

**COMMISSION AUTHORIZED**

**BEFORE THE  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C. 20551**

Interdistrict Transportation  
System Price Structure, 1991

Docket No. R-0705

**COMMENT OF  
THE STAFF OF THE BUREAU OF ECONOMICS OF THE  
FEDERAL TRADE COMMISSION<sup>1</sup>**

(submitted March 19, 1991)

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<sup>1</sup> These comments represent the views of the staff of the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner. Questions about these comments may be addressed to James D. Reitzes or John C. Hilke, Federal Trade Commission, Bureau of Economics, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580, telephone: (202) 326-3349 or 326-3483.

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**I. INTRODUCTION**

The staff of the Bureau of Economics of the Federal Trade Commission [FTC] appreciates the opportunity to submit this comment to the Board of Governors of the Federal Reserve System [FRS] concerning proposed changes in the price structure for transporting checks using the FRS's Interdistrict Transportation System [ITS]. As part of the FRS's check collection service, the ITS network transports checks between pairs of the FRS's forty-eight check-processing locations. The FRS proposes to amend the current ITS pricing structure by establishing a maximum charge for transporting checks that have been presorted by destination before delivery to a local FRS office. The FRS states that its "objective of modifying the price structure of ITS surcharges is to ensure that the price structure reflects the underlying cost function of interdistrict check transportation." Currently, the FRS charges a specific fee per check for shipping checks on the ITS network. Under the new proposal, per-check

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charges would apply until a maximum charge is attained per shipment. In effect, per check charges would be reduced for any shipment whose volume exceeds the ceiling. The proposed maximum charge would not apply to bundles of unsorted checks that are sorted by the FRS and transported using ITS. Unsorted checks are priced separately and are unaffected by the present proposal.

In what follows, we discuss ambiguities in the FRS's pricing proposal and go on to consider what effects certain interpretations of its proposal might have on private firms that provide check transportation services in competition with the FRS. However, before turning to these topics, the check clearing process and the FRS's role in it are briefly described.

## II. EXPERTISE OF THE STAFF OF THE FEDERAL TRADE COMMISSION

The FTC is an independent regulatory agency responsible for maintaining competition and safeguarding the interests of consumers. The staff of the FTC, upon request by federal, state, and local government bodies, often analyzes regulatory or legislative proposals that may affect competition or the efficiency of the economy. In the course of this work, as well as in antitrust and consumer protection research and litigation, the staff applies economic theory and empirical analysis to address policy issues that include the determination of the effects on consumers and competition arising from particular price structures, and the assessment of the market in which sellers compete.

The staff of the FTC has commented previously on various issues before the Board of Governors of the Federal Reserve System.<sup>2</sup> The staff also has commented before the Postal Rate Commission on issues involving rates for transportation services, competition between government and private industry, and the regulatory advantages of government suppliers.<sup>3</sup> In the area of transportation regulation, the staff has prepared several reports and provided numerous comments to state and national regulatory agencies.<sup>4</sup>

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<sup>2</sup> Comments have been submitted in: Docket R-0687, The Matter of Truth and Lending; Home Equity Disclosure and Substantive Rule (April 20, 1990); Letter from Acting Chairman Calvani, dated December 23, 1985, concerning application of margin requirements to takeover bids; Docket R-0545, Amendments of Regulation Z (July 19, 1985); Docket R-0541, Revision of Regulation B (June 21, 1985). For additional discussion of instances in which government enterprises compete with private firms, see Statement of Timothy J. Muris, Director, Bureau of Consumer Protection Concerning The Provision of Telecommunications and Information Services By the Federal Government in Competition with the Private Sector, submitted to the House Committee on Government Operations (February 25, 1982).

