Before the
United States of America
Postal Regulatory Commission
Washington, DC 20268-0001

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In The Matter Of	)	
The Notice Of Postal Services filing Of	)	
Annual Compliance Report And	)	Docket No. ACR2015
Request For Public Comments	)	
	)	

Comments of the American Consumer Institute
Center for Citizen Research

The American Consumer Institute Center for Citizen Research (ACI) is a nonprofit (501c3) educational and research institute with the mission to identify, analyze and protect the interests of consumers in selected policy and rulemaking proceedings related to information technology, health care, retail, insurance, energy, postal and other issues. In this proceeding, the Postal Regulatory Commission (Commission) seeks comments on the United States Postal Service's (USPS) Annual Compliance Report, including performance, service and related matters.

General Discussion

Based on the USPS's performance for 2015, we see a continued deterioration of service quality and a weakened ability of the USPS to adequately fulfill its primary responsibilities consistent with its original charter.

As millions of American consumers across country depend on the USPS's basic service to send and receive mail in a timely and affordable manner, it is greatly concerning that the agency continues to lose money and it struggles to meet last year's lowered performance goals. New service standards mandated by the USPS at the start of 2015 indicated that mail would be expected to reach its recipients on an average of 2.1

days – up from the previous goal of 1.8 days. Despite these relaxed standards, according to a recent Inspector General management alert, the USPS reported a 48% increase in delayed mail for the first six months of 2015.

The USPS's reduction of standards and inability to meet them is just one component of the agency's shifting philosophy to neglect its core obligations – letter mail delivery. Of gravest concern, however, is that the USPS continues to lose money, while shifting dollars from profitable regulated services to unprofitable or less profitable unregulated ventures. This cross-subsidization of new experimental products has included the delivery of packages and groceries, as well as the provision of same-day delivery services and potentially banking services.

The remaining portion of these comments will address this issue, how it poses a serious threat to the reliable performance of postal services, and how the Commission can address this threat. Attached, at the end of this filing, is a Forbes commentary written by ACI. The commentary provides additional examples of the cross-subsidization of nonregulated ventures by regulated mail services.

The Problem: Cross-Subsidization of Services

Congress mandated that competitive services offered by the USPS must cover its direct costs, including a share of regulated fixed and institutional costs. In other words, the USPS is not allowed to subsidize its competitive services with its monopoly dollars. Yet this is happening. According to a study by economist Robert J. Shapiro, 28% of the postal system's attributable costs go to providing unregulated services, yet only 5.5% of fixed and institutional costs do.[1] This misallocation of cost recovery clearly undermines the USPS's mission of delivering letter mail in a timelier fashion and at a reasonable rate.

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[1] Robert J. Shapiro, "How the U.S. Postal Service Uses Its Monopoly Revenues and Special Privileges to Cross Subsidize Its Competitive Operations," Sonecon, Washington DC, October 2015, p. 3, at http://www.sonecon.com/docs/studies/Study_of_USPS_Subsidies_for_Its_Competitive_Operations-Robert_Shapiro-Sonecon-October_21_2015.pdf.

Keeping the USPS on task is a primary responsibility of the Commission, if performance, consumer satisfaction, financial solvency and operational efficiency are paramount objectives.

While Congress required that unregulated services cover its costs, this requirement has been easily circumvented because the USPS attributes only a limited portion of its costs to its unregulated products, thereby leaving the rest of its costs categorized as fixed and institutional overhead. This preference for incomplete cost attribution is deliberate, and it not only hinders the USPS's ability to accurately price its products in fluctuating markets, but enables the agency to use its monopoly power to prop up unregulated products and services.

Because any unregulated venture requires upfront support, it is correct to assume that this funding, at least initially, comes from its regulated activities. This means, if the prohibition against cross-subsidies were to be strictly considered, there would be no funding to create any unregulated entity.

Some economists argue that (by a restricted definition) there is no cross-subsidy present as long as incremental costs are being covered. However, this is only true in the short-run for competitive markets, because longer term all ventures must cover their full costs (included all fixed costs), as microeconomic theory explains, or these ventures will go out of business.

When a century's old government-sanctioned monopoly can financially cover the shortfalls of its unregulated affiliates, that affiliate may never need to contribute to its fix costs and, longer term, it may never need exit the market from unprofitable operations. Therefore, the criteria that unregulated firms only need to cover incremental costs is totally inappropriate and one that the commission should reject if USPS performance is a concern. The reason is simple – current regulations are perpetuating a rule that unregulated entities need only to recover short term incremental costs, and that has long term consequences on the solvency of entity. In short, it means that unregulated operations are never required to cover total costs and payback the regulated entity, and that perpetuates the subsidy. Therefore, using a short-term breakeven point (to judge whether a subsidy is present) is fiscally irresponsible and counter to basic financial and economic principles that require businesses to <u>eventually</u> cover all of its costs.

The point is that all costs should and can be allocated. By not allocating all costs, the true profitability of services is obscured and they are never paid back, and it allows the USPS to abuse its monopoly power by supporting unregulated ventures outside of its core mission.

Solution: Affiliated Interest Regulations

Addressing this problem is simple – the USPS needs to accurately and completely allocate all of its costs. That solution would prevent the cross-subsidization of unregulated business activity with regulated dollars. A fully-allocated cost model is and has been used in many regulated industries – including electric utilities, telephone exchange carriers and others.

