

The Cost of the USO in the U.S.

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Scope of Entire Study is Much Broader than USO COST

- Includes the value of the US monopoly
- Theoretical pieces by John Panzar on cost of USO and value of monopoly
- The history of the monopoly in the US
- The history of the USO in the US
- Survey research on public attitudes towards the USO
- Link:<http://digilib.gmu.edu:8080/dspace/handle/1920/3477>

US has no Legal Definition of a USO

- We define the USO as postal obligations That conform to the following principles:
 - Universality—applies to virtually everyone
 - Service—directly effects the public as mailers and recipients
 - Obligations –that are based on statutes

Our Analysis of the Cost of the USO Includes:

- Statutory Elements already approved by Congress
- Potential Statutory Elements that might realistically become obligations if Congress were to address the subject of a USO

Definition of the Cost of the USO

- First formulated by Cremer and Panzar
- Calculate savings from removing the obligation (or element of the USO)
- Subtract the lost revenue
- USO cost is the sum of additional net income if all USO elements were eliminated

Statutory elements

- Frequency of delivery
- Discounts for social mail categories
- Uniform rate with respect to distance
Required for Media Mail/Library Rate Mail
- Losses on market dominant products
- Measuring service performance of market dominant products
- Maintaining small rural post offices

Potential statutory elements

- Alaska Air subsidy
- Uniform rate for First Class
- Delivery to all addresses who involuntarily receive no delivery
- Six day a week delivery for all (except for businesses served by five day a week business routes)

USO Cost for Statutory USO

Elements	2007 Cost (\$ millions)
Six Day a Week Delivery	5,780
Social Mail Discounts	1,150
Unzoned Media/Library	63
Losses on Market Dominate Products	448
Measuring Service	30
Maintaining Small PO's	586
Total	7,737

Cost of Potential Statutory Elements

Elements	2007 Cost (\$ millions)
Alaska Air Subsidy	107
Uniform rate for FC	130
Require Delivery to all Addresses	101
Six Day a Week Delivery to all Addresses	001
Total	339

Delivery Cost in US

- \$29.4 billion or 38% of total cost
- 51.2% of delivery cost is a fixed cost
- 48.8% of delivery cost variable

Frequency of Delivery

- Basic question underlying this element of the USO:
 - How many days per week would a *profit maximizing* post deliver given that it had a letter monopoly and a mailbox monopoly?
 - Answer depends on how much mailers would reduce volume when delivery frequency is reduced

Savings from Reducing Delivery Frequency

Days Per Week	Volume Loss (%)	Contribution Loss (\$B)	Cost Savings (\$B)	Percent of Total Cost
5	2.0	0.58	1.93	2.5
4	5.0	1.46	3.56	4.6
3	6.0	1.75	5.78	7.5
3	8.0	2.33	5.20	6.7
3	10.0	2.91	4.62	6.0

Volume that must be lost to offset savings from reducing delivery frequency

Delivery Days	Cost Savings \$ Billion	Total Volume Loss to Equal Cost Savings
5	1.93	8.6%
4	3.56	17.2
3	5.78	25.8

Social Rate Categories

Class	Social Rate Category	Corresponding Ordinary Category
Periodicals	Within County	Regular Rate
Periodicals	Nonprofit	Regular Rate
Periodicals	Classroom	Regular Rate
Standard	Nonprofit	Regular
Standard	Nonprofit ECR	Regular ECR
Packages	Library Rate	Media Mail

USO Cost of Social Rates

- Raised prices to the equivalent ordinary rate
- Used R2006-1 forecasting model to take into account price elasticities
- \$1.15 B addition to net revenue for 2007 from increasing prices
- Virtually all the increase is from solicitations by nonprofit organizations

Uniform Rate for Media/Library Rate

- Required to have uniform rates with respect to distance
- Bound printed matter is zoned and is similar in weight and contents
- High cross elasticity with Media mail
- Using the contribution per piece for BPM, estimate that an additional \$63 M to net revenue in 2007

