**Parcel Shippers Association Response
to Assertions and Recommendations
made by
United Parcel Service
to the
President's Commission
on the
United States Postal Service**

**By
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The Parcel Shippers Association (PSA) responds to the following assertions and recommendations of United Parcel Service (UPS):

1. **UPS (Written Statement of Mike Eskew at 1,3,4,6) – The Postal Service should be "dedicated to providing high quality service in the physical delivery of letters, advertising and periodicals."**

Woven throughout the written statement of Mr. Eskew (Chairman and CEO of UPS) are assertions that the Postal Service should not be in the business of processing and delivering packages. Rather, according to Mr. Eskew, the Postal Service should focus on its "core 'postal' role." Written Statement at 3. The "movement of goods," according to Mr. Eskew, "should not be part of the Postal Service's core mission, or even its broader mission." Ibid. The United Parcel Service is asking the President's Commission to help it eliminate a competitor, the United States Postal Service.

Of course, the Postal Service was delivering packages long before there was a United Parcel Service. So his suggestion that the Postal Service is engaging in "markets already well served by the private sector" is odd as it relates to package delivery. Ibid. The overwhelming market share of the ground package delivery business controlled by UPS also makes one wonder why Mr. Eskew is concerned about facing competition from the Postal Service. His assertion that "UPS is the only Fortune 100 company that has the U.S. government as its primary competitor in its core line of business," Written Statement at 4 (emphasis added), must surprise FedEx which most recognize as, a worthy UPS competitor, the leader in the overnight package delivery market and at least the Postal Service's equal in ground package delivery (although UPS dwarfs both in the ground market).

As I noted in initial comments on behalf of the Parcel Shippers Association:

> Package delivery service is a core business of USPS. Only the Postal Service provides truly universal parcel delivery service: post office boxes; APO's; FPO's; Alaska; and Saturday delivery, just to cite some examples. USPS delivers parcels everywhere, everyday, with published and uniform tariffs. Unlike some of its competitors, it does not penalize parcel deliveries to your home with a hefty surcharge; it does not hide from, but welcomes at one of forty thousand post offices, the ordinary citizen with one package to send. The USPS parcel post service long pre-existed the entry of the United Parcel Service (UPS) and FedEx into this market. It was and remains a vital core business of the Postal Service, which must be preserved so there is some competition for parcels. PSA Comments at 3-4.

Mr. Eskew's "market failure" assertion is addressed below.

2. UPS (Written Statement of Mike Eskew at 5) – "Substantial subsidies flow from [the Postal Service's] monopoly to their competitive products."

In his written statement, Mr. Eskew asserted that subsidies flow from the Postal Service's monopoly products to its competitive products (Express Mail, Priority Mail, and Parcel Post). This is not the case. In fact, the contribution to institutional costs made by competitive products helps the Postal Service maintain reasonable rates for monopoly products. In its Opinion and Recommended Decision in R2001-1, the most recent rate case, the Postal Rate Commission estimated that competitive products will not only cover their costs, but also make a contribution of nearly $3 billion to institutional costs in FY 2003.[1] The Postal Service would need to raise First-Class Mail rates by nearly 8 percent[2] to compensate for the loss of contribution that would result if it exited these competitive markets.

Mr. Eskew's assertion stems from his definition of a subsidy – "a special, governmentally-derived advantage that has economic benefit." Written Statement at 6. This is, by no means, a standard definition of a subsidy. A noted economist in testimony before the Postal Rate Commission provided a more reasonable definition of a subsidy. This definition should be used to evaluate whether a product is being subsidized:

> The test accepted by economists to determine whether or not any service (or group of services) is receiving a subsidy is
>
> > *The Incremental Cost Test.* The revenues collected from any service (or group of services) must be at least as large as the additional (or *incremental)* cost of adding that service (or group of services) to the enterprise's other offerings.
>
> This test is a very intuitive fairness standard. For if a service's revenues do not cover the additional costs the enterprise incurs in providing it, the users of that service are receiving a subsidy from the enterprise's other customers. On the other hand, if the revenues from all services (or groups of services) are at least as large as their incremental costs, then no user or group of users is burdened by their provision. Indeed, in that case, the provision of each service (or group of services) reduces the amount of revenues which must be collected from the remaining services in order for the enterprise to break even. And, the rate schedule is free from cross-subsidy.[3]

In Docket No, R2001-1, the Postal Service found that rates for the competitive subclasses passed this test. In fact, the revenues generated

[1] $2,978 million = $2,312 million (Priority Mail) + $517 million (Express Mail) + $149 million (Parcel Post). Docket No. R2001-1, Opinion and Recommended Decision, Appendix G, Page 1.
[2] $2,978 million/$38,901 million. Docket No. R2001-1, Opinion and Recommended Decision, Appendix G, Page 1.
[3] Docket No. R97-1. Testimony of Witness John C. Panzar (USPS-T-11) at 8.

by the competitive subclasses also exceeded their respective incremental costs by nearly $3 billion.[4]

Mr. Eskew also suggests that the monopoly is cross subsidizing competitive products because the markup on competitive products is significantly less than the systemwide average. Written Statement at 5. While, as discussed above, having a markup that is less than the systemwide average does not imply cross subsidization, Mr. Eskew's contention that the markup on competitive products is significantly less than average is wrong because it is based upon outdated information.

Specifically, Mr. Eskew calculated markups based upon FY 2001 information that does not fully reflect the substantial rate increases experienced by competitive products in the last two rate cases. Fully reflecting these rate increases paints a different story. In particular, the Postal Rate Commission expects the markup on competitive products to be only slightly below the systemwide average, 53.6 percent versus the 64.8 percent, in FY 2003.[5] This aggregate 53.6 percent markup on competitive products is the third highest among mail subclasses, trailing only the Standard Mail Enhanced Carrier Route and First-Class Mail Letter subclasses.

Furthermore, it is worth noting that this markup is dragged down by the low rates that the Postal Service is required by the regulatory regime to charge for single-piece Parcel Post mail. For example, while the FY 2003 markup for Parcel Post as a whole is only 14.1 percent[6], the markup on the destination delivery unit (DDU) rate used by most commercial parcel shippers is over 80 percent.

[4] $2,947 million = $2,293 million (Priority Mail) + $500 million (Express Mail) + $154 million (Parcel Post). Docket No. R2001-1. USPS-T-28, Exhibit USPS-28E.

[5] Calculated from Docket No. R2001-1, Opinion and Recommended Decision. Appendix G, Page 1.

[6] Ibid.

On a related topic, Mr. Eskew argues that allowing the Postal Service to offer competitive products “redirects [the Postal Service’s] energies away from their core monopoly functions.” Written Statement at 4. Assuming that this is the case, the best solution would be for the Postal Service to hire additional managers, rather than exiting markets that generate $3 billion in contribution.

3. UPS (Written Statement of Mike Eskew at 3) – “[T]here is no failure in the private marketplace to justify an exception to the general rule that governments should not be competing with private industry.”

There is a failure in the private marketplace. No private provider of package delivery services provides universal service. As we noted, only the Postal Service “delivers parcels everywhere, everyday, with published and uniform tariffs. Unlike some of its competitors, it does not penalize parcel deliveries to your home with a hefty surcharge; it does not hide from, but welcomes at one of forty thousand post offices, the ordinary citizen with one package to send.” PSA Comments at 3-4.

Furthermore, the Postal Service exiting the package delivery market could cause a further failure in the private marketplace. Currently, UPS has a 78 percent share of the ground parcel market. If the Postal Service exits this market, UPS could leverage its near monopoly to capture the Postal Service’s 7 percent share, thereby increasing its market share to 85 percent.