Practices of the U.S. Postal Service That Imply Anti-Competitive Behavior:

Historical Parallels and Remedies Across Other Regulated Sectors

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This document was submitted to the Postal Regulatory Commission under Docket No. PI2016-3, in response to its request for public comment concerning the operation of the amendments made by the Postal Accountability and Enhancement Act of 2006, and for recommendations to improve the effectiveness or efficacy of the postal laws of the United States.

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Summary

As have previous government monopolies, the U.S. Postal Service has been engaging in a pattern of business practices that appear anti-competitive, leveraging postal law to enable it to gain impermissible advantages over the private sector at the expense of consumers. It is not unusual for government monopolies to utilize their monopoly advantages to compete in services already offered by the private sector. The regulator of the monopoly is normally charged by statute with preventing such abuses.

Consumers of the Postal Service's monopoly products and services have recently been required to pay increased costs, in terms of higher prices and clearly reduced quality of service. Other indicators, including cost coverage and service quality measures, also point to increased costs charged to monopoly consumers compared with consumers of competitive products.

Present accounting practices, including poor public transparency, exacerbate this situation. The Service's Inspector General issued a 2013 management advisory urging the Postal Service to in effect start over and adopt a bottom-up costing methodology, a "Greenfield" approach which would generate more disaggregated and granular data to address cross-subsidy issues.

This paper examines how the cost burden assigned to regulated products is disproportionate to that imposed on competitive products, effectively giving the latter a financial boost, if not a free ride. Postal management has seemed intent

upon focusing the agency's priorities on competitive products, acknowledging this on numerous occasions, in seeming contradiction with federal postal statute calling unequivocally for the Postal Service to give highest consideration to the delivery of "important letter mail," not competitive products.[1]

Examples of terms of other U.S. monopolies have included legal and regulatory remedies based on structural separations, as well as accounting separations. Among those discussed in this paper include monopolies in the telecommunications, electric utilities and government research sectors.

Not just consumer welfare is at stake. The precarious financial condition of the Postal Service makes it all the more essential that its efforts to compete with the private sector can stand alone in the future without increasing risks of requiring multi-billion dollar bailouts from Congress. Regulatory experience from other monopolies suggests more than one way to ensure that result.

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1 39 U.S.C. §101(e).

Introduction

"Look, mom, I'll write you all about it tomorrow – this long distance call will cost me a week's salary." With that, Spencer Tracy's sensible sportswriter cut short a hurried phone call informing his mother of his engagement to Katherine Hepburn's celebrity columnist in the 1942 classic film, "Woman of the Year."

Tracy's character took some liberties to exaggerate, like most good sportswriters. In 1940, a three-minute, station-to-station long-distance call from New York City to San Francisco cost $6.75, or a whopping $113 in current dollars.[2] Today, 33 years after the AT&T breakup, the same call can be made at virtually no cost using cellular or VoIP technology.

But in 1974, as the federal Justice Department prepared to sue AT&T in an effort to break up the Bell System, this future outcome was far from apparent. "I can't understand why Justice would take an action that could lead to dismemberment of the Bell System, with the inevitable results that costs would go up and service would suffer," AT&T Chairman John DeButts told reporters in New York.[3]

It is of little surprise that the executive responsible for leading an incumbent monopoly operator would argue in support of his monopoly, and even offer foreboding warnings of what changes might portend for customers. In its complaint and in supporting documents, the government alleged that AT&T had used monopoly control to preclude competition and deter potential competitors, to the detriment of consumers.

Irrespective of the intentions of the monopoly operator, captive consumers find themselves imperiled by the presence of financial incentives for it to pursue unfair competitive advantage at their expense. Evidence implying anti-competitive behavior can take various forms, some quite complicated, wherever these consumers' rates are not tethered to the attributed costs of the specific monopoly services they seek to purchase, and especially when the monopoly operator is also engaged in competitive markets without appropriate separations between the two types of activities.

In such cases, the presence of financial incentives for designated monopoly operators to act in anti-competitive fashion, along with opportunities to do so, are sufficient to raise suspicions of anti-competitive behavior. Incumbent entities facing such incentives need not demonstrate predatory intent. Incumbent operators of a monopoly instinctually apply downward pressure to their costs associated with servicing monopoly consumers, and upward pressure on the rates which they are charged.

