of processing parcels could be separated by assigning it to the Bulk Mail System, but those facilities are government involvement if similar services were being offered by the private sector.

government involvement if similar services were being offered by the private sector.

Moreover, the same could be said of any USPS service offered through a separate subsidiary. If the subsidiary were truly separate, there would appear to be little advantage to having USPS rather than a private enterprise offer the service. Total separation could only be achieved through the use of different facilities and work forces, which would result in the loss of any economies of scope otherwise achievable and, in all probability, gross inefficiencies.¹

On the other hand, if a separate subsidiary were created only for "accounting and ratemaking purposes," as suggested in the 1979 PRM, it is unlikely that the effect would be significant. Because cost analysis and accounting techniques are already used to estimate the cost of each of the services USPS offers, there is no reason to believe the separation would result in any greater degree of assurance that rates would truly reflect the "full cost" of the service, however that concept may be defined.

B. Natural Monopoly

Related to the separate subsidiary issue is the question of whether there is a natural monopoly in the provision of mail services. If a natural monopoly exists, then the separation of competitive services or the encouragement of private sector competition could increase the costs to the public. Without entering into detail, it can be noted that to date there

¹ See John C. LeGates, "An Overview of Long Distance, Local, and Customer Premise Equipment Market," testimony before the Sub-Committee on Telecommunications, Consumer Protection, and Finance, House Committee on Energy and Commerce, May 21, 1981.

has not been any demonstration of increasing returns to scale in the provision of postal services.¹ The question was viewed as relevant to reliance on IER pricing in early PRC proceedings, but has not been at issue in recent years.

C. Cream-skimming

The Postal Service has consistently followed a policy of maintaining a single rate schedule effective nationwide, and as a result its competitive services have been susceptible to cream-skimming. The offsetting of USPS advantages in the pricing of competitive services would result in higher postage rates, opening the door to cream-skimming even further, as private firms would be able to extend their competition into new USPS markets. For example, Dow Jones could be expected to expand in-house delivery of the Wall Street Journal (through its wholly-owned subsidiaries), but one would not expect abandonment of the mails as its primary means of distribution nationwide.

One solution to the problem would be to offset the net advantages only when USPS competitors provide nationwide service, as the Postal Service is required to do by law, but difficulties exist with such an approach. First, there is nothing in §3622(b)(4) to suggest that the effect on private enterprise engaged in the delivery of non-letter mail matter is to be considered only with respect to firms which compete with USPS

¹ See, e.g., Leonard Merewitz, "Costs and Returns to Scale in U.S. Post Offices," J. Amer. Stat. Assn., 504-09 (1971); Rodney E. Stevenson, "Postal Pricing Problems and Production Functions," (Ph.D. dissertation, Mich. St. Univ., 1973).

² See, e.g., Op. & Rec. Dec., Docket No. R74-1, at 152-56.

nationwide. Second, what would be the criteria for determining whether competitors are providing "nationwide service"? Would each firm have to offer service to the entire country, or would it be sufficient if different parts of the country were covered by different competitors? What would happen if there existed both local and nationwide competition for a given service? The distinction would be particularly difficult to make in markets organized along local or regional lines. In such markets, the imposition of restrictions on firms which compete with the Postal Service could well result in a less efficient allocation of resources.

Another method of combatting cream-skimming would be to set postage rates to reflect costs, possibly on the basis of delivery point density.¹ While USPS has until now refrained from such an approach, the law does not appear to prevent it from doing so. Only with respect to classes sealed against inspection,² which are generally monopoly services, are rates required to be "uniform throughout the United States, its territories, and

¹ Private competitors could also engaged in cream-skimming by pursuing a particular type of customer such as large volume commercial mailers. Different approaches would be required in such situations.

Owen and Willig have suggested the problem might also be addressed through the imposition upon the recipient of a fee for delivery services. See Bruce M. Owen and Robert D. Willig, "Economics and Postal Pricing Policy," Program on Information Policy Research, pp. 81-82, January 1981.

² Classes sealed against inspection can only be opened pursuant to a search warrant authorized by law, or by a USPS employee for the sole purpose of determining an address at which the letter can be delivered. One such class must receive "the most expeditious handling and transportation afforded mail matter by the Postal Service." 39 U.S.C. § 3623(d).

possessions."¹ Other classes need only be priced in a manner which avoids "undue and unreasonable discrimination among users"² and comports with the provisions of section 3622. Given the continuing emphasis which has been placed on cost-of-service principles, it is not likely that rate differentiation, if based on costs, would be viewed as "undue or unreasonable discrimination." The primary difficulties involved in shifting to such rates would be the development of the criteria for differentiation (likely to become a political issue) data collection, ratesetting, and enforcement.