<sup>3</sup> These matters include: (1) discussion of competition issues inherent in proposed rate and classification changes related to electronic computer-originated mail, ECOM (PRC Docket No. R83-1, filed June 1, 1983); (2) drawbacks to a proposed modification of the test period for cost recovery in ECOM (PRC Docket No. R83-1, filed June 16, 1983); (3) advantages of setting ECOM rates to cover full costs (PRC Docket No. R84-1, filed December 23, 1983); (4) expedited procedures in reviewing proposed rate changes for Express Mail (PRC Docket No. RM88-2, filed October 14, 1988); (5) a complaint urging a study of the potential public benefits of exempting addressed third-class mail from the private express statutes (PRC Docket No. C89-1, filed February 28, 1989); and (6) recent developments in monopoly theory (PRC Docket RM89-4, filed September 1, 1989 and related testimony published in Monopoly Theory Inquiry, Washington, D.C.: PRC, November 1989, pp. 357 - 390).

<sup>4</sup> See, for example, Ogur, J., et al., The Deregulated Airline Industry: A Review of the Evidence, Washington, D.C.: FTC, 1988; "Pricing Practices of Motor Common Carriers of Property Since the Motor Carriers Act of 1980, Ex Parte No. MC-166," before the Interstate Commerce Commission (January 19, 1983); Breen, D., Regulatory Reform and the Trucking Industry: An Evaluation of the Motor Carriers Act of 1980, submitted to the Motor Carrier Ratemaking Study Commission (March 1982); "Economic Deregulation of Trucking," submitted to the Washington State Legislature, March 1985; FTC staff comments to Congress in the Railroad Antimonopoly Act of 1986, submitted May and June, 1986; (continued...)

### III. BACKGROUND

#### A. The Check Clearance Process

The FRS has operated the ITS check-transportation system as part of its check collection services for many years.<sup>5</sup> Check collection includes a series of steps whereby a financial institution that receives a check, known as a bank of first deposit [BFD], returns that check to the payor bank for payment of funds. As illustrated in Figure 1, the check collection process typically requires the services of check sorting, check transportation, and check presentment. In Figure 1, providers of these services within the check collection process are denoted by boxes; all providers of a given service are located in the same column. Note that once the customer uses an FRS service, such as sorting or transportation, that customer must use FRS services for the remaining steps in the clearance process.

Figure 1 indicates that the BFD must obtain sorting services prior to transportation. Sorting is required to determine the location of the payor bank, and, in some instances, to separate checks for large amounts. Sorting can be conducted directly by the BFD, or obtained for a fee from a correspondent bank or the FRS.<sup>6</sup> When a bank leaves an unsorted

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<sup>4</sup>(...continued)

Frankena, M., and Pautler P., An Economic Analysis of Taxicab Regulation, Washington, D.C.: FTC, 1984; "Possible Restrictive and Anticompetitive Practices in South Carolina's Public Service Commission Statutes," submitted to the Legislative Audit Council of South Carolina, 1987; and, Reitzes, J., Mathios, A., and Daniel, T., An Analysis of the Maritime Industry and the Effects of the 1984 Shipping Act, FTC Report to Congress, 1989.

