

COMMISSION AUTHORIZED**BEFORE THE
UNITED STATES OF AMERICA POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268-001**

Complaint of the TCMA, 1989

Docket No. C89-1

**BRIEF, IN THE FORM OF COMMENTS, OF
THE STAFF OF THE BUREAU OF ECONOMICS OF THE
FEDERAL TRADE COMMISSION¹
(submitted February 28, 1989)****I. INTRODUCTION**

The staff of the Bureau of Economics of the Federal Trade Commission (FTC) appreciate the opportunity to submit these comments to the Postal Rate Commission (PRC) in support of a complaint by the Third Class Mail Association (TCMA), Docket No. C89-1, requesting a study of an exemption from the private express statutes which are administered by the United States Postal Service (USPS). We also offer an alternative proposal, which involves granting a rate discount for privately delivered addressed third class mail,² should the PRC reject the TCMA's complaint. We take no position on the PRC's jurisdiction in this matter.

The TCMA's complaint requests that the PRC investigate and report on whether the public interest would be served by exempting addressed third

¹ 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 John C. Hilke, Federal Trade Commission, Bureau of Economics, 6th Street and Pennsylvania Avenue, N.W., Washington, D.C. 20580, telephone: (202) 326-3483.

² Private firms are currently allowed to deliver unaddressed third class items, usually by placing an item at every household in an area. Delivery of addressed third class mail is currently part of the monopoly of the USPS.

class mail from the private express statutes. The TCMA filed the complaint after the USPS declined to initiate a rulemaking proceeding on the subject. We support consideration of the issues raised in the TCMA's complaint because we believe that substantial benefits to consumers from improved mail service, lower postal costs, and perhaps lower prices on advertised goods generally could result from implementation of the proposed exemption.

II. FEDERAL TRADE COMMISSION STAFF EXPERTISE

The FTC is an independent regulatory agency responsible for fostering competition and safeguarding the interests of consumers.³ The staff of the FTC, upon request by federal, state, and local government bodies, regularly analyze regulatory or legislative proposals that may affect competition or the efficiency of the economy.

The FTC staff have commented on several previous issues before the PRC, including: (1) use of a single set of rate hearings to establish a series of rate changes;⁴ (2) elaboration of competition issues inherent in proposed rate and classification changes related to electronic computer originated mail (E-COM);⁵ (3) drawbacks to proposed modification of the test period for cost recovery in E-COM;⁶ (4) advantages of setting E-COM rates to cover full

³ 15 U.S.C. Section 41 et seq.

⁴ PRC Docket No. MR82-3, filed November 4, 1982.

⁵ PRC Docket No. R83-1, filed June 1, 1983.

⁶ PRC Docket No. R83-1, filed June 16, 1983.

costs;⁷ (5) costs and benefits of current preferred mail rates;⁸ and, most recently, (6) expedited procedures in reviewing proposed rate changes for Express Mail.⁹

III. THE COMPLAINT

The basic economic question presented by the complaint of the TCMA is whether cost considerations require including addressed third class mail in the postal letter monopoly. The TCMA believes that cost conditions do not require inclusion of addressed third class mail, but it also acknowledges that current empirical information is insufficient to determine this for certain.

An exemption might be economically justified either if costs for first class and other letter mail would be largely unaffected by it or if efficiency improvements resulting from increased private delivery services would exceed any increase in costs for first class and other letter mail. Information on both cost and quality of service effects of the proposed exemption appears to be sparse. Nevertheless, the USPS declined to conduct an inquiry to determine whether granting the requested exemption would have an

⁷ PRC Docket No. R84-1, filed December 23, 1983.

⁸ PRC Docket No. SS86-1, filed April 20, 1986. Preferred mail receives a rate discount because the contents of such mail are considered beneficial to the public. Preferred mail discounts are granted, for example, for educational materials and for mailings of nonprofit organizations. Congress reimburses the USPS to make available these discounts for preferred mail. Other types of postal discounts are justified on the basis of lower costs.

⁹ PRC Docket No. RM88-2, filed October 14, 1988.

appreciable effect on costs for first class and other letter mail. The petitioner now asks the PRC to initiate such an inquiry.