Telephone exchange carriers, which are also price-capped (along with a productivity offset), are subject to very strict provisions that require transactions from the regulated company to affiliated unregulated businesses at prices that would at least cover all costs – including fixed and common overhead. Alternatively, in cases where an affiliate sells services to the regulated business, prices would be set at <u>the lower of market prices</u>. In other words, transactions between regulated and unregulated entities would never benefit the unregulated business, but may benefit regulated entities. This is an important philosophical distinction – unregulated ventures should never be allowed to siphon off regulated its resources. The USPS's failure to fully allocate its costs works to benefit the unregulated entities at the expense of regulated operations – jeopardizing its mission.

The Commission should consider a fully-allocated cost model, like public utilities currently use. These models required ventures to take an equal or larger share of costs (including fixed costs and opportunity costs) than regulated services. What the USPS is doing, instead, is the opposite.

Conclusion

There is no evidence that these financial diversions directly improve the core obligations of postal services to consumers. Instead, it is clear that the USPS is using its monopoly position to promote unregulated activities at the expense of its core mission. With a decline in some service volumes and overall financial losses, how can the Postal Service perform efficiently and productivity without knowing the profitability of its products and services?

We urge the Commission to open a notice of rulemaking to promulgate rules for a full cost allocation model – one that would insure that unregulated ventures pay (at least) their full share of fixed and institutional costs. This model would also provide USPS with profitability information to better manage its regulated products and services offerings in these changing times.

Failure to fully allocate costs is the major threat to Postal Service performance. Using an overhead cost factor that fully allocates fixed and institutional costs is the answer and it would be an important step in returning the USPS's full attention to delivering letter mail in a timelier fashion and at reasonable rates for consumers.

Respectively,

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ATTACHMENT:

FORBES – Postal Monopoly Abuse: Consumers Deserve a Refund

A new study by a former US Department of Commerce official confirms something that many observers have long concluded – the US Postal Service overcharges its monopoly customers and then uses these proceeds to subsidize unregulated services in direct competition with the private sector. The study, conducted by economist Robert Shapiro with support provided by UPS, finds consumers are overpaying for regulated monopoly services like first class mail, so that competitive services like package and priority mail can be subsidized – and sometimes the subsidy is as high as 40%.

The Postal Service, as a monopoly provider, has a number of "protected" advantages that firms in the private sector do not have. For one, the Postal Service has exclusive use of residential and business mailboxes, which saves it around $14.5 billion a year in delivery costs. Its competitors are not allowed to have access to these mailboxes and they are not allowed to compete against the Postal Service for these monopoly services. All of this advantages the Postal Service over the private sector.

And, there are other advantages for the monopoly. While the private sector is subject to real estate and property taxes, Shapiro finds the postal service is advantaged by exemptions totaling $2.2 billion. In addition, the study finds the monopoly benefits from exemptions on vehicle and registration fees, road tolls, fuel taxes and parking fees that its competitors must pay. Because the Postal Service has $15 billion (in debt) borrowed from the U.S. Treasury, it avoids $450 million in service costs.

If a monopoly is given financial advantages, it should not be allowed to use these advantages to enter and compete against private firms in nonregulated markets, but it does. Not only is the Postal Service cross-subsidizing competitive services for overnight delivery and package delivery, it has used its monopoly power to startup new ventures to deliver grocery food in competition with Peapod and others, financial services and Sunday delivery.

Another venture by the Postal Service, called *Metro Post*, promised same day delivery to businesses. By one estimate, the Metro Post trial generated $100 in cost but collected only $10 per delivery. Now we know where the subsidies are going. Meanwhile, the US Postal Service continues to lose money, having lost around $50 billion in the last eight years.

Normally, in competitive markets, when consumers get overcharged, they simply move to another competitor. No so, when facing a monopoly. According to Shapiro's figures, a 10% increase in "first class letter" monopoly services would result in less than a 2% decline in demand, which means that consumers are unlikely to leave the monopoly and its total expenditures increase. Alternatively, a cross-subsidy that results in a 10% decrease the price of the competitive service "express mail" would stimulate demand by 16%, which takes business from competitive rivals. Effectively, the Postal Service is using its monopoly power to harm private competitors, thereby reducing private sector investment and jobs.

While competitors are certainly being harmed, so are consumers. By using regulated revenues to support unregulated ventures, the Postal Service is price gouging its monopoly customers. The cross-subsidies need to stop or the Postal Service should be required to give up its monopoly protections.

Going forward, regulators should not wait for the next time consumers face an increase in monopoly postal prices. Instead, they should begin now and require the Postal Service to refund consumers for years of overpayments. It is also time for Congress to require the postal service payback taxpayers for the $15 billion in debt held by the U.S. Treasury.

For the sake of consumers, taxpayers and small businesses, the financial abuse by the postal monopoly needs to stop.

This Commentary was written by Steve Pociask, president and CEO of the American Consumer Institute Center for Citizen Research, and is available on FORBES online at http://www.forbes.com/sites/stevepociask/2015/10/30/postal-monopoly-abuse-consumers-deserve-a-refund/2/#383e277518ce. For more information about ACI, visit www.theamericanconsumer.org.