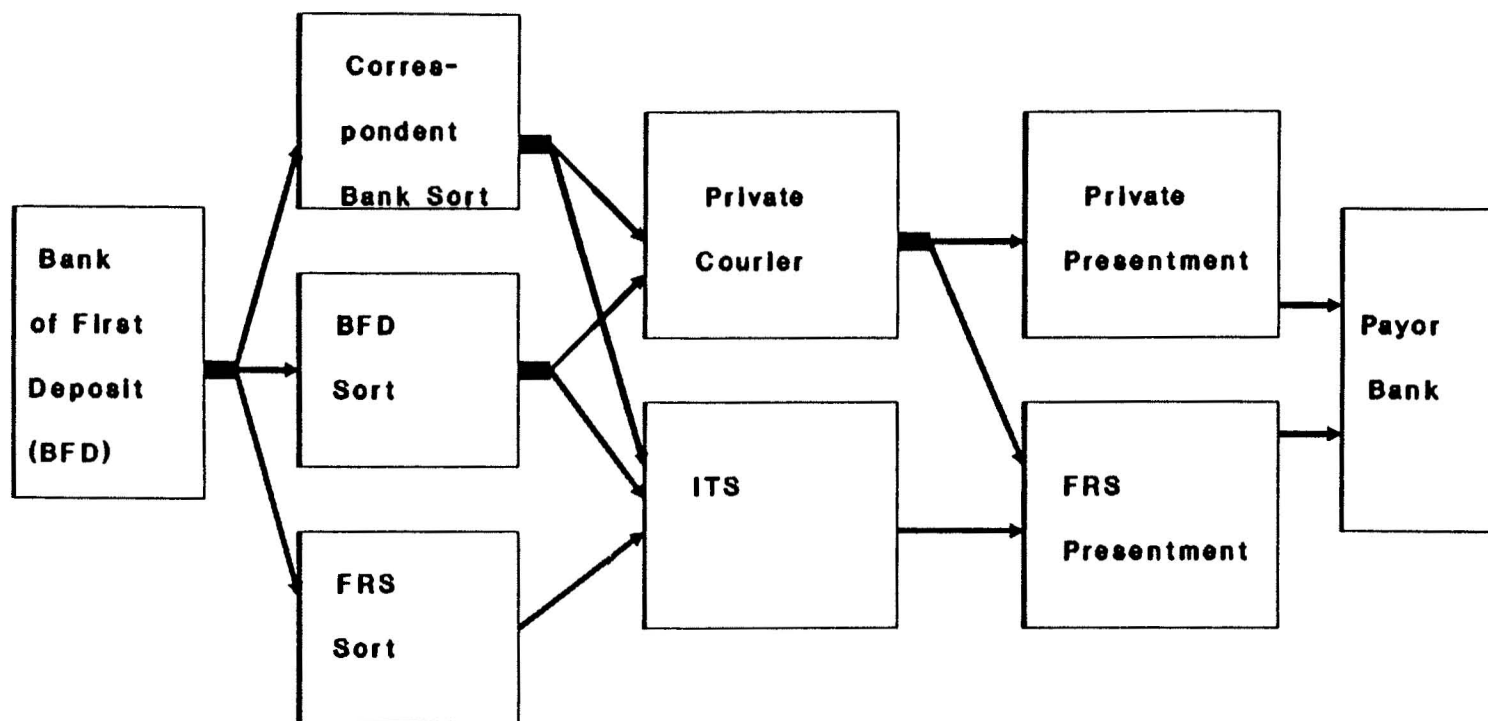
<sup>5</sup> This section relies heavily on the GAO Report No. GAO/GGD-89-61., Check Collection: Competitive Fairness Is an Elusive Goal, Washington, D.C.: May 1989.

<sup>6</sup> The FRS has 48 offices throughout the United States, each of which is a drop-off point for sorting services.

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**Fig. 1 CHECK CLEARING PROCESS: INTER-DISTRICT CHECKS**

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**Notes:**

**FRS - Federal Reserve System**

**Decision points occur at the branches at the ends of the thick lines.**

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bundle of checks at the FRS, that bundle is considered a "mixed sort." If the FRS sorts the check, it then requires that the check also be transported and presented by the FRS.<sup>7</sup> If, instead, a correspondent bank performs the sorting services, that bank typically arranges transportation and presentment services as well. The correspondent bank then charges the BFD for the performance of all these steps.<sup>8</sup>

If sorting services are furnished by a non-FRS supplier, that supplier has the option of using private transportation services or the ITS service to transport the check to the payor bank. Private transportation services are available from couriers that operate their own fleets of planes, or from freight forwarders that typically rent freight space aboard commercial airlines. A presorted bundle of checks, which is then given to the FRS for transportation [and presentment], is considered a "consolidated sort."