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2 *East Hampton Star*, May 2, 1940. http://fultonhistory.com/Newspapers%2023/East%20Hampton%20NY%20Star/East%20Hampton%20NY%20Star%201939%20Mar-jan%201942/East%20Hampton%20NY%20Star%201939%20Mar-jan%201942%20-%200477.pdf Currency converted using Bureau of Labor Statistics currency converter.

3 Steve Coll, *The Deal of the Century: The Breakup of AT&T*, Simon & Schuster, 1986, p. 71.

Nobel laureate economist Jean Tirole discussed "asymmetric schemes – where some parts of the incumbent's business are tightly regulated and others less so (or not at all) – that give rise to perverse incentive" that might lead to less productive inputs concentrated to the regulated segment.[4]

In his authoritative book The Economics of Regulation, Alfred E. Kahn, former chairman of the Civil Aeronautics Board and the New York Public Service Commission, observed that where regulated processes continue to be set, directly or indirectly, "on the basis of total company costs and revenues, or on the basis of some continuing process of allocation of costs between regulated and unregulated operations, there will always be the danger, in principle, of subsidization of the latter by the former."[5]

Finally, the U.S. Supreme Court noted in its 1967 Federal Power Commission v. United Gas Pipe Line (1967) ruling, "Ratemaking is, of course, subject to the rule that the income and expense of unregulated and regulated activities should be segregated."[6]

All of this sage advice was of course available to Congress when it enacted the Postal Accountability and Enhancement Act of 2006. That Act appointed the United States Postal Service as the designated government postal operator responsible for fulfilling a universal service obligation with the benefit of two statutory monopolies. The first governs provision of first-class mail, and the second provides the Postal Service exclusive access to consumers' mailboxes. The reform legislation took two essential steps to refine the terms of the postal monopoly and to extend protections to its consumers. The first was to delineate market-dominant offerings from competitive offerings according to statutory definitions.[7]

The second defined the role of the Postal Regulatory Commission, assigning explicit responsibilities including, "to allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products,"[8] and "to prohibit the subsidization of competitive products by market-dominant products."[9] The law further stipulated the Commission's responsibility for ensuring that each competitive product must cover its attributable costs, as well as what the Commission determines to be an appropriate share of overhead, known as institutional costs.[10]

The Commission responded to this statutory requirement with the determination that competitive products be required to contribute at least 5.5 percent toward the

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4 Royal Swedish Academy of Sciences, Scientific Background on the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel 2014, October 13, 2014.
5 Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions*, p. xxxvi, The MIT Press, 1988.
6 Federal Power Commission v. United Gas Pipe Line Co., 386 U.S. 237 (1967).
7 39 U.S.C. §3622.
8 39 U.S.C. §3622.
9 39 U.S.C. §3633.
10 39 U.S.C. §3633.

Postal Service's institutional costs. More recently, this share has increased, and in FY 2015, the Commission determined competitive products' contribution to be $4.5 billion, or 13.3 percent.[11]

While this represents progress, it remains considerably below what other prominent indicators would suggest to be an appropriate share. Revenue from competitive products accounted for 24 percent of the Postal Service's total operating revenue for FY 2015[12] , up from 23 percent in FY 2014.[13]

By weight, shipping and package services accounted for 35 percent of total weight for the Postal Service's FY 2015 deliveries, up from 29 percent in FY 2013.[14]

The Commission ruled in 2012 that it may accept a petition to reexamine the appropriate share at any time in advance of five-year intervals.[15]

The law also included a modest structural firewall between the regulated side of the Postal Service and competition with the private sector. Specifically, the Postal Service is prohibited from undertaking any non-postal product or service offerings, effectively grandfathering activities undertaken as of January 1, 2006.[16] But the 2006 legislation erected no other structural firewalls between monopoly and competitive products to prevent cross-subsidy. Thus, the only other safeguards are accounting restrictions, the details of which were left to the Commission. This left the Postal Service with strong incentives to shift costs from competitive products to market dominant products and impose them on a captive audience.