Some types of rate differentiation could be expected in high density areas. As a result, cream-skimming would probably be reduced--although not necessarily eliminated--as firms with high costs would find it more difficult to compete with lowered USPS rates. Rate differentiation also would adversely affect some mail users, but they could be compensated through direct subsidies if Congress concluded public policy so required. The Chairman of the Federal Trade Commission, James C. Miller III, recently

¹ The provision has been interpreted as permitting rates which vary with distance--e.g., the zoning of rates for priority mail--but not differences based on the entry or destination points. See PRC, Transmittal of Twelve Opinions and Recommended Decisions to the Governors of the Postal Service, Docket Nos. Mc76-1-4, Dec. 22, 1977, at B-5 - B-11. In one of those decisions, a proposal for local/nonlocal rates for first-class letters, the Commission noted that rate variations based on weight, shape, speed of delivery, mailer preparation, and method of payment (business reply mail) have not been found to violate the "uniformity" requirement of §3622(d). The PRC pointed out that 39 U.S.C. §3683, which applies to books and library materials, states that the rates for such mail matter shall be "uniform for such mail of the same weight, and shall not vary with distance transported." Section 3623(d), on the other hand, refers only to "uniform" rates.

² 39 USC §403.

advocated this approach in testimony that cream-skimming resulting from the repeal of the Private Express statutes could lead to a more efficient allocation of resources.¹

Aside from cream-skimming against the Postal Service, one must also consider the potential for cream-skimming by USPS. With Express Mail, for example, USPS has been quite selective in choosing the markets it serves. The principal explanation given is that airline schedules determine which connections can or cannot be made. But were USPS required by law to provide nationwide service, it could overcome the difficulties attributed to airline schedules by making arrangements for special flights, albeit at an increased cost. Depending on the extent of service provided by its competitors, the USPS decision to restrict itself to markets already served by commercial flights could amount to cream-skimming inasmuch as these are the markets which are least costly to serve. Nevertheless, if USPS is competing fairly, and the market is open to new entrants, such cream-skimming could bring about a more efficient allocation of resources.

Cream skimming by the Postal Service or its competitors could be addressed by legislation requiring all carriers of mail matter to provide nationwide service. Yet, as discussed above, that approach could also result in an inefficient allocation of resources. Whether the dimensions of the cream-skimming problem are such that attention need currently be focused upon it, or whether legislation regulating USPS competitors would

¹ Testimony before the Subcommittee on Economic Goals and Intergovernmental Policy of the Joint Economic Committee, June 21, 1982.

be desirable from the standpoints of economics and social policy, are questions worthy of further inquiry.

D. The Self-Enforced Monopoly

Another issue that has arisen in recent years involves the potential for anticompetitive behavior in the Postal Service's enforcement of its Private Express monopoly. The Postal Service is unique in that it enjoys the authority to enforce a statutory monopoly with its own police force (the Postal Inspection Service). In Docket No. MC79-2 several couriers alleged that postal inspectors investigating Private Express violations had promoted use of Express Mail as an alternative to private carriers.¹ The couriers, however, did not demonstrate that the alleged anticompetitive conduct adversely affected their businesses,² and the outcome of the case before the PRC as not affected.

In 1970, when private sector competition to USPS was essentially limited to fourth-class mail, the Private Express monopoly was not a matter of central importance in the consideration of the services USPS offered in competition with private enterprise. Today, with private courier services competing with Express Mail and USPS preparing to offer electronic mail services which would compete directly with offerings of communications carriers, the situation is different.

For example, in early 1979 the Postal Service proposed new regulations regarding the applicability of the Private Express Statutes to

¹ See, PRC Op. & Rec. Dec., Docket No. MC79-2, at 38-43.

² See, PRC Op. & Rec. Dec., Docket No. MC79-2, at 46.

electronically transmitted messages.¹ The communications industry protested loudly, and the FCC argued that the proposed regulations intruded upon its exclusive jurisdiction under the Communications Act of 1934.² Rather than press the issue, USPS quietly pulled back, subsequently announcing that the proposals would be reconsidered.³ Two years have since passed, but the Postal Service has made no public move to revive the matter.

