CPC Policy Brief
November 14, 2013

Is the Exigent Rate Case Overburdening Market Dominant Mailers?
by Don Soifer

The Postal Service has renewed its request to the independent Postal Regulatory Commission for an exigent rate case. By raising prices on market-dominant products by an average of 5.9 percent, including increasing the price of a first-class stamp from 46 cents to 49 cents, the Postal Service hopes to generate at least $2 billion in additional 2014 operating revenue. This is in contrast to the Postal Service’s recently announced rate increase for competitive products -- only 2.4 percent.

Does the proposal represent the best way to preserve mail delivery for most Americans? Or is it possible that a large portion of what they are being asked to pay would mostly benefit other business lines -- paying for infrastructure and costs for shipping competitive products?

Mail isn’t dead. The U.S. Postal Service may be out of money, having reached its legal borrowing limit of $15 billion, and after posting losses in 16 out of 18 fiscal quarters. Yet it still handled 160 billion pieces of mail last year, for which it received over $53 billion in revenue and sold 21.8 billion stamps. For now, mail still plays a substantial role in Americans’ lives.

The continued importance of the Postal Service for many Americans means there is also still significant political will to preserve the post office as an institution. Congressional efforts to solve the largest postal issues remain stuck in the mud and it appears unlikely that sufficient political consensus will emerge on these anytime soon.

Yet one thing is clear. Nobody matters more to the economics of the mail than consumers of the U.S. Postal Service’s government monopoly. These are the same consumers who would be required to pay for the current rate increase. Amid unprecedented financial losses at the Postal Service, taxpayers may also have a great deal at stake. A few years ago, Postal Service management projected cumulative losses between $115 billion and $238 billion by FY 2020, and current trajectories are in line with those estimates.

In 2006, Congress passed the Postal Accountability and Enhancement Act, which divided all postal products into two categories, market-dominant and competitive. Market-dominant products are primarily letter mail, flat mail, and periodicals, while competitive products primarily consist of packages and include Priority Mail.
The statute imposed a hard cap on price increases for market-dominant products, prohibiting the Postal Service from raising prices above the rates of inflation. Competitive products were granted considerably more pricing flexibility. Unlike other partially deregulated government monopolies, the 2006 law imposed no structural firewalls between the regulated and unregulated postal products to prevent cross subsidies. The only safeguards were accounting restrictions, for which regulators were charged with determining the details.

Unfortunately, it appears that Congress’ attempt to provide flexibility for the Postal Service to compete in the small parcel market may have resulted, at least in part, in the need for the exigent rate increase now before us. It came as little surprise to most close observers that postal management responded to these changes by applying its immediate focus to competitive products, like Priority Mail, package delivery, and express mail. When was the last time you saw a Postal Service commercial advertising anything else?

As the below chart indicates, the volume of the Postal Service’s competitive products are booming – up 59.2 percent between 2008-12. Revenue from competitive products is also up sharply – 35.5 percent over this same period.

But a third indicator defies these trends - costs incurred by the Postal Service that are attributed to competitive products, which increased by only 27.0 percent between 2008-12, despite volume increasing at twice that rate. Costs attributed to competitive products are defined by the Postal Service and its regulator as “volume variable”, so in theory they should track closely with volume. Different trends may be partially explained by changes in the mail mix and characteristics, but such a large variance is highly questionable.

**Fig. 1 – Competitive Product 5-Year Trends, 2008-2012**

In addition, institutional cost trends during the same period seem out of sync. Disturbingly, between 2008-12, institutional costs increased by 4.4 percent, even after
removing the retiree health care prepayments mandated by the 2006 law. This defies overall trends of cost-cutting where the Postal Service achieved overall spending reductions of 5.5 percent while its volume fell by more than 20 percent.

These trends, when combined, create major problems for consumers of market dominant products, as it evidences that the Postal Service may be pushing the cost of processing competitive products to market dominant mailers.

- First, the Postal Service regularly under-reports its costs attributed to competitive products in relation to volume.

- Second, the Postal Regulatory Commission only requires the Postal Service to apply a bare minimum of revenues it receives from competitive products to institutional costs.

An example of how the Postal Service may be over-burdening market dominant mailers is their allocation of capital asset costs, where, in a regulatory inquiry concerning its Competitive Products Fund (Docket No. PL2013-1, questions 4 a-b-c), the Postal Service reported that it was not allocating the costs of any capital expenditures toward its competitive products. The reason it provided was that no assets were used exclusively for competitive products.

From 2011-2013 alone, the Postal Service reported capital commitments of $3.0 billion. Through the Postal Service’s allocation methodologies outlined above, only 5.5 percent of the total, or $165 million, was allocated to competitive products. This means that every asset used to deliver or sort competitive products – i.e., trucks, warehouse space, freight handling equipment – was substantially paid for by market dominant products.

As most businesses choose to invest capital into their most promising growth areas, it is reasonable to assume that the Postal Service is investing substantially in assets that support its competitive products. This follows a comparable strategy to what one would conclude from its investments in television commercials. And new initiatives like the Intelligent Mail Package Barcode and PostalOne Assignment Support System (PASS) support the fact that the Postal Service is investing heavily in competitive products.

This allocation should greatly concern market dominant mailers, especially when the Postal Service just announced that it would offer Sunday package delivery as a new competitive product, with no apparent additional cost. It should also concern market dominant consumers and mailers that the Postal Service announced a 2014 rate increase of 2.4 percent for competitive products, far below the 5.9 percent rate increase asked of market dominant mailers.

Are market dominant mailers footing the tab for competitive product infrastructure and programs?
This disturbing trend is further enabled by a lack of transparency for costs allocated to competitive products. The Postal Service does not publish line item expense details for competitive products, at odds with Securities and Exchange Commission reporting guidelines as well as Treasury Department guidelines. Most information on the Postal Service’s new product tests and Competitive Pricing Agreements is redacted, thwarting any public review. In addition, the Postal Service does not even allocate 50 percent of its costs, classifying them as “institutional”, again, obscuring the nature of many costs.

Americans and their policymakers certainly ought to be concerned about the financial crisis surrounding the U.S. Postal Service, its multi-billion-dollar annual losses and its badly broken business model. Short-term solutions that fail to return the business model to sustainability will continue to place unfair burden on the captive consumers of the Postal Service’s government monopoly.

While policymakers attempt to address drivers of the Postal Service’s broken business model, consumers, mailers and the Postal Regulatory Commission may be well advised to examine the Postal Service’s cost allocation methodologies and trends to make sure that market dominant mailers are not, through the exigent rate case and beyond, being asked to foot the bill for competitive products.