Moreover, the potential for cross-subsidy was enhanced because of the very favorable subsidies that the Postal Service enjoys by law, nearly all of which are available to the competitive side of the Postal Service. In a 2008 Congressionally-mandated report, the Federal Trade Commission (FTC) noted that, "because the United States Postal Service (USPS) is a federal government entity, the USPS' competitive products operations enjoy an estimated implicit subsidy of between $39-117 million a year."[17] These include Postal Service immunity from state and local taxes and fees, immunity from federal income tax, and access to federal lending at government rates, and special customs treatment.[18]

The FTC report asserted that implicit subsidies "mask from consumers the true costs of providing competitive services," and that current practices, including the 5.5 percent assigned by the regulator for appropriate share, distort market outcomes in the competitive products sectors, "likely leading the USPS to charge artificially low prices for its competitive products."[19]

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11 Postal Regulatory Commission, FY 2015 Annual Compliance Determination, Docket No. ACR2015, p. 92.

12 U.S. Postal Service, Final Revenue, Pieces, and Weight by Classes of Mail, FY 2015.

13 Postal Regulatory Commission, FY 2014 Financial Analysis Report.

14 U.S. Postal Service,

15 Postal Regulatory Commission, Order #1276, Docket No. RM2012-3, March 7, 2012.

16 39 U.S.C. §404(2).

17 Federal Trade Commission, "Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors," 2008, p. 8.

18 Federal Trade Commission, pp. 23-36.

19 Federal Trade Commission, p. 85, p. 92.

A 2015 report by Robert Shapiro updated estimates of the same subsidies examined in the FTC report, calculating a new total value of $1.021 billion. Shapiro noted that the Postal Service's Office of the Inspector General in 2012 estimated the fair market value of Postal Service real estate holdings to be more than three times the cost-basis value used in its annual 10-K filings. Applying this valuation to average property tax rates would raise the value of the Postal subsidies to $2.18 billion annually.[20]

Service Quality and Cost Coverage

First-class mail volume has historically served as the Postal Service's profit center, yielding among its highest transactional profit margins. For this reason, continued sharp declines in projected first-class mail volume have seemed especially foreboding to the Service's future business model. Not just higher cost, but poorer service quality as well can accelerate the decline of the demand for first-class mail.

Federal statute explicitly stipulates that the Postal Service "shall give the highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail," in its decision-making.[21]

But several high-consequence policy decisions by the Postal Service appear to have diverged from this statutory requirement, contributing to a deterioration in service quality for letter mail.

Mail Processing Network Rationalization undertaken by the Postal Service has produced changes to service quality standards that result in slower delivery times. An official release explaining phase two network rationalization described how the resulting cost savings "would better position the Postal Service to make needed investment in package processing and other automation equipment, and in our delivery fleet, which will help us to grow our package business."[22]

In January 2015, the Postal Service issued new first-class mail service standards that primarily affected single-piece letters. "The majority of this mail is being delivered in two days instead of one," stated an official fact sheet.[23] Observers have expressed differences of opinion regarding the extent of the actual impact of this change on customers, as results sometimes fall short of these targets.

The Postal Regulatory Commission noted in its 2015 Annual Compliance Determination that network rationalization, along with severe winter weather, were cited by the Postal Service as reasons for not meeting service standards for first class mail. "With respect to First-Class Mail products with a 3-5 day service

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20 Robert J. Shapiro, The Basis and Extent of the Monopoly Rights and Subsidies Claimed by the United States Postal Service, Sonecon, LLC, March 2015, pp. 21-22.

21 39 U.S.C. §101(e).

22 United States Postal Service, "Phase 2 Network Rationalization: Frequently Asked Questions," undated, p. 2.

23 USPS Delivery Standards and Statistics Fact Sheet, March 2015.

standard, service performance results have declined in every fiscal year since FY 2012," stated the determination.[24]

The report further noted that service performance for Market Dominant flats products across all mail classes have been substantially below targets since FY 2012.[25]

The Postal Service noted in its 2015 Annual Report to Congress that, as a result of ongoing growth in package mail, it had shifted mail traffic from its air transportation network to its surface network, impacting service performance negatively for some two-day and three-to-five day mail.[26] This policy decision would appear to directly contradict its statutory mandate to give priority to letter mail delivery.