Whether Congress should re-examine the substance of the Private Express Statutes is an intriguing question, and one which requires in-depth study. Wholly separate, however, is the question of the Postal Service's power to interpret and enforce those statutes. Since 1970 circumstances have changed sufficiently to warrant a reevaluation of the advisability of permitting a quasi-corporate Postal Service to enforce the statutory monopoly it enjoys in the carriage of "letters." Given the increasing direct and indirect competition to letter mail, the various allegations of anticompetitive USPS conduct, and the importance currently attached to promoting competition, there are strong grounds for concluding Congress should address the issue, irrespective of the substantive merits of the Private Express monopoly.

E. Timing of Rate Increases

Aside from the levels at which rates are set, the timing of rate increases can also have an impact on competition. Under section 3622(a)

¹ 43 F.R. 60615 (1979).

² 71 F.C.C. 2d 100 (1979).

³ 44 F.R. 40899 (1979).

requests for changes in rates and fees are to be filed "[f]rom time to time" when the Postal Service determines that such changes would be "in the public interest and in accordance with the policies (of Title 39). The timing of changes has been held to be within the "exclusive authority" of the Board of Governors.¹

If the Postal Service is able to identify the need for a rate increase 12 to 15 months in advance,² it can prepare and file a request for a recommended decision in time to avoid operating deficits. Postal management, however, has been reluctant to raise rates more than once every two to three years, a policy which it has referred to as preservation of "rate stability."³

Thus, instead of seeking to increase rates by 5 to 10 percent each year, USPS has spaced its increases and sought rate jumps of 23 to 33 percent.⁴ While achieving "rate stability," the policy has also resulted in the incurrence of significant losses in the periods immediately

¹ Newsweek, 633 F.2d, at _____.

² The statute requires the PRC's Recommended Decision at a rate proceeding to be issued within ten months from the date on which USPS files its request. 39 U.S.C. §3624(c)(1). The preparation of the Postal Service's request typically requires a minimum of several months of effort.

³ See, Decision of the Governors of the United States Postal Service on Rates of Postage and Fees for Postal Services, Docket No. R80-1, at 1-11.

⁴ The figures are for the first ounce of a first-class letter-- from 6-8¢ (Docket No. R71-1); from 8-10¢ (Docket No. R74-1); from 10-13¢ (Docket No. R76-1); from 13-16¢ (Docket No. R77-1); and from 15-20¢ (Docket No. R80-1). Figures for other rate categories obviously vary.

preceding the institution of new rates.¹

To appreciate the potential anticompetitive effects of this policy, one must understand how the Postal Service's revenue requirement is calculated for the purposes of a rate proceeding. The PRC, consistent with accepted public utility regulatory practice, requires the Postal Service to file requests for changes in rates on the basis of cost and revenue estimates for a "test year"--a 12-month period commencing at about the time the rates are to go into effect.² Assuming rates are set at levels which enable the Postal Service to break even in the test year, the potential for anticompetitive effects occurs in the 12 to 24 months after the conclusion of the test year, before the institution of the next set of rates.

¹ In the first decade the Postal Service incurred operating losses totally over four billion dollars. The early losses have frequently been blamed on lengthy PRC proceedings (17 months and 23 months for the first two rate cases), but that contention is difficult to support in light of the fact that during each of those proceedings USPS exercised its power to institute the rates it requested on a temporary basis three months after the filing of its request.

The Governors are well aware that their current policy of rate stability leads to net gains in the early part of a rate cycle and losses in the later part. In their first decision on the PRC's Recommended Decision in Docket No. R80-1, the Governors defended the practice in the following terms:

It is plainly erroneous to suggest that the Postal Reorganization Act's mandate for practicable cost/revenue equilibrium (39 U.S.C. § 3621) requires a rate filing whenever projections of future costs and revenues forecast a deficit for a fiscal year. It certainly does not violate the statute to space rate filings so that the net financial gain in one year or an eighteen-month period is roughly balanced by the net loss of the next. In fact, the rate stability resulting from this approach (as recent record mail volumes attest) fosters the 'development of postal services of the kind and quality adapted to needs of the United States,' as envisioned by the same §3621.

Governors' Decision, March 10, 1981, at 18. See also, Transcript of the June 8, 1982, Board of Governors meeting, at 4-5 (remarks of PMG Bolger). To the knowledge of the author, no empirical data exist to support the Governors' contention that "recent record mail volumes" are related to the maintenance of rate stability.

² See 39 C.F.R. §3001.54(f).