Once a check reaches its destination, it is then presented for payment. If presented by the FRS, immediate payment is required by law, and the FRS need not pay a presentment fee. If presented by a private bank, however, then that bank must typically pay a fee in order to receive immediate payment. Hence, the FRS enjoys an apparent regulatory advantage in the presentment of checks.<sup>9</sup> Unless there are

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<sup>7</sup> The existence of private providers of sorting, transportation, and presentment services implies that this requirement, by itself, is unlikely to be inefficient.

<sup>8</sup> BFDs that use the FRS or correspondent banks for sorting and subsequent check-processing steps may do so in part because they prefer "one-stop shopping."

<sup>9</sup> See the GAO Report, Check Collection: Competitive Fairness Is an Elusive Goal, *supra* note 5. The report states that, "The inability of [private] collecting banks to match Reserve bank collection terms, especially obtaining same-day payment without incurring bank fees, has constrained the collection options open to collecting banks; the collection services they may sell; and, in turn, the potential efficiencies they may (continued...)"

economies from vertical integration, however, this advantage should not necessarily affect competition in the transportation segment of the check clearance process. Correspondent banks can also obtain immediate payment upon presentment of checks without paying a fee if the private bank sorts and bundles the checks and delivers them to the appropriate FRS office for presentment.

Of the bundle of services that comprise check collection, the proposed fee change concerns only charges related to check transportation through the ITS system. Further, the proposed ceiling on transportation charges affects only checks that have been presorted by destination when they arrive at an FRS office. These consolidated sorts will be assessed a standard fee per check that varies based on the origin and destination until the ceiling on charges is reached.<sup>10</sup>

#### **B. FRS Presence in the Check Clearance Process**

Until 1980, the FRS provided check-collection services, including transportation, as a "free" service to member banks.<sup>11</sup> The Monetary Control Act of 1980, and subsequent FRS regulations, established that the FRS should price these services using pricing principles that consider

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<sup>9</sup>(...continued)  
bring to the market. GAO found no evidence that the check collection system would be damaged if the differences in basic check presentment abilities of collecting and Reserve banks were narrowed or eliminated. In fact, the system might be improved by such a change." See pp. 2 and 3.

<sup>10</sup> Mixed sorts are typically assessed a standard fee per check regardless of the destination of each check. The transportation component of this fee is not subject to any ceiling, based on the new FRS rate proposal.

<sup>11</sup> The costs of these services were effectively paid by interest the FRS earned on the reserves that member banks were required to deposit with the FRS. Member banks received no return on these reserves. Nonmember banks could utilize the FRS's check collection services by using a member bank as a correspondent bank.



costs that would be borne if the FRS operated as a private organization.<sup>12</sup> Other goals of the pricing policy are to foster private competition, improve the efficiency of the payments mechanism, and lower the costs of check-processing services to society at large. The FRS seeks these goals within the context of its overriding mission of maintaining public confidence in the integrity and safety of the nationwide payments system.<sup>13</sup>

After 1980, the FRS's check-collection system was opened to all banks on a fee-for-service basis. Partially as a result of its fee structure, FRS check-collection volume apparently declined six percent from 1980 to 1981.<sup>14</sup> Since then, however, FRS check-collection volume has grown: 14.6 billion checks in 1983, 16.0 billion checks in 1985, 17.0 billion checks in 1987, and 18.0 billion in 1989.<sup>15</sup>

The FRS's market share of check-collection services differs based on the size of the bank of first deposit. A study by the Association of Reserve City Bankers indicates that smaller banks are less likely to use

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<sup>12</sup> FRS Transmittal 45, Nov. 1984, p. 7.53 and 7.54.

<sup>13</sup> FRS Transmittal 111, May 1990, pp. 7.85 - 7.87.

<sup>14</sup> See GAO Report No. GAO/GGD-89-61, Check Collection: Competitive Fairness Is an Elusive Goal, supra note 5, p. 71.