Another important measure of value of services to consumers is cost coverage, defined as revenue per piece as a percentage of attributable cost per piece (unit revenue divided by attributable cost). For single-piece first class letters, cost coverage was 187.5 percent in FY 2015, an increase from 168.1 percent in FY 2010. First class mail overall reported cost coverage in FY 2015 of 225.8 percent. On the other hand, priority mail cost coverage, the agency's flagship competitive product, was 126.2 percent for FY 2015, down slightly from 133.2 percent in FY 2010.[27]

Such disparities in cost coverage are concerning, because if more costs are attributed to specific products, a stated goal by Congress during Postal Accountability and Enhancement Act deliberations, this might place certain products, particularly competitive package delivery, into negative profitability. The fact that competitive products could be losing money should be alarming to policymakers, as significant investments being made by the Postal Service, outlined below, could escalate losses and potentially necessitate a large taxpayer bailout.

Monopoly on Mailbox Access

The United States is one of very few countries where the designated postal operator enjoys a statutory monopoly on access to consumers' mailboxes.[28] Postal Service regulations prohibit private companies, its competitors in the package delivery marketplace, from depositing items for which required postage rates have not been paid to the Service. They therefore must bear the extra cost of delivery to the door.

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24 Postal Regulatory Commission, Annual Compliance Determination Report 2015, Docket No. ACR2015, p. 133.
25 ACR2015, P. 3.
26 United States Postal Service, 2015 Annual Report to Congress: FY 2015 Annual Performance Report and FY 2015 Performance Plan, p. 15.
27 Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015, U.S. Postal Service annual reports.
28 Canada Post operates a regulatory monopoly on mailbox access based upon limited authority granted in statute.

The U.S. Postal Service has asserted that relaxation of the mailbox monopoly would place consumers at increased risk of harm from hazardous materials, pornography or mail fraud. [29] Yet, most postal consumers are responsible for the purchase and maintenance of their own mailboxes. While the relatively small size of many mailboxes would seem to render them of limited use for packages, the Postal Regulatory Commission's December 2014 Report on City Carrier Street Time Study noted that an average of 60 percent of packages delivered daily by city carriers were "in receptacle" packages that fit into consumer mailboxes. [30] In communities where cluster mailboxes are in use, the Postal Service has sought to increase mailbox size specifically to accommodate package delivery.

Two historical examples, from the telecommunications and electric utility sectors, may offer guidance here. First, in a 1956 ruling, the District of Columbia Circuit of the United States Court of Appeals rejected a Federal Communications Commission ruling which prohibited use of a cup-like device, called Hush-a-Phone, which consumers could snap onto their telephone receivers to afford increased privacy for conversations. The decision rejected the Commission's prior finding prohibiting the use of the add-on contraption and called the decision an "unwarranted interference with the telephone subscriber's right reasonably to use his telephone in ways which are privately beneficial without being publicly detrimental." The Court applied the standard that a monopoly entity's imposition upon its customers must be "just, fair and reasonable."[31]

Second, the Tennessee Valley Authority is another example of an agency that was provided with a monopoly position and protected from competition from other private sector providers. Created in 1933 as a part of the Roosevelt administration's New Deal, the Tennessee Valley Authority, or TVA, was intended to improve the quality of life in the Tennessee River Valley. One of the TVA's responsibilities was to generate electrical power and provide electricity to communities in the region, many of which were underserved during the era. The TVA reports today that it "provides electricity for 9 million people in parts of seven southeastern states at prices below the national average."[32]

As a subsidized federal corporation, the TVA has historically been able to sell its energy costs well below the competitive market price, putting the TVA in the position of a monopoly provider for energy in the region. The TVA was the focus of a 1936 Supreme Court case brought by the stockholders of the Alabama Power Company, which challenged the constitutionality of the program. Alabama Power Company, as a private energy provider, was facing competition from the new subsidized entity that could provide discounted prices.[33] The Supreme Court upheld the TVA's constitutionality, but it did not end questions about the TVA's monopoly power and authority.

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29 Federal Trade Commission, pp. 88-89.