Particularly in times of double-digit inflation, operating losses can be significant as costs rise rapidly and revenues stagnate.¹

The basic problem is that during such periods some competitive services may not be covering their attributable and assignable costs.² For example, if the average markup over attributable and assignable costs were estimated at 125 percent, and there is a revenue shortfall of eight percent, the actual markup would be 115 percent. But some competitive classes, such as fourth-class zone-rated parcels (parcel post) typically have much lower markups. In Docket No. R80-1, for example, the parcel post markup was 106 percent. An eight percent revenue shortfall—assuming changes in costs, volumes and productivity for the subclass would not differ from the systemwide averages—would result in a markup of less than 98 percent, meaning a rate which would be below attributable and assignable costs. Because the shortfall would be reflected in an operating loss, and not be made up by revenues from other classes, one could argue that the subclass would not be cross-subsidized. The analysis is complicated, however, by the fact that in recent rates cases, recoveries for period year losses have been included in the USPS revenue requirement and treated as institutional costs. If this practice were retained, it would be future mailers who, in the hypothetical, would have to make up the difference

¹ Increases in productivity and volume have a favorable impact on the cost/revenue balance but in recent years their impact has been overshadowed by cost increases, which can largely be attributed to inflation.

² See generally, "Statement of A. Lee Fritschler, former Chairman and Commissioner, U.S. Postal Rate Commission," before the Subcommittees on Postal Operations and Services and Postal Personnel and Management of the House Committee on Post Offices and Civil Service, in "Effectiveness of the Postal Reorganization Act of 1970," Serial No. 97-23, p. 234, at 238-239.

While the marginal cost is relevant to a determination of anticompetitive behavior, attributable and assignable costs would seem to be the best available proxy because they are based upon volume variability.

between the costs of parcel post and its rates. Should parcel post then continue to make a below-average contribution to institutional costs in the years in which the losses would be recovered, one could argue that cross-subsidization would be occurring between parcel post mailers in the year of the deficit and mailers of other classes in subsequent years.¹ Definite conclusions would require all the relevant figures, but the hypothetical demonstrates that USPS implementation of its policy of rate stability could bring about anticompetitive consequences.

Possible solutions to the problem include legislation requiring USPS to file rate requests whenever projections indicate future losses of a specified magnitude; strengthening the PRC's authority in proceedings instituted upon complaints filed pursuant to 39 U.S.C. §3662;² or extending the test period used in PRC proceedings from one year to the expected life of the rates, i.e., two to three years under the current USPS "rate stability" policy. The comparative evaluation of these alternatives is

¹ Because first and third class account for the lion's share of the Postal Service's institutional costs, these classes would be paying the prior year losses incurred when parcel post would have been priced below cost.

² The complaint procedure of §3662 currently permits the PRC to examine rates, but its authority is purely advisory, and there is little reason to believe the Postal Service would accept a PRC recommendation to change a rate if USPS itself had not deemed it necessary to request a change or acquiesce in the requested relief during the course of the §3622 proceeding. The statute provides for judicial review only if the Governors "approve, allow under protest, or modify the recommended decision of the Postal Rate Commission." 39 U.S.C. §§3662, 3628. Surprisingly, there is no right of appeal to the courts when the Governors reject a PRC finding that the policies of the statute require a change in an existing rate. The legislative history provides no suggestion that Congress intended this anomalous state of affairs, i.e., that a complainant enjoys the right of appeal to the courts when the Governors accept a PRC recommendation responding positively to his complaint, but not when the Governors reject a PRC finding that a rate change is required and refuse to change the status quo. In all probability, the drafters failed to give careful consideration to the wording of §3628 in referencing it as the appeals procedure to be followed with respect to complaints brought under §3662.

beyond the scope of this paper, but again the problem is deserving of immediate further study.¹

F. Regulating Postal Ratemaking

The framework of postal ratemaking is also an area ripe for further examination, particularly if USPS continues to expand offerings which compete with private enterprise. As noted in the first chapter, final authority in the ratemaking process currently rests with the Postal Service Governors. While the PRC recommends proposed rates and classifications, the Governors may reject or even modify PRC decisions.