<sup>15</sup> The FRS estimates that 55 billion checks will be written in 1990. Of these, 25 percent are "on us" checks, i.e., those for which the BFD and the payor are the same bank. Another 11 percent of the checks are presented through local clearinghouse arrangements. The remaining 64 percent include checks presented directly between banks [either locally without the aid of clearinghouses or interdistrict], checks collected through correspondent banks, checks collected through Federal Home Loan Banks, and checks collected through the FRS. (See, Board of Governors of the Federal Reserve, Annual Report, Washington, D.C.: 1983-89.) Unlike correspondent banks and the FRS, Federal Home Loan Banks can only offer check-collection services to thrift institutions. For diagrammatic simplicity, this source of check-collection services was omitted from Figure 1.

the FRS directly for check-collection services.<sup>16</sup> Overall, however, the FRS's share of check-collection services has increased over the past several years according to survey data from the American Bankers Association and the Association of Reserve City Bankers.<sup>17</sup>

Historically, the FRS's revenue from check collection has exceeded its reported costs. Between 1983 and 1989, FRS revenue from commercial check collection rose from \$383 million in 1983 to \$549 million in 1989. During this same period, the FRS reported that its real and imputed costs<sup>18</sup> associated with FRS check collection rose from \$358 million to \$538 million.<sup>19</sup>

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<sup>16</sup> The following table presents the proportion of checks collected (exclusively) through the FRS and through correspondent banks (CBs) in 1987 for various size categories of BFDs. Percentages in each row do not sum to one hundred because some checks were collected in other ways (e.g., clearinghouses and holding company affiliates). In addition, checks that reach correspondent banks may subsequently be given to the FRS for some check-collection services.

<u>BFD Assets (\$ millions)</u>	<u>Percent of checks collected by FRS</u>	<u>Percent of checks collected by CBs</u>
25-100	36%	51%
100-500	41	44
500-750	44	32
over 750	43	20

Source: GAO Report No. GAO/GGD-89-61, Check Collection: Competitive Fairness Is an Elusive Goal, Appendix II.

<sup>17</sup> This survey indicates that from 1983-87, the market share of correspondent banks dropped 10-16 points for depository institutions in the \$25-\$100 million asset range, 13-23 points in the \$100-\$500 million asset range, 12-18 points in the \$500-\$750 million asset range, and 2-7 points in the over \$750 million asset range. These data also indicate that the FRS has gained market share in the smaller asset ranges [below \$750 million]. See GAO Report No. GAO/GGD-89-61, Check Collection: Competitive Fairness Is an Elusive Goal, Appendix II.

<sup>18</sup> This category includes float costs and charges that would accrue to a private firm involved in check collection [such as sales taxes and any finance charges that would normally be associated with the private acquisition of assets used in check collection].

<sup>19</sup> See "Pro Forma Income Statement for Federal Reserve Priced Services, by Service," contained in the Board of Governors of the Federal Reserve System, Annual Report, Washington, D.C., 1983-89.

#### IV. THE PRICING PROPOSAL

The FRS proposes a pricing schedule that would establish a maximum charge for shipping bundles of presorted checks between two FRS banks. Once the maximum charge is reached, larger bundles would not lead to higher total charges. A major effect of the FRS proposal would be to lower shipping costs to large shippers. There is nothing necessarily wrong with such a result. Shippers of large bundles of presorted checks may impose less cost per check on the ITS system than shippers of small bundles of presorted checks. Costs per check may be lower for a great many reasons which we do not here attempt to articulate. If the cost per check of transporting checks declines as a shipper's volume increases, it would be efficient to establish a pricing schedule that reflects such declining costs. We are concerned, however, that the reasons given by the FRS in support of its proposal do not demonstrate that large shippers impose lower costs per check than small shippers. The FRS notes:

ITS network costs are essentially fixed. Of total 1990 network costs, more than 90 percent do not vary with volume. Once the Federal Reserve enters into multi-year contracts with the couriers to provide aircraft, pilots, ground operations, and other components of the network, those costs are fixed....Thus, the Federal Reserve uses an entirely variable price structure to recover largely fixed costs....A price structure with some fixed element would enable depository institutions, and particularly shippers of large volumes, to enjoy the benefits of the largely fixed cost ITS network.<sup>20</sup>

The foregoing description of ITS network costs paints a picture in which total costs and total capacity are relatively fixed over the life of the FRS's multi-year contracts. While such a situation may mean that the

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<sup>20</sup> Federal Reserve System, Docket No. R-0705, pp. 3-4.