30 Postal Regulatory Commission, Report on City Carrier Street Time Study, December 2014, Table 40, p. 98.

31 Hush-A-Phone Corporation v. United States, 238 F. 2d 266 (1956).

32 About TVA, Tennessee Valley Authority, at: http://www.tva.com/abouttva/index.htm (accessed April 4, 2015).

33 Ashwander v. Tennessee Valley Authority, 297 U.S. 288.

TVA's monopoly position for providing discounted electrical power in the region was debated for more than a quarter century after its creation. In 1959, Congress and the Eisenhower administration reached a compromise reform bill that prevented the TVA from offering discounted power to states and communities that it was not serving as of July 1, 1957.[34] The 1959 legislation also protected the TVA's monopoly within its existing region of service by allowing it to deny certain services for private energy providers seeking to compete in the area. As a result, this compromise created what is commonly known as the TVA Fence.[35]

The Postal Service supports preserving the mailbox monopoly, offering warnings of the implications of its potential demise not unlike those of operators of the incumbent telephone monopoly, warning of systemwide risk of allowing inferior equipment to access the network in the Hush-a-Phone case. If the District Court of Appeals had sided with the incumbent monopoly, any adaptation or innovation of the phone system, other than those offered by the monopoly operator, would have been prohibited.

Opening up access to mailboxes for private providers, as is the case in most countries currently, may allow for competition to improve the efficiency and convenience for consumers. But if this were deemed unacceptable to decisionmakers, the geographic "TVA Fence" may suggest another approach to addressing the mailbox monopoly – continuing to allow exclusive access to mailboxes for monopoly mail products, while opening up mailbox access through an orderly process for competitive product providers (perhaps one recognizing pre-registered private operators).

The Costing Challenge

Recently much attention has been paid to the cost allocation system utilized by the U.S. Postal Service. "Now is the time for the organization to develop a similar versatile and dynamic costing system [to competitors and companies of similar size in other industries]," asserted a 2014 white paper by the Service's Office of Inspector General, calling it a "Greenfields" costing approach.[36] The Postal Service's present costing methodology, implemented and developed to ensure compliance under cost-of-service regulation, diverges from industry best-practice costing systems that rely on more granular data and new technologies, areas where the Postal Service has improved its capabilities, the report notes. Greater transparency and accountability for fixed costs and management could guide decisions toward more profitable actions, the report suggests. It would also prove valuable to improving the confidence of regulators seeking to prevent illegal subsidies between market-dominant and competitive products.

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34 "The Great Compromise," Tennessee Valley Authority, at: http://www.tva.com/heritage/great_compromise/index.htm *(accessed April 4, 2015)*.

35 Government Accountability Office, Tennessee Valley Authority: Information on Benchmarking and Electricity Rates, May 2002, at: http://www.gao.gov/new.items/d02636.pdf (accessed April 4, 2015).

36 A.T. Kearney, "Greenfield Costing Methodology: An Opportunity to Deliver Transformative Change," U.S. Postal Service Office of Inspector General, RARC-WP-14-005, January 7, 2014.

While the Postal Service's percent of costs deemed to be non-attributable, or institutional costs, tended generally lower from 1980-2000, they have increased more sharply since that period. Robert Cohen and John Waller explain a variety of operational (volume, volume mix, weighted volume and productivity) and exogenous, institutional factors for this change in ratio, noting that attributable cost percentages declined by 24 percent from 2007-2014, in 2007 dollars.[37]

In particular, Cohen and Waller observe that the prodigious decline in single-piece first-class mail over this period, and the growth of volume for competitive products, which typically carry lower attributed costs, are important drivers of this increase in unattributed institutional costs. Package delivery volume by the Postal Service increased by more than 20 percent from 2008-2013, while all other mail volume decreased by more than 20 percent. [38] Package delivery produced 18 percent of all Postal Service revenue in 2013, and it is growing annually.[39]

The precarious overall financial situation of the U.S. Postal Service adds urgency to its relative lack of financial transparency. The Service recorded its ninth consecutive financial loss in FY 2015, producing a total net deficit of over $56 billion since FY 2007. [40] These deficits have certainly not been lost on responsible federal policymakers, for whom the looming possibility of eventual taxpayer responsibility for these deficits should make improved public financial transparency a near-term necessity. It should be noted that the Postal Service in its 10-K filed with the Securities and Exchange Commission routinely observes that if the Postal Service runs out of cash, Congress would likely support the agency to continue mail service.[41]