A recent case in the D.C. Circuit, National Easter Seal Society v. United States Postal Service,² held that a decision by the Governors to modify a PRC decision is subject to the same standards of review as other agency decisions brought before the Court of Appeals. The Court may set aside a decision by the Governors only if "it is arbitrary, capricious, or an abuse of discretion or if it is unsupported by substantial evidence."³

¹ Another potentially troubling aspect of the "rate stability" policy is that it creates an incentive for postal management to seek rate increases greater than those required to break even in the test year. If USPS can obtain additional revenue and achieve a surplus in the first year after rates are implemented, that surplus can be used to offset future losses and thereby delay the next increase. This is precisely what appears to be happening with the Docket No. R80-1 rates (20¢ for first-class letters), which were instituted by the Postal Service in November, 1981. PMG Bolger announced a surplus of \$634.7 million for the first eight accounting periods (thirty-two weeks) of fiscal year 1982, even though the 20¢ rate not in effect for the first month of that period. The implication from the PMG's remarks was that the Postal Service would not seek implementation of another rate increase before the end of fiscal year 1984. It is of more than passing interest that in instituting the 20¢ rate the USPS Governors modified a PRC decision concluding that 18¢ was adequate to break even, and that the PRC had thrice rejected USPS requests for a 20¢ rate.

² 656 F.2d 754 (D.C. Circ. 1981).

³ Id., at 763.

In addition, the Court held that the Governors are not bound by the Administrative Procedure Act in receiving PRC decisions.¹

The Second Circuit has taken a similar approach in Time, Inc. v. United States Postal Service,² the review of the Governors' modifications of the PRC's decision in Docket No. R80-1. Holding 5 U.S.C. §706 to be the relevant standard,³ the court found USPS must provide class-by-class explanations for modifications and "the rationale for the new interrelationships created."⁴ "At a minimum...[the Governors must] evince that [they have] considered the record as a whole as well as the factors set forth in 39 U.S.C. §3622(b) in selecting [their] individual modifications."⁵ The Time decision, however, suggests that a distinction is to be made between revenue requirement and "ratemaking" issues. While the Newsweek court emphasized the responsibilities of the Governors in assuring the adequacy of postal revenues, the Time panel read the legislative history as requiring "ratemaking...authority [to be] vested primarily in [the] Postal Rate Commission," and referred to its role as "predominant."⁶ Nevertheless, both panels adopted the "substantial evidence" standard of 5 U.S.C. §706.

1 Id., at 766-68.

2 _____ F.2d _____; Docket Nos. 81-4183, 81-4185, 81-4203, 81-4205, 81-6216 (2d Cir. 1981) (hereinafter "Time"). The Newsweek case involved the Governors' decision to implement the PRC's recommended rates under protest; Time related to the Governors' subsequent modifications of those rates after the PRC refused, upon reconsideration and further reconsideration, to make the changes requested by the Governors.

3 See 39 U.S.C. §3628.

4 Time, Slip Opinion, at 21.

5 Id., at 23 (footnote omitted).

6 Id., at 19-20.

Under that standard it is possible for the Postal Service to escape independent review of its rate decisions, even when a substantial impact on competition or competitors may be involved. If the Postal Service were to present evidence tending to show that a low rate for a competitive service was necessary to compete with private sector alternatives, the Governors could rely on that evidence to overturn a PRC decision. Even if the PRC, as an independent decisionmaker, were to find that a strongly adverse impact on competition or competitors required a higher rate, the Governors could modify, were they to make the requisite statutory finding of insufficient revenue. Such a finding need only be supported by substantial evidence--for example, the testimony of Postal Service witnesses, even if the PRC arrived at a different conclusion based on all of the evidence on the record.

The Governors, in acting upon PRC Recommended Decisions, are often called upon to perform a delicate task of balancing public and private interests, yet there are serious concerns as to their objectivity. In the past they have relied heavily on the judgment of the management officials who make the decisions regarding the conduct of litigation before the PRC.¹ Frequently, the Governors are briefed on PRC decisions by the same Postal Service attorneys who are responsible for litigating the USPS position at the Rate Commission.² Because they are exempt from the Administrative Act, the Governors are not required to separate employees involved in

¹ In addition, the Board of Governors must approve USPS rate and classification requests before they can be sent to the PRC. As a result, the Governors have a stake in the outcome of PRC proceedings from the outset.

² See pleadings filed by the Postal Service in Graphnet, Inc. v. United States Postal Service, U.S. District Court for the District of Columbia, Docket No. 80-0246.

decision-making. Nevertheless, there is a legitimate question as to the consistency of such procedures with basic principles of procedural fairness.¹

The Time decision, however, by requiring the Governors to consider the record as a whole, may limit the ability of the Governors to modify future PRC decisions. Serving part-time, the Governors generally meet only one or two days a month, and their compensation is limited by statute.² It is almost inconceivable that the Governors would be either willing or able to satisfy the Court's requirement given the 20,000 page, highly technical record which typifies general rate proceedings.