FRS's total short-run costs are more or less the same regardless of the total volume of checks shipped by all shippers, it does not necessarily mean that large shippers should be charged a lower average price per check than small shippers. If the cost per check of transporting checks declines as a shipper's volume increases, a fee schedule that rises less than proportionately with shipper volume would be desirable. But the FRS does not express why or how the shippers of large volumes impose less cost per check than do shippers of small volumes.<sup>21</sup>

A second potential difficulty with the FRS proposal is that it assumes not only that large shippers impose lower costs per check than small shippers, but also that costs per shipper do not increase at all with any volume larger than that eligible for the ceiling or maximum charge. Although this could be true, the FRS proposal does not indicate why or how this might be so. As the FRS notes, total costs may not vary substantially with total volume while contracts are in place in the short run.<sup>22</sup> However, over a longer time horizon, the zero charge for shipment volumes larger than the ceiling volume could induce a larger proportion of shipments of such sizes. When contracts are renegotiated, it seems to us unlikely that an increase in shipments of this size would impose no cost on the FRS. If they do impose additional cost, then charging zero for such shipment sizes as suggested by the FRS proposal

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<sup>21</sup> We assume that transportation costs and prices can be considered independently of the other steps in the check clearance process (sorting and presentment). This assumption appears consistent with the FRS's approach to this issue. It is possible that cost and demand interrelationships exist between transportation and these other services. Accounting for these interrelationships would complicate the development of a cost-based price structure. See Baumol, W., Panzar, J., and R. Willig, Contestable Markets and the Theory of Industry Structure, New York: Harcourt Brace Jovanovich, 1982.

<sup>22</sup> The FRS believes that as much as 10 percent of its costs vary with volume even when contracts are fixed and in place.

would not reflect costs accurately. If costs are imposed by an increase in larger shipment volumes, then the FRS might account for this by an increase in the ceiling charge during the next contract period. We note however that this implies that shipment volumes above the current ceiling would impose costs on the FRS rather than zero cost as the pricing proposal suggests. It may well be that larger shipment volumes do not impose as much cost as do smaller shipment volumes. But again, the reasons why this might be so are not discussed in the FRS proposal.

It is true that the FRS might be able to align its price structure more closely with costs by using flexible fee ceilings. In fact the FRS has suggested that it might ultimately adopt ceilings that vary as origins and destinations vary.<sup>23</sup> Nonetheless, geographically flexible fee ceilings may not accurately reflect variations in costs due solely to shipment volume. We note that if large shipment volumes are priced below cost, efficient private competitors could be disadvantaged. This is discussed in greater detail in the following section.

It is possible that a price structure with a maximum charge is easier to administer than alternative pricing structures that more accurately reflect ITS costs in relation to shipment volume. If the FRS believes that such administrative simplicity will save costs, then the FRS may then wish to consider more explicitly whether any reduction in administrative costs due to a price ceiling offsets the benefits from a closer relationship of prices to costs.

The FRS supports its fee ceiling proposal, in part, by noting that private couriers purportedly charge their customers a fixed fee that is independent of volume. The FRS notes that a price structure with some fixed element, "would also bring the Federal Reserve closer to prevailing

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<sup>23</sup> See Docket No. R-0705, p. 6.

market practice...."<sup>24</sup> If private couriers actually do set a maximum charge, then the FRS proposal may well be appropriate. Some of the comments submitted to the FRS suggest otherwise, however. Private couriers may assess a flat charge plus a fee that increases at various volume increments.<sup>25</sup> Under the FRS proposal, a flat fee is charged only to shippers of bundles equal to or larger than the size eligible for the ceiling charge. All other shippers are charged a fee that varies directly in proportion to bundle size. This seems quite different from the fee structure used by private couriers.