Important to preventing cross-subsidies between market-dominant and competitive activities of the U.S. Postal Service is the allocation of costs associated with carrier delivery routes. The Postal Regulatory Commission's Public Representative, in response to a proposed change by the regulator in analytical principles asserted that the time period sampled for its analysis, "likely understates the proportion of total street time dedicated to package and accountable delivery, reducing the costs attributed to parcels." The Public Representative went on to assert that, "as most parcel products are competitive, understating the costs attributable to parcels has serious compliance implications."[42]

This raises the question of how thoroughly can consumers rely on the Postal Regulatory Commission to protect their interests? As recently observed by Postal Regulatory Commission Acting Chair Robert Taub, "unlike taxpayer-

37 Robert Cohen and John Waller, "The Postal Service Variability Ratio and Some Implications," 2014. Also Cohen and Waller, "Ratio of Attributable to Institutional Costs and Inframarginal Costs 2007-2013," 2014.

38 "Package Services: Get Ready, Set Grow!" U.S. Postal Service Office of Inspector General, RARC-WP-14-012, July 21, 2014, p. 7.

39 "Package Services: Get Ready, Set, Grow," p. 8.

40 Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, March 29, 2016.

41 United States Postal Service Form 10-K for the fiscal year ended September 30, 2014, p. 52.

42 Postal Regulatory Commission, Public Representative Comments, Docket No. RM2015-7, March 18, 2015, p. 8.

appropriated dollars, we're getting our appropriation out of the Postal Service fund, which is the rate payers' money, and it's out of an entity and a fund that's nearly insolvent." [43] It has been broadly observed that where incentives exist for a designated operator to exploit its monopoly power by anti-competitive behavior, relying upon regulation for remedy will invariably be less effective for reasons of incompleteness and delay, *i.e., regulatory lag.*[44] Perhaps this argues for protection against cross-subsidy through structural separation, and only on accounting measures, only as a second-best alternative to structural separation.

The Bell Doctrine and Structural Separation

John Panzar argues that the prevalence of economies of scale with local delivery networks renders it highly likely that the U.S. Postal Service can be considered a natural monopoly, despite the intrinsic difficulty of obtaining econometric evidence. [45] Panzar suggests that unbundling pricing of the Service's offerings could produce a system of nondiscriminatory access charges to its network that would better serve its consumers.

The Bell Doctrine, authored by Professor William Baxter as a guiding theoretical framework for the 1983 breakup of the American Telegraph and Telephone Company, considers various possibilities to address a regulated monopoly that also operates in competitive markets. The Bell Doctrine outlines two types of remedies: structural separation and accounting separation.

The 1982 Modified Final Judgment required a structural separation that removed ownership and control of the monopoly operating units from the ownership and control of the competitive units.[46]

A second alternative provided for under the Bell Doctrine is to "regulate the company's internal business practices in a manner that minimizes the extent of anti-competitive activity."[47]

The divestiture of operating companies required by the AT&T case settlement imposed a structural separation that removed the ability of AT&T to disadvantage competitors in the interexchange and equipment markets. Such an approach has value in considering how implied anti-competitive actions in the postal sector may be remedied.

Crandall and Sidak in their 2002 analysis noted three distinct meanings of "structural separation" in this context:

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43 Al Urbanski, "PRC Chief Robert Taub on the Near Future of the Postal Service," DMNews.com, April 7, 2015.

44 Economics of Regulation, II, p. 48.

45 John C. Panzar, "The Economics of Mail Delivery," in Governing the Postal Service, The AEI Press, 1994, J. Gregory Sidak, ed.

46 Paul L. Joskow and Roger G. Noll, The Bell Doctrine: Applications in Telecommunications, Electricity, and other Network Industries in Stanford Law Review, Vol. 51, No. 5 (May, 1999), pp. 1249-1315.

47 Joskow and Noll, p. 1266.

1. Divestiture of retail service from the wholesale network division.
2. Separate ownership of telecommunications from any companies providing the service to end users.
3. Functional separation whereby incumbent local exchange carriers are restricted to interaction at arm's length.[48]

The changing marketplace for postal and delivery services in the United States sheds some light on how a structural separation might be designed. As described above, the mail mix in the United States has shifted dramatically, and is widely expected to continue to shift toward fewer first-class letters and more packages. The fast-growing package delivery market, driven by sharp increases in online purchases, is a highly competitive one. The Postal Service delivered 39 percent of the nation's domestic package volume in 2013, while UPS delivered 38 percent and FedEx delivered 23 percent.[49] The Postal Service earned 18 percent of package delivery revenue in 2013.[50] A significant share of the Postal Service's package business is the result of the private delivery companies depositing their lighter-weight packages into the Postal Service's network for final-mile delivery.

