

# ***IRET Congressional Advisory***

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## **THE POSTAL SERVICE SHOULD KEEP ITS HANDS OFF E-COMMERCE**

The U.S. Postal Service and its predecessor, the U.S. Post Office Department, have been delivering mail for more than two centuries. Increasingly, however, the Postal Service's top officials appear to wish the government agency were also a "dot-com" company. As a symbol of its dot-com aspirations, the U.S. Postal Service has exchanged its previous Internet address of [www.usps.gov](http://www.usps.gov) for [new.usps.com](http://new.usps.com). Postmaster General William J. Henderson has declared, "E-commerce is a passion of mine."<sup>1</sup> This focus is troubling because it disregards the principle that, as part of the federal government, the Postal Service's business activities should be strictly limited and that it is not the mission of government to be a business.

***The Postal Service Looks To E-Commerce.*** According to the Postal Service, its long experience with what many people now call "snail mail" has given it the technical and organizational tools to become a major, successful provider of Internet services to homes and businesses. Furthermore, the Postal Service hopes that its status

as a government agency and the public's confidence and familiarity with its service would make it the provider of choice for millions of potential customers. It contends that many people would prefer conducting electronic commerce through the Postal Service rather than turning to the enormous array of e-commerce services offered by a growing number of private-sector firms.

The Postal Service provides some on-line tools to customers at its Web site that directly assist in its core mission of non-urgent letter delivery. Those support-role services, such as an on-line ZIP code book and an on-line Post Office locator, are convenient, well liked, and noncontroversial; they put the Internet to good use. The Postal Service has much loftier ambitions, however. Its goal is to become a leading Internet player.

Since 1998, for instance, the Postal Service has sought (unsuccessfully so far) to gain control over a large block of Internet addresses — those with the top level domain "us" — which are now used primarily by thousands of state, local, and other government entities throughout the country. The Postal Service optimistically argued that its achievements, among them the ability to forward letters, shows it has the skill to develop this chunk of the Internet into what it has characterized as a variety of socially desirable and profitable services, such as a Postal-Service-approved Internet yellow pages.

The Postal Service's latest e-commerce product is USPS Electronic Postmark, a feature verifying the time and date of e-mail. Recently, the Postal Service has been touting USPS eBillPay, an Internet-based bill paying service that it features prominently on its Web site. The Postal Service is assuming that its government status will attract e-payment customers, but it

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remains to be seen whether people would be reassured or alarmed at the thought of paying their personal bills through a "trusty" government agency. A logical question for potential customers to ask is: Could other government agencies more easily access confidential personal and business information relating to the transactions if e-commerce is handled by the Postal Service instead of private-sector companies?

Postmaster General William J. Henderson reiterated the agency's Internet ambitions in a recent speech. While cautioning not to "write off hard copy mail just yet" and stressing the need to control mail costs, he also said, "Cost cutting alone, however, will not secure our future... [O]ur second challenge is to create new business models, new products, and new streams of revenue to assure that the mailing industry grows. Opportunities for growth lie in the global embrace of e-commerce..."<sup>2</sup>

In 1999, Mr. Henderson even hinted that the Postal Service, which he said would act as a "trusted third party", should be given an e-payment monopoly, or at least made the industry's dominant player, supposedly to improve the industry's technical efficiency:

"We think the Postal Service has a role in E-payments. If one private sector company owned the platform for E-payments ten years from now, you would have a monopoly model...where you're forced to use one service. On the other hand, if you don't have one supplier, then everyone builds his own model, [and] you will have ... suboptimized networks. So we think the answer is our role as a trusted third party... And we're exploring how to facilitate E-payments throughout America as a part of the future of delivering the promise and binding our nation together."<sup>3</sup>

USPS is arguing that e-payments are a natural monopoly, or at least need a dominant firm to set uniform industry procedures, and better that the industry be monopolized or dominated by a government agency than by a private-sector firm. But Internet protocols already provide the needed standards for transmitting payment information, and it is not inefficient — quite the contrary — when competing e-commerce firms each strive to develop better products, software, and customer services than their rivals. Just as there is no efficiency loss by having several different credit card companies, there is no efficiency loss by having multiple private-sector e-payments companies. The choice Mr. Henderson posits is not valid because his premise and conclusion are wrong.