By establishing a price schedule that reflects its costs, the FRS would encourage competition by promoting the entry or survival of efficient providers of check-transportation services.<sup>26</sup> The FRS would

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<sup>24</sup> See, Federal Reserve Docket No. R-0705, pp. 4-5. Discussions with FRS staff indicate that their information concerning industry pricing practices was not based on a detailed investigation of the market. These discussions suggested that more information was being gathered.

<sup>25</sup> For example, comments of First Wisconsin National Bank of Milwaukee, submitted October 8, 1990 [p. 3], state, "We currently have contracts that charge per pound, and we have a base rate with additional charge[s] when the weight exceeds a determined amount." Similarly, First Fidelity Bancorporation, comments as follows [submitted October 26, 1990, p. 2]: "... we are not aware of any private courier company that prices for check shipments in the manner proposed by the Federal Reserve. The majority of prices quoted to FFB by private couriers asks for a minimum price per endpoint which varies upward as certain weight limits are reached."

Our conversations with industry sources and review of industry comments also indicate that ITS pricing behavior differs from that used by private providers. Private couriers tend to negotiate rates with customers, whereas the FRS does not.

<sup>26</sup> The policy guidelines of the FRS require that as part of its cost adjustments, the FRS include an allowance for sales and income taxes. After these adjustments, the FRS then compares its "net" return on capital with the "normal" return on capital earned by a private firm engaged in similar activities.

Although these "private sector" adjustments are not normally part of the accounting costs of government enterprises, we believe that they allow the FRS to assess more accurately the efficiency of its provision of check-collection services. Without the tax adjustments, the FRS might overinvest in the provision of check-clearing services.

also encourage efficient provision of related services such as check sorting and check presentment.

If the FRS sets a price schedule that recovers its costs, but charges certain banks (larger shippers) less than the costs they directly impose, then smaller shippers will pay more than the cost of providing their check-transportation services if the ITS is their only shipping option. It would seem that this effect should be avoided. Competition from private couriers may prevent FRS prices from significantly exceeding the cost of providing check-transportation services to smaller shippers. If so, the FRS could not charge some banks (large shippers) less than the costs they directly impose without also subsidizing ITS operations. The FRS may also wish to avoid this possibility.

#### **V. COMPETITION WITHIN THE RELEVANT MARKET**

The proposed change in the ITS fee structure will likely influence the demand faced by private couriers and the quantity of checks they ship. In most markets, staff would not suggest that firms should be constrained from lowering price because their competitors would be injured. Similarly, staff would suggest that the effects on private couriers be given little consideration if ITS prices reasonably follow the costs that its services impose. So long as prices reflect costs, more-efficient [or equally-efficient] private providers of transportation services will compete successfully with ITS. Furthermore, pricing by the FRS that reflects its costs will be more likely to induce the FRS to adjust the quantity of its services to an efficient level. However, if the FRS chooses a pricing structure that does not recover ITS costs, and maintains the structure by subsidizing the ITS network with funds

derived from other sources (such as other sources of FRS income), then potentially more-efficient providers of check transportation services might exit the market or curtail their service.

In its initial review of the competitive impact of the proposed fee change, the FRS concluded that it should improve the competitive position of correspondent banks [that provide check-collection services] because the ITS transport price to large shippers may be lower. The FRS acknowledges that the ITS rate change may shift demand to ITS from private air networks, but concludes:

The modified ITS price structure may induce a shift in volume from direct-sent arrangements through private air couriers to consolidated shipments on ITS. The Federal Reserve does not compete directly with private sector air couriers. The ITS network transports only checks that are accounted for on the books of the Reserve Banks and other Federal Reserve materials between Federal Reserve Bank offices. Thus, ITS is an integral part of the Federal Reserve's check collection service. Private air couriers provide a broad range of services, including delivery of checks to correspondent banks and transportation of many other types of cargo.