The vast delivery network operated by the Postal Service to fulfill its Universal Service Obligation certainly makes it convenient for competitive products to piggyback on mail delivery routes. But important elements of the processing and delivery infrastructure are not shared. Packages are so different from mail physically that the processing and sorting equipment is rarely common between them.

Postal Service executives have regularly made billion-dollar investments in infrastructure upgrades to support their strategy to grow volume in the package business. As investments, including in package barcode technology service, led to increased volume, new capital improvements have upgraded package-sorting efficiency in 19 bulk mail centers around the country. Lean Six Sigma projects have been undertaken to increase sorting accuracy and improve processing efficiency.

In recent years, billion-dollar capital investments in assets that will exclusively or predominantly serve competitive products have been more common and more expensive. The Wall Street Journal 's Laura Stevens in August 2014 reported on Postal Service plans to invest $10 billion over the next four years on infrastructure to support its pursuit of growth in competitive markets, including larger delivery vehicles and package-sorting equipment.[51] "We have a very structured plan around all we're trying to do to grow our package business," a USPS vice president said at the close of FY 2014.[52]

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48 Robert W. Crandall and J. Gregory Sidak, "Is Structural Separation of Incumbent Local Exchange Carriers Necessary for Competition?" Yale Journal of Regulation, 2002, p. 340.

49 "Package Services: Get Ready, Set, Grow," p. 9.

50 "Package Services: Get Ready, Set, Grow," p. 9.

51 Laura Stevens, "For FedEx and UPS, a Cheaper Route: The Post Office," The Wall Street Journal, August 4, 2014.

52 Mike O'Brien, "Parcels – Including Groceries – the Future of USPS," Multichannel Merchant," September 26,

Postal executives have begun advancing plans to replace 163,000 delivery trucks at an estimated cost of $4.5 billion. The new trucks, of which postal management is reportedly seeking 180,000, will be larger and better equipped to accommodate greater package delivery volume. [53] No plan has been put forward publicly to finance this major new investment. Amid persistent questions regarding the understatement of costs associated with competitive products, there is little public transparency to ensure how such a capital investment in competitive activities will be financed, and how operational costs associated with the new vehicles once in operation can be sustained.

Strategic pricing breaks for commercial customers have long been hallmarks of Postal Service strategies to increase volume, and sales executives have adjusted thresholds required for creatively-designed special deals. [54] The Service cut shipping rates sharply for some commercial customers during the 2014 holiday shopping season, some as much as 57 percent. [55] Postal regulators have periodically criticized Postal Service contracts for offering worksharing price discounts in excess of savings, but on only one occasion have commissioners rejected a Negotiated Service Agreement.[56]

Filings with the Postal Regulatory Commission by FedEx called into question whether the appropriate share of institutional costs can be expected to be sustained at present rates if Postal Service price discounts for package delivery offered to e-commerce customers continue to increase. [57] The filing noted that the volume of parcels has increased on an absolute basis, and that volume from market-dominant products has shifted to competitive categories, particularly for packages. [58] Only 25 percent of Postal Service revenue was linked to letter post in FY 2014, down from 35 percent just two years earlier, according to data from the Universal Postal Union.[59]

These concerns would seem to support instituting a structural separation between the Postal Service's provision of monopoly and competitive products. Such a separation could permit competitive products to utilize the Postal Service's network for last-mile delivery (as FedEx and UPS do currently). Sorting and processing functions could be split between the two business units, with separate accounting.

Congress and the U.S. Department of Energy established a stricter legal and regulatory framework governing that agency's Work for Others program, by which

2014.

53 Anne Steele, "Postal Service Seeks to Retire the Old Mail Truck, The Wall Street Journal, February 12, 2015.

54 Anita Bizzotto, "New Opportunities Await Shippers and the U.S. Postal Service," Parcel Industry.com, Spring 2007.

55 James Cartledge, "Regulators Allow USPS Price Drop Despite Complaints from UPS, Fedex," Post & Parcel, August 19, 2014.

