IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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September 30, 2002 **Advisory No. 136**

News of the Future, 20 years from now.
Dateline: Washington, Sept. 30, 2022.

POST OFFICE BUYS MALL OF AMERICA

Postmaster General for Life John E. Potter announced today that the United States Postal Service, the nation's largest retail and shipping conglomerate, has bought the Mall of America in Bloomington, Minnesota, for $5 billion.

"We had a store and branch office on the second level," said General Potter, "and we figured, hey, better to own than rent. We'll lease out the space we don't need to leverage the property. The current tenants want to stay, and we've had over 1,000 inquiries from area businesses for the four vacant stores on level three. The income will let us limit the next quarterly increase in first class postage. It'll go from $2.12 an ounce to $2.24, instead of $2.25."

"They made an offer we couldn't refuse," said Mall Board Chairman Donald Trump, Jr.

"No kidding," said Professor Sven Svensen of Minnesota University School of Business. "The Mall was paying income and property taxes. The Postal Service is tax exempt and can borrow dirt cheap. It offered the Mall a price that equals all the future net rental income and half of the tax savings. No wonder they grabbed it. The Postal Service will still be able to undercut every other landlord in the state."

To preserve their income, sales and property tax bases, Treasurers of the State of Minnesota and Hennepin County sought to block the takeover in state and federal courts. State Supreme Court Justice Vanessa Ventura ruled that she had no jurisdiction over the federally-owned USPS. Federal District Court Judge Benjamin P. Franklin ruled the takeover to be in accord with the Postal Service Transformation Act of 2003, stating succinctly: "Yes, sir, that's my baby." (The Judge is the former one term Congressman who authored the 2003 Act, his first and only major piece of legislation.)

The 2003 Act was based on suggested reforms contained in the 457 page *United States Postal Service Transformation Plan* submitted by Mr. Potter to Congress twenty years ago, on April 4, 2002. It recommended that the Postal Service move into new lines of products and services to "leverage" its assets and expand its way out of the red. It would operate as a Commercial Government Enterprise (CGE), retaining its tax exempt status and access to a federal line of credit. This suggestion was adopted in the Transformation Act. The Postal Service has expanded ever since.

The 2003 Act sought to give the Postal Service a new source of profit to support its mandated task of delivering mail to everyone in the country at a low uniform postage rate without an explicit on-budget federal subsidy. In practice, the Postal Service's outlays for expansion and a puzzling series of cost increases in the acquired businesses have kept it perpetually in the red since 2003, in spite of seventy-three subsequent rate hikes.

The Postal Service now sells most of the nation's clothing, appliances, food, autos, and package goods (liquor), and package delivery (mail) and e-mail services. Its obstetrics division delivered over a million babies in 2021. Federal, state and local revenues from private business income, sales and property taxes have plunged. On hearing of the Mall deal, former Secretary of the Treasury Paul O'Neill quipped, "That's one way to get rid of the corporate income tax." The revenue collapse has forced up rates on remaining taxpayers.

Speculation had been rife that the Postal Service was on the acquisition trail again since it floated $60 billion of ten year bonds last week. The issue was thrice over-subscribed at a precedent setting 25 basis points *below* comparable ten year Treasuries. When asked what he'll do with the remaining $55 billion from the bond issue, General Potter winked and hummed. Reporters present said it sounded like "I'll Take Manhattan, the Bronx and Staten Island Too." Rogers and Hart were right: "It's lovely going through the zoo."

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The above news flash is, of course, tongue-in-cheek. The subject matter, however, is serious. Is expansion into other product lines the answer to the Postal Service's problems? Or would a larger Postal Service merely spread its problems to a broader sector of the economy?

The key problem facing the Postal Service is that it is saddled with a public policy mandate requiring money-losing deliveries and other services to high cost neighborhoods, while having only limited legal ability or political backing to control labor costs, trim delivery services or consolidate post offices in a rational manner. It is also burdened with a seriously under-funded retirement program. The result is ever-escalating postal rates, which are beginning to annoy ordinary citizens and mass mailers, and may become a political problem for Congress.

The Postal Service believes that the situation cannot continue to escalate as in the past. It claims that it has dwindling room to raise prices without losing a lot of business to competing forms of communication (such as e-mail and computer voice services, telephony, and private delivery firms), threatening its ability to increase revenues. This competition is emerging in spite of the postal monopoly on ordinary mail delivery. The Transformation Plan suggests that, given the labor and productivity constraints facing the Service, it may become impossible to pay for the expenses of the mandate to serve high cost customers simply by raising the rates for other mail users. Its proposed solution is to be allowed to expand into other lines of business, with the same tax subsidies that it enjoys in its current restricted monopoly sphere. The Postal Service hopes that revenues from selling additional services would exceed costs and help to avoid future rate increases in its core business.