An exemption for addressed third class mail could increase the costs of delivering first class and other letter mail if mail delivery exhibits economies of scope.¹⁰ If the costs of delivering nonexempt mail would increase, an exemption for addressed third class mail might be ill-advised. If exempting third class mail would not have this effect, however, an exemption might be in the public interest.¹¹

¹⁰ The proposed exemption might increase the costs for first class mail and other letter mail if the USPS has achieved economies of scope in processing different classes of mail and achieved economies of scale in processing individual classes of mail. An "economy of scope" exists when the cost of providing a good or service is lower if it is produced in conjunction with another good or service than if it is produced alone. By comparison, an "economy of scale" exists when the per item cost of providing a single good or service decreases as the quantity of production increases. Economies of scope and scale may exist simultaneously.

¹¹ If there are sufficient economies of scope between addressed third class mail and first class and other letter mail, the USPS monopoly in both types of mail may be self-sustaining. If it is self-sustaining, no legal restrictions on entry, such as the private express statutes, should be necessary. A natural monopoly (where average costs decline over the whole range of output) providing two or more products is said to be self-sustaining if no entry could profitably take place against the monopoly at the current prices. Self-sustainability of a natural multi-product monopoly is unlikely when there are no entry barriers, economies of scope between the products are small, economies of scale in the production of each product are large, and the products of the monopolist are good substitutes for each other. (See Baumol, W., J. Panzar, and R. Willig, "On the Theory of Perfectly-Contestable Markets," in Stiglitz, J., and G. Mathewson, Eds., New Developments in the Analysis of Market Structure, Cambridge, Mass.: MIT Press, 1986, pp. 339-370.) Opponents of the proposed exemption may be concerned that these four conditions apply to the USPS. The TCMA's proposed study by the PRC could evaluate whether the cost conditions facing the USPS are consistent with a natural monopoly model and with attendant concerns about the sustainability of such a natural monopoly.

An exemption from the private express statutes could also be in the public interest, even if an exemption increased some of the costs for first class and other letter mail, provided that (a) private delivery services would be more efficient,¹² and (b) the gains from such private delivery would be sufficient to outweigh any increased costs of first class and other letter mail. Net cost reductions or improved service could ultimately benefit consumers by lowering advertising costs (and potentially lowering prices),¹³ and encouraging distribution of better or more timely information about products that consumers might wish to buy.

In summary, there is a potentially strong public interest rationale for exempting addressed third class mail from the private express statutes. The USPS declined to develop an analysis of the cost structure of third class mail that could lead to an informed decision on the desirability of an exemption for addressed third class mail. If the PRC determines that its jurisdiction covers the concerns raised in the TCMA's complaint, we urge the

¹² One of these efficiency effects could be a more efficient USPS resulting from increased competition between the USPS and private addressed third class mail delivery firms.

¹³ Addressed third class mail consists largely of advertising. If exempting addressed third class mail would reduce the (marginal) advertising costs of goods (and services) that advertise by this means, and if these goods are sold in competitive markets, then exempting addressed third class mail service could lead to lower prices for such goods. In addition, if advertising through addressed third class mail competes with other forms of advertising, exempting addressed third class mail might increase competition in advertising services, thereby generally reducing advertising costs of goods. If costs of all advertised goods would be reduced by the exemption, and if these goods are sold in competitive markets, then an exemption for addressed third class mail could generally lead to lower prices for advertised goods.

PRC to consider providing a forum in which these potential gains for consumers might be assessed.

IV. AN ALTERNATIVE APPROACH

Although we believe that the TCMA's proposed exemption is worthy of a PRC study, we realize that an exemption for addressed third class mail has the potential to increase costs for first class and other letter mail.¹⁴ Accordingly, we believe that the PRC might wish to consider an alternative proposal that would continue to recognize the USPS's monopoly, compensate the USPS for cost increases in mail that the USPS continues to deliver, and allow more efficient private-delivery firms to deliver addressed third class mail.

We suggest that the USPS expand its current array of rate discounts to allow a rate discount for user-delivery of addressed third class mail. Currently, private delivery services might conceivably distribute addressed third class mail, provided that each piece has full-price-postage attached to it. This full-price rate appears to be high in comparison to discounted rates charged in other instances where private firms perform mailing tasks in lieu of the USPS. Thus, for example, postal patrons who pre-sort items (before submitting them to the USPS for delivery) are often eligible for a discount; however, those who might choose to perform all of the delivery tasks for the same type of items would have to pay the same or higher

¹⁴ Low costs from private delivery of addressed third class mail might, however, offset any cost increases within the USPS.