56 In March 2015, the Postal Regulatory Commission rejected a Postal Service Request for a Negotiated Service Agreement with Discover Financial Services.

57 Reply of Federal Express Corporation, Docket No. ACR2014, February 13, 2015.

58 Comments of Federal Express Corporation, Docket No. CP2014-55. July 17, 2014.

59 Universal Postal Union, Global or Regional Estimates, 2012-2014.

national laboratories conduct research for private clients or other federal agencies. The program is prohibited from engaging in activities which compete directly with the domestic private sector. The agency runs 17 national laboratories, overseen by various offices fulfilling a diversity of missions, 16 of which are operated by contractors under management and operations contracts. [60] The Work for Others program directs the laboratories to conduct work for other federal agencies and non-federal entities on a reimbursable basis provided certain conditions are met.

As directed by the agency's Office of General Counsel, work under this program "must pertain to the mission" of the facility, and "cannot compete directly with capabilities that are available in the private sector." [61] The program is authorized by statutory language in the Atomic Energy Act of 1954, which stipulates that private facilities or laboratories must first be deemed inadequate to conduct this work, and that the work must have the potential to lend significant assistance to activity in the fields of protection of public health and safety,[62] and also by the Economy Act of 1932, which requires the fulfillment of the precondition that "ordered goods or services cannot be provided by contract as conveniently or cheaply by a commercial enterprise."[63]

It should be noted that the Government Accountability Office identified certain shortcomings in the program's implementation in a 2013 report; specifically, that Department of Energy contracting officers improperly delegated these determinations to laboratory employees. The GAO observed in its investigation that in more than half of the instances examined, the agency relied on written determinations by the laboratories, a shortcoming it cited in its recommendation to Congress calling for improved oversight of the program.

Are there ways this model, a more drastic remedy than others discussed in this paper, could be employed for regulation of the Postal Service? Such a prohibition on competition with the private sector would deprive the agency's present business model of potential growth its executives covet highly. But some observers would view the solution as preferable to the acceptance of implied anti-competitive behavior engrained within present circumstances.

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60 "National Laboratories: DOE Needs to Improve Oversight of Work Performed for Non-DOE Entities," Government Accountability Office, GAO-14-78, October 2013, p. 2.

61 Department of Energy Order 481.1C, March 14, 2011.

62 42 U.S.C. § 2053.

63 31 U.S.C. § 1535.

Conclusion

As the designated operator of a government monopoly that is also heavily engaged in competitive markets, scrutiny of the Postal Service must ensure that it is fulfilling its core obligations. In addition to the core responsibility of delivering letter mail, such scrutiny includes ensuring that new products are profitable enough to justify expansion, and that long-term, sustainable profitability of competitive product services can justify future investments.

Weak public transparency for data pertaining to Postal Service costs increases the likelihood that monopoly consumers are being overcharged, and proceeds will continue to be applied to create market distortions in competitive markets. Market trends suggest this situation will likely worsen for consumers before it gets better. While Postal Service executives have argued that financial transparency to the regulator is sufficient, it is doubtful that this transparency meets the established standards by which transparency is evaluated in other regulated industries.

The burden of proof in postal regulatory proceedings, as a practical matter, falls upon industry and trade organizations to show harm, a burden that is often exceedingly difficult in light of the lack of public transparency for financial data. Federal postal statute expressly charges the Postal Regulatory Commission with the role of preventing cross-subsidy between market-dominant and competitive products, and most financial data pertaining to how the Postal Service attributes costs to specific products is never made publicly available.

Because mail and packages are so physically different that their processing requires separate infrastructure, some potential for structural separation between monopoly and competitive activities is possible without significant disruption to economies of scale for market-dominant mail products. Structural separation within the Postal Service, with appropriately-regulated pricing of services within the postal network, should be considered in such instances.

Where structural separation of activities is not practical because of harm to the provision of universal service, accounting separation should establish a fair market value charge for utilization of shared infrastructure, which protects monopoly ratepayers from funding competitive activities.

Finally, the serious predicament of the Postal Service's business model, indicated by more than $50 billion in combined deficits since 2007, raises the stakes for financial transparency. With the viability of the Postal Service's present business model called into question by most serious observers, the emerging likelihood that taxpayers may become responsible for its mounting losses increases the urgency to establish public financial transparency.

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