In fact, the recent postal rate increases have clearly raised revenue, and there is room to raise more revenue from further rate increases. Doing so would indeed be unpopular, but that does not justify expansion into other business lines as an alternative. Rather, it suggests that the Postal Service management be given greater power to rein in the costs associated with its current operations. If it had such power, it would not need to raise rates so high, nor expand into other areas. If it does not get that power, then costs would be as uncontrolled in the new product lines, and there would be no profit in them to help to hold down postal rates. Furthermore, its tax favored expansion would force more efficient competing private sector companies out of business, and cost federal, state and local governments billions of dollars in tax revenue.

Congressional restrictions on cost control take a huge bite out of the Postal Service's bottom line. The postal monopoly brings in huge amounts of revenue, but bloated staffs and thousands of under-utilized money-losing neighborhood post offices drain those revenues as fast as they come in. An efficiently managed private company would either reform or close down such money losing operations, and would stand up to uncompetitive compensation demands. The Postal Service management could do the same if Congress got out of its way, and if it were not saddled with a pushover arbitration process that too often winks at unreasonable compensation and work rule packages.

The Postal Service management would need more than power, however. It would need the same profit motivation that guides private sector management. Barring serious miscalculation, a privately-owned company invests only to the point at which additional investment can still yield a competitive market rate of return. If it over-invests, it will suffer financial embarrassment. It will be punished by its competitors, its income and share price will fall, and the market will force it into restructuring. Its management will fix its errors or be replaced, either by the board or by take-over by another firm.

Government owned businesses, however, are generally happy merely not to lose money. They push investment to the point where it barely breaks even, which is far beyond the point at which it earns a market return. This over-investment wastes resources, and there are no irate owners or shareholders, no board, and no potential outside buyers to put a stop to it.

Amtrak is a case in point. Amtrak's previous management, instead of contesting outdated Federal Railroad Administration requirements that rule out most foreign rail passenger equipment, simply went ahead with a unique new design for its high speed trains (the new Acelas) that not surprisingly are plagued with problems. In addition, it loaded up the new trains with "cutting edge" technology and designs that were so complex that the manufacturer warned against them, even though they meant a higher priced product.

Other examples of problematic behavior by government sponsored enterprises are the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation (Fannie Mae and Freddie Mac). These formerly federally-owned companies, which are viewed by the markets as having an implicit Treasury guarantee against failure and default, can attract credit more cheaply than competing firms. Using their access to below market interest rates, they have grown to dominate the secondary market for home mortgages. Indeed, they have gone further. They do not merely buy, package, and resell mortgages; they hold them, effectively becoming huge lending institutions. They borrow by issuing their own bonds and notes, and buy long term mortgages.

For years, Fannie and Freddie have not been subject to the same reporting requirements that the SEC has imposed on non-government-affiliated companies. The credit markets are now wondering if these two huge financial companies have been skillful and prudent in hedging their interest rate risks (as indeed they may have been). The current very low level of mortgage interest rates has led millions of homeowners to refinance, canceling old mortgages with high interest income for the lenders and replacing them with assets yielding a much lower return. Insofar as mortgage lenders issued non-callable bonds paying higher interest rates, they may find themselves in an interest rate squeeze, and may face liquidity problems. The markets want to know if Fannie and Freddie face such problems. If they were purely private companies, only the bondholders and shareholders would be exposed to loss. But with these government-sponsored enterprises, which may be "too big to fail", the taxpayers may be on the hook as well if something were to go wrong.

Encouraging the expansion of government owned or government sponsored enterprises is seldom necessary and seldom in the public interest. The Postal Service is no exception. The Postal Service is not losing money because of the market it is in, but rather, because of the government-imposed constraints on cost control and the lack of incentives created by government ownership. Privatization would be the best solution (if pension "legacy costs" and government service mandates were compensated for). The next best solution would be to relax Congressional restrictions on Postal Service operations and management that drive up costs, and require the management to aim for a normal return on invested capital. Letting the USPS expand its operations, with its current inefficiencies plastered over by means of hidden government subsidies, is not the answer.

Stephen J. Entin
President and Executive Director

Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.