Even if the Federal Reserve were perceived to be in competition with private air couriers, the proposed ITS price structure would not have a direct and material adverse effect on the ability of air couriers to compete effectively. The proposed price structure is consistent with the current pricing practices of most air carriers.<sup>27</sup>

Our examination of the FRS's request for comments, comments and interviews with private couriers and banks,<sup>28</sup> GAO reports,<sup>29</sup> and

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<sup>27</sup> Docket No. R-0705, pp. 8-9.

<sup>28</sup> Thirty-six comments were received in response to the initial request for comments due on October 19, 1990. This initial deadline was subsequently extended for ninety days.

<sup>29</sup> See GAO Report No. GAO/GGD-90-17 The Federal Reserve: Information on the System's Check Collection Service, Dec. 1989, and GAO Report No. GAO/GGD-89-61 Check Collection: Competitive Fairness Is an Elusive Goal, May 1989.



publicly available market information<sup>30</sup> suggest that private air courier services do compete with ITS. The FRS seems to conclude that because the FRS integrates sorting, transportation, and presentment activities into a single service offering, private couriers do not compete with the FRS. The FRS may wish to reexamine this interpretation. A vertically integrated supplier [such as the FRS] does compete with firms that supply one stage of the vertical process whenever single-stage suppliers can be linked with suppliers at other stages to provide a close substitute for the integrated service. Our current understanding is that customers, in fact, have such alternatives.

Of particular relevance is that the FRS offers ITS transportation services to banks that do not purchase sorting services from the FRS. Correspondent banks are welcome to presort and then deliver checks to either the ITS or a private courier for transportation prior to presentment. Faced with these alternative sources of transportation, some correspondent banks may be expected to switch toward ITS services when the price of ITS services declines and away from ITS services when the price of ITS services increases.<sup>31</sup>

Further, the fact that non-ITS private couriers provide transportation services to many other industries need not mean, as the FRS appears to conclude, that these couriers would therefore experience little, if any, impact if forced to cease or curtail the provision of check-transportation services. The ability to shift resources to serve the transportation requirements of other industries reduces the risk of

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<sup>30</sup> Public references that provide information on air courier services include Moody's Transportation Manual, U.S. Industrial Outlook, and filings by air couriers to the Securities and Exchange Commission.

<sup>31</sup> The FRS also expressed this expectation in the passage previously cited in this section.

providing transportation services to any given industry. Nevertheless, it may be, although we do not know this as a fact, that non-ITS private couriers bear significant expenses, some perhaps specified in long-run contracts, particular to the provision of check-transportation services. If so, then a reduction or cessation of these services may imply that insufficient revenues are generated to offset these costs. Hence, losses may be experienced.

While the impact on firms from a rival's pricing policy would generally reflect the procompetitive workings of market forces -- and thus not warrant regulatory scrutiny -- the FRS's proposed pricing change, were it not to reflect costs reasonably, may adversely affect efficiency. This would be so if the FRS's pricing proposal caused private competitors to curtail their service or leave the market when they would not curtail their service or leave if the FRS's proposal reasonably reflected its costs.

## VI. CONCLUSION

The pricing schedule proposed by the FRS would establish a maximum charge for shipping bundles of presorted checks. The effect of the maximum charge would be not only to reduce per-check prices to shippers of large bundles, but also to establish a ceiling above which total charges would not vary with volume. We would encourage the FRS to explore the relationship between bundle size and cost. Although it may be that large bundles impose lower costs per check on the FRS, we do not believe that the FRS has demonstrated that this is so. Moreover, our analysis suggests that a rate ceiling may not appropriately consider the relationship between cost and volume.