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***The Urge to Expand.*** The Postal Service, like many government agencies, has often sought to extend its reach. That is not surprising, because one of the surest paths to success for a government agency's managers is to create new tasks for the agency and increase the agency's staff. A

century ago, for example, the Post Office Department urged Congress to let it take over America's telephone and telegraph systems, supposedly to benefit the public. Fortunately, Congress declined the invitation. More recently, in the early 1990s, following a long period during which large deficits and deteriorating mail service had raised questions about whether the Postal Service could provide even basic mail delivery, let alone additional services, Postmaster General Marvin Runyon cited improving mail performance and renewed the call for product expansion.

***The Crisis Scenario and Why It Is Wrong.*** Mr. Runyon added a new rationale for expansion to previous ones. He warned that the fax, the Internet, and other new technologies might eventually divert so much business that it would cause a drop in postal volume and revenues, particularly of lucrative

first-class mail, and lead to higher per unit costs due to lost economies of scale. The choices, he continued, are either to develop new products to replace the lost volume and revenues and recapture the economies of size or to boost postage rates sharply, which would hurt customers, especially those within the postal monopoly. The current Postmaster General, Mr. Henderson, echoes the we-need-to-grow argument, and the corollary that any drop in sales would be catastrophic, when he says, "Our efficiency and our productivity are volume-driven. We have to have volume and its associated revenue to thrive in the future. There simply isn't any other way."<sup>4</sup>

On examination, however, this crisis scenario appears to be alarmist, and the suggested remedy of product expansion seems unwise. Until very recently, projections by the Postal Service and independent consultants contradicted the scenario's fundamental premise. The studies, which took electronic diversion into account, projected that USPS's sales would continue to grow.<sup>5</sup> It is true that the projected growth rates would have been faster if not for technological alternatives, but slower growth rates than those of alternative products is not the same as an absolute sales decline. Moreover, although the Internet may cost the Postal Service some of its share of the mail business, the Internet also acts to speed economic growth, and a larger economy leads to an increase in total mail volume, including snail mail. The Postal Service's volume has risen dramatically in the past despite the introduction of powerful substitute technologies like the telegraph, telephone, and fax.

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Last October, though, the General Accounting Office (GAO) reported that the Postal Service had issued a new forecast in which first-class mail volume keeps growing through 2002 but then declines from 2003 to 2008.<sup>6</sup> Since then, the Postal Service has cited its projection numerous times as evidence that it must expand into e-commerce. Some might wonder whether the new projection is a reliable estimate, a wild "guesstimate", or a worst case scenario being used to support a policy change. Even if USPS's projection is accepted at face value, however, it points to a

challenge, not a crisis. Adjusting to reduced sales is never pleasant, but it is a common occurrence in the private sector, where companies do not enjoy a government-enforced, statutory monopoly that shelters their main product line.

If the Postal Service needs to downsize, the task would be less difficult than the wrenching adjustments private-sector companies must frequently carry out in response to sudden, unforeseen drops in sales. The Postal Service would have several years in which to adjust. Furthermore, according to its new projection, the decline in first-class mail volume starting in 2003 will be partially offset by continued growth in Standard (A) mail volume through 2008; the Postal Service projects that

total mail volume will grow until 2006. Probably the biggest adjustment hurdle for the Postal Service is that, because it is part of the government, it may encounter political obstacles if it tries vigorously to cut input costs. In fact, political roadblocks that the Postal Service might encounter if it were to attempt the cost economies that private-sector businesses

must frequently undertake would be a warning against Postal Service expansion. Product expansion in such circumstances would only increase the number of products that might become cost problems for the Postal Service and to which the agency would have difficulty responding.

If mail volume does decline, what of the diseconomies of size argument? The answer is found by recognizing how huge the Postal Service is. If it were a private-sector company, its sales would place it among the 10 largest in the United States. If it were just half its present size, it would still be among the 50 largest. The Postal Service, which is, in essence, a delivery company, is more than large enough to capture all significant size-based cost economies and would continue to be large enough even if it downsized substantially. Besides, even if one accepted the counterfactual premise that a drop in mail volume would trigger diseconomies of size, the capital and labor requirements for delivering mail are so different from those needed in e-commerce that lost economies in mail delivery would not be restored by forays into e-business. Does anyone seriously believe, for instance, that a postal worker's productivity would be improved by spending two-thirds of the day moving mail and the other third designing Web pages?