¹ With respect to adjudicatory proceedings, the Administrative Procedure Act provides that "[a]n employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision..except as a witness or counsel in public proceedings." 5 U.S.C. §554(d). Although ratemaking is generally considered rulemaking under the APA, 39 U.S.C. §3624 requires postal rate and classification proceedings to be held in accordance with the hearing procedures of 5 U.S.C. §§556-57 (applicable to adjudications), indicating Congress's strong concern that procedural fairness be preserved in the process.

² The Governors receive \$10,000 per annum plus \$300 per day for no more than 30 days each year. 39 U.S.C. §202(a).

VI. CONCLUDING COMMENTS

Postal ratemaking will remain in a state of uncertainty until the Supreme Court decides the appeal now before it in the Newsweek case. But that decision will not affect the immediate need to reconsider the totally discretionary approach to pricing which has followed the D.C. Court of Appeals' rejection of IER. Under either the Second Circuit decision in Newsweek or the D.C. Circuit's decisions in the NAGCP cases, several billion dollars of costs of the Postal Service will fall into the residual category and be allocated on the basis of the non-cost criteria of §3623. The allocation of these costs could be decisive in the setting of rates and is certain to have an important impact on the competitive position of the Postal Service.

While many observers look askance at the discretionary nature of the current approach to pricing, it does have its supporters. Generally they argue that there is nothing wrong with judgmental decisionmaking if the decisionmakers have the knowledge and experience required to make the decisions. They point out that the statute requires appointees to the PRC to be selected on the basis of their "professional" qualifications and confirmed by the Senate.¹ The latter requirement was imposed to counter the strictly political, non-professional appointments which too often characterized the first years of reorganization.² Nonetheless, politics can still strongly influence the appointment process, and "professional" commissioners can still exercise their powers arbitrarily. Moreover, the USPS Governors enjoy final authority in the ratemaking process, and, as was

¹ 39 U.S.C. §3601.

² See "Postal Reorganization Act Amendments of 1975," House Committee on Post Office and Civil Service," H. Rep. No. 94-391, at 6.

demonstrated in the most recent rate case, they are willing and able to overrule the PRC on major substantive issues.

The discussion here has shown that an adequate legal basis exists for engaging in competition analysis in postal ratemaking. Past proceedings, however, have seen little attention devoted to the subject, which is not difficult to understand. Alternative delivery of third class mail matter is in a fetal stage. Private delivery of newspapers and magazines, with limited exceptions, has not been shown to be economically viable. USPS prices have not stopped United Parcel Service from capturing the lion's share of the parcel market, and only recently has UPS even found it necessary to contend that proposed USPS rates would adversely affect its business. Courier firms are increasingly finding themselves in stiff competition with USPS--witness the controversy over the Federal Express television commercials in early 1982--but they have not yet been represented collectively at the PRC. Communications companies wet their feet in the E-COM proceeding, but the Postal Service has still not taken the plunge into the world of electronic communications. Finally, the Postal Service's indirect competitors--telephone, newspaper inserts, and other media--apparently have not yet viewed their interests as sufficiently threatened to justify active participation in postal rate proceedings.

One approach to the pursuit of fair competition has been discussed here--offsetting statutory advantages and disadvantages in the pricing process. From the standpoint of economics, no problem is presented. From the socio-political and legal perspectives, however, there are numerous unresolved issues. Because the mails have always been viewed as a public service, economics alone has rarely been decisive in the resolution of major postal issues. The perceived responsibility of government to provide

services to rural areas, the political power of the postal unions, and the traditional perception of the Postal Service as an institution "binding the Nation together" all have heavily influenced past postal policy-making and there is no reason to believe the future will be any different in this regard.

A broad range of competition issues currently awaits in-depth consideration by the Postal Service, the PRC, other interested Executive branch agencies, and the Congress. Immediate efforts could achieve considerable progress in the search for solutions to the problems presented here. There is no need to wait for the issues to arise in the course of concrete cases, and it is preferable not to do so. As the E-COM proceeding so clearly demonstrated, the pressures of litigation require a focusing of efforts, and the time and resources indispensable to the conduct of a far-reaching, broad-based examination of the issues are generally not available at such times.

It is hoped that this study will stimulate further analysis of at least some of the competition considerations which have been raised. Only through careful investigation of the issues and policies at stake will it be possible to provide a foundation for sound, informed decisionmaking in the future.

MK
Ramat Gan, Israel
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