rates.¹⁵ We propose that a discount equal to the net costs which the USPS saves (as a result of someone else delivering the item) be granted.¹⁶ The price of the discounted stamp for such an item of mail could then be set to compensate the USPS for any increase in the cost of first class and other letter mail.¹⁷

The proposed alternative could promote efficient and high quality mail service, since private delivery firms would only deliver addressed third class mail if their costs, for any given quality of service, were lower than those

¹⁵ In providing a pre-sort discount, the USPS has relied on the principle that users deserve discounts when they perform part of the service that the USPS would otherwise have to perform. In effect, the USPS charges the user a lower price because the USPS is providing fewer services to the user and is thereby incurring lower costs. In the alternative proposal presented here, users perform all of the services otherwise performed by the USPS, but recognize the USPS monopoly by paying a fee to the USPS designed to recover cost increases brought about by any loss of addressed third class mail volume.

The principle of charging lower prices to reflect lower costs might be applicable to a variety of mail services, but our comments are directed solely to treatment of addressed third class mail.

¹⁶ If the USPS's savings from granting the exemption are equal to the current full-cost stamp, then the price of the discounted stamp should be zero. If a price of zero is economically appropriate, then the discount stamp approach would be functionally equivalent to the TCMA's proposal.

¹⁷ For example, assume that many third class mailers decide to deliver their own addressed third class mail privately. Further assume that this withdrawal of addressed third class mail results in direct delivery cost savings for the USPS of \$3 billion, but increases costs of first class and other letter mail delivery, because of lost economies of scale and/or scope, by \$500 million. In this situation, the USPS's delivery discounts would total \$2.5 billion. That is, the discount would equal the net cost savings for the entire USPS system.

If increased costs equaled or exceeded savings, then no discount would be indicated and a charge of at least the current postal rate would be economically appropriate.

The appropriate amount of the discount for user-delivery could be reexamined from time to time (for example, as part of the PRC's omnibus rate hearings) to adjust for cost changes and changes in demand.

of the USPS. In determining whether this proposal promotes the public interest, the PRC might consider and balance potential cost savings from private delivery of addressed third class mail against any resulting increase in the USPS's costs for first class and other letter mail.¹⁸

V. CONCLUSION

The economic appropriateness of the TCMA's proposed exemption depends on whether a decrease in addressed third class mail volume would substantially increase the USPS's costs of delivering first class and other forms of letter mail. If such a linkage of costs does not exist, then the proposed exemption may provide considerable benefits from improved service and increased efficiency with little cost to society. Current information is insufficient to answer this important question and to balance any cost increases against potential cost savings. Consequently, a study by the PRC, assuming such a study is within the PRC's jurisdiction, is likely to produce a better informed basis for considering an exemption for addressed third class mail.

As an alternative to an exemption for addressed third class mail, the PRC could consider authorizing a discount for firms that perform the delivery function themselves. This approach may be economically attractive because the postage due on privately delivered addressed third class mail

¹⁸ The public interest will be served best if care is taken to determine accurately the appropriate magnitude of the "delivery discount." Like other cost savings calculations considered by the PRC, this may prove to be a difficult determination to make and one that requires considerable time to refine.

could be set to compensate the postal service for any increase in its costs of delivering first class and other letter mail caused by the exemption. Under this arrangement, therefore, only private firms efficient enough to make a profit, as well as to compensate the USPS, could afford to operate. Thus, efficiency of delivery of addressed third class mail could be improved while at the same time the USPS could be compensated for any increase in its costs. We respectfully urge the PRC to consider this alternative if it does not accept the TCMA's complaint.

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STAFF OF THE BUREAU OF ECONOMICS OF
THE FEDERAL TRADE COMMISSION

Pursuant to Rule 20 of the Postal Rate Commission's Rules of Practice, the Staff of the Bureau of Economics of the Federal Trade Commission hereby provides notice of its intervention in this proceeding by presenting comments. The staff of the Bureau of Economics, as part of the Federal Trade Commission, submit comments on matters before government bodies in pursuit of the Commission's mission to improve consumer welfare through increased competition.

Service upon the staff of the Bureau of Economics of the Federal Trade Commission should be made by mailing copies to the following:

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Respectfully submitted,



Paul A. Pautler, Deputy Director for
Economic Policy Analysis

Dated: February 28, 1989

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document by mail to the individuals on the service list maintained at the document room of the Postal Rate Commission.



John C. Hilke, Staff Economist

Dated: February 28, 1989