***More Reasons Why the Postal Service Should Not Be Entering New Markets.*** In calling for

expansion, the Postal Service's top officials naively presume that the organization would make money on new products. As mentioned above, however, the political constraints the agency already faces in attempting to control the costs of its existing products would likely follow it into new markets. An additional pitfall is that when the Postal Service offers products in competitive markets, it confronts private-sector companies that are often leaner, more innovative, and more entrepreneurial than it is. Would anyone find it plausible, for instance, if the Agriculture Department decided that, on the basis of its long experience with farm policy, it could make money and help the public by operating a supermarket chain? What if the U.S. Navy got the idea that, to more fully use its expertise and help cover its costs, it should launch its own tropical cruise line? The Postal Service's claims are no more credible.

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A GAO study issued in 1998 provides a dose of reality.<sup>7</sup> The GAO study found that 15 out of 19 new Postal Service products it examined were either losing money or had been discontinued; on net, the new products were a financial drain for the Postal Service. Why should e-commerce, a promising but intensely competitive arena in which most dot-coms are bleeding cash, be any different?

A further drawback to e-commerce ventures by the Postal Service is that they are unfair to customers, taxpayers, and competitors. If the Postal

Service loses money on e-businesses, the first place it will look for added revenues is from the customers within its statutory monopoly, especially first-class mail users. Although the Postal Service supposedly exists to better serve those customers, they have become the agency's cash cow, perhaps because the postal monopoly restricts their choices. First-class mail customers cover their own costs and most of the agency's unallocated costs. A Postal Service expansion into e-commerce could well mean a few extra rate hikes for them.

If the Postal Service were to lose too much on e-products for the deficits to be inconspicuously shifted to core-market postal customers, taxpayers would be next in line. Because the Postal Service is part of the government, Washington would not let it go bankrupt but would mount a bailout first with taxpayers' hard-earned dollars.

The Postal Service's access to an extensive array of hidden government subsidies is unfair to private-sector companies and their employees. For example, it escapes paying many government taxes and fees that private businesses are forced to bear. Of most relevance to e-commerce, the Postal Service never has to pay federal, state, or local income taxes if it has income; it never has to pay state and local taxes on the property, inventory, and other assets it owns; and it can borrow at artificially low interest rates because lenders regard it as being protected from default by its connection to the government. A further hidden

government subsidy is that it never has to earn a market rate of return.

The last point refers to the fact that whereas investors want private-sector businesses to earn market rates of return — which forces the businesses to strive constantly to meet customers' needs and to achieve efficiencies in production — governments are happy if government enterprises just break even. While the hope might be that government enterprises would earn less than private businesses by offering bargain prices to customers, the evidence from government enterprises throughout the world is that they usually have sub-market returns because they have difficulty controlling costs and are plagued by inefficiencies in production. Thus, an additional, very

important reason why the Postal Service should not expand into e-commerce is that it would lower the economy's overall productivity if it did so by displacing more efficient private-sector businesses.

One more danger should be considered. Up to now, the Internet's growth has been speeded by government's hands-off attitude and the absence of regulation. Would the government's posture remain as hands off if the government-owned Postal Service attempted to become a major Internet player? The Postal Service has a long record of attempting to

persuade Congress to place restrictions on private-sector businesses in order to clear more of the field for itself.

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***[E]-commerce ventures by the Postal Service ... are unfair to customers, taxpayers, and competitors. If the Postal Service loses money on e-businesses, the first place it will look for added revenues is from ... first-class mail users... [T]axpayers would be next in line... The Postal Service's access to an extensive array of hidden government subsidies is unfair to private-sector companies and their employees.***

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**Legislation.** In an effort to prevent the Postal Service from subsidizing some products by overcharging customers of other products, Congress established an independent regulatory agency, the Postal Rate Commission (PRC), whose main regulatory power is that it sets postal rates. The Postal Service has long complained that the regulatory environment is too inflexible. The agency cannot quickly change postal rates, has some of its requests disapproved, and is slowed in its efforts to introduce new products. (Regulatory considerations may explain why the Postal Service has undertaken many of its non-postal ventures via strategic alliances with private companies. Undercutting the Postal Service's economies of size argument, the companies with which it partners are often relatively small ones.) Under Postmaster Generals Runyon and, now, Henderson, the Postal Service has urged Congress to loosen the constraints.