Losses on Market Dominant Products- Domestic

- A profit maximizing post would increase prices to breakeven or discontinue them
- Periodicals, Media/Library and SP Parcel Post were loss making in 2007
- Price caps apply to classes, not subclasses
- Service could have eliminated losses for Media/library and SP PP subclasses under price caps—but not for the entire Periodical class
- \$448 m losses on Periodicals is a USO cost

Losses on Market Dominate Products- International

- Overall International mail is profitable
- Profit maximizing post would retain International mail treaty commitment despite losses on inbound
- Because inbound and outbound terminal dues are closely related, it is not clear if the USPS can reduce the losses on one without reducing the profits on the other

Measuring Service Performance of Market Dominant Products

- The PAEA requires the measurement of service for market dominant products
- Thus, service measurement is a cost of the USO
- USPS estimated the cost to be \$182 mil

Maintaining Small Rural Post Offices

- Annual rider bars USPS from using appropriations to close rural post offices
- The USPS however has closed hundreds
- Notwithstanding we take the rider to be Congressional intention and include small rural post office costs as part of the cost of the USO

Rural Carriers in US

- Deliver to roadside boxes and roadside and cluster boxes in suburbs
- Provide retail services to all customers
- Customers who live within quarter mile of post office that provides rural delivery, must pick up mail at post office, but they receive a free post office box

Estimating the Net Savings from Closing Small Offices

- Estimate cost of delivering to all box holders (paid boxes and free boxes) assuming delivery to cluster boxes near old post office locations
- Estimate the number of retail transactions conducted at these offices
- Estimate the cost of substituting rural carrier retail transactions
- Account for lost revenue from paid boxes

Cost Detail in Closing all Small Offices

- 9218 small offices with costs of \$664 m in 2007
- \$72,000 per office
- Estimated \$280 million in retail revenue
- 1.1 m box holders (390,000 free boxes)
- Revenue from paid boxes-\$26 million
- Cost to deliver to cluster boxes is \$0.13/box
- Cost for increased delivery points is \$37 million
- Cost for additional rural carrier retail transactions is \$14 million (9 cents a transaction)

USO Cost of Small Offices

- \$586 million
- We assume no lost revenue
- So this is the net additional contribution

Potential USO Elements

- Alaska Air subsidy
- Uniform rate for First Class
- Delivery to all addresses that involuntarily receive no delivery
- Six day a week delivery for all who receive delivery only 3 days a week

Alaska Air Subsidy

- A profit maximizing USPS would eliminate air service for ground products
- PRC considers all Alaska air cost for ground products to be a USO cost
- Alaska Air does not meet our statutory criteria
- Thus, it is a potential USO cost
- Alaska Air for ground products is \$107 m

Meaning of Uniform Rate

- (1) Uniform with respect to the distance that mail is sent
- (2) Uniform no matter where the sender is located
- US statute requires a uniform rate for FC
- PRC has ruled that statute refers to (2),
- However, if statute means (1) then dropship rates for FC is not allowed

Potential Impact on Net Income if Dropship for Bulk FC Not Allowed

- Assumed USPS would offer ECP (cost avoided) discounts
- Service benefits from ECP discounts because mailers have lower costs and increase volume
- Analyzed discounts of 1, 1½, and 2 cents affecting 40% of presort FC
- Used R2006-1 financial forecasting models
- Increased net contribution of \$89.4 m, \$130.1 m, and \$164.6 m respectively
- Most came from Standard mail converting to FC

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Delivery to all Addresses who involuntarily receive no delivery

- Currently 1.365 million rural addressees in areas served by small post offices do not get delivery, but get a free PO box
- A potential USO might require that all addresses get delivery
- The cost of providing delivery and retail transactions to these addresses-\$10.9 m

Six Day a Week Delivery for all who Receive 3 Day a Week

- Currently 25,009 addresses receive delivery only 3 days per week
- Cost of providing delivery an additional 3 days a week to these addresses-\$862,000