Representative John M. McHugh (R-NY), Chairman of the House Subcommittee on the Postal Service, has responded to the Post Service request with H.R. 22, the Postal Service Modernization Act of 1999, which may be reintroduced in slightly modified form this year. H.R. 22 would slightly trim the agency's monopoly and enact new rules that supposedly would protect consumers, but it would continue the government's ownership of the Postal Service and grant the agency much more discretion regarding pricing and expansion. H.R. 22's underlying, but mistaken, premise is that Postal Service expansion is necessary and desirable.

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As explained above, the Postal Service is wrong in both its economies of size argument and its assumption that it would assuredly make money in new markets. The danger of H.R. 22 is that the Postal Service might use its new-found flexibility in ways that would decrease the nation's productivity while harming consumers of its monopoly products, taxpayers, and the owners and employees of private-sector businesses.

Economically sound reform would move in the opposite direction. A case can be made on efficiency grounds for privatizing the Postal Service and abolishing its statutory monopoly. However, if it is decided to retain a government-owned Postal

Service with a large monopoly market, the most efficient policy and the fairest one to monopoly-market customers, taxpayers, private-sector businesses, and the employees of private-sector businesses would be to enact legislation that confines the Postal Service to its core, monopoly market. Also, to sharpen the focus on controlling costs and protecting customers within the postal monopoly, the independent Postal Rate Commission should have greater authority to examine the Postal Service's cost data. The Postal Service should not be allowed to leverage its government ownership and large, hidden government subsidies into e-commerce or other competitive-market businesses.

**Conclusion.** The Postal Service proposes to respond to the Internet's challenge to its traditional product lines by moving vigorously into e-commerce. The move has strong bureaucratic

appeal: government agencies like to become bigger. Postal Service expansion is not in the national interest, however, and should be rejected. There is no natural monopoly in e-commerce services and no reason to give the USPS a monopoly over the industry or empower it to set industry standards. The rapidly growing number of households and businesses connected to the Internet are all just a mouse click away from thousands of private-sector companies offering a breathtaking variety of Internet-based services. People do not need imitative products from the Postal Service. Nor should core-market postal customers, taxpayers, private-sector businesses, and the employees of private-sector businesses be forced to bear the costs and risks that Postal Service e-businesses would create.

The crucial determinant of the Postal Service's financial future is whether it can control costs in its core market. If it succeeds in that, it will report acceptable financial results and not have to raise postal rates so frequently. If it fails to control costs there, expansion will only divert the organization from the real problem and probably generate additional cost-control headaches. To best serve the public and strengthen its own finances, the Postal Service should concentrate on improving service and more effectively controlling costs within its core business of non-urgent letter delivery. It should leave, not enter, markets already well served by private-sector businesses.

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Endnotes

1. Remarks by William J. Henderson, Postmaster General, Delivered at the National Postal Forum, Chicago, Illinois, September 1999, cited in Susannah Zak Figura, "Feeling The Byte," GovExec.com, February 2000, accessed at [www.govexec.com/fea-tures/0200/0200s.htm](http://www.govexec.com/fea-tures/0200/0200s.htm).
2. Remarks by William J. Henderson, Postmaster General, "Breaking Through To A New Golden Age Of Mail," at the National Postal Forum, Nashville, Tennessee, March 20, 2000, accessed at [new.usps.com](http://new.usps.com).
3. Remarks by William J. Henderson, Postmaster General, Delivered at the National Postal Forum, San Antonio, Texas, May 17, 1999, accessed at <http://new.usps.com>.
4. Henderson, "Breaking Through To A New Golden Age Of Mail"
5. See, for example, the Postal Service's estimates in United States Postal Service, *United States Postal Service: Five-Year Strategic Plan, FY 1998-2002*, 1997. Also see U.S. General Accounting Office, *Postal Service Reform: Issues Relevant To Changing Restrictions On Private Letter Delivery* (Washington, DC: Government Printing Office, Sept. 1996), Appendix I, which cites a study that Price Waterhouse undertook for the Postal Service, in which Price Waterhouse developed estimates for the years 1996-2005.
6. U.S. General Accounting Office, Testimony by Bernard L. Ungar (Director, Government Business Operations Issues) before the House Subcommittee on the Postal Service, "U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century," October 21, 1999.
7. U.S. General Accounting Office, "U.S. Postal Service: Development And Inventory Of New Products," November 1998.