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THE POSTAL SERVICE'S "TRANSFORMATION PLAN" ATTACKS A STRAW MAN; THE AGENCY NEEDS BETTER COST MANAGEMENT, NOT A NEW BUSINESS MODEL

Executive Summary

In the "Transformation Plan" it issued in April 2002, the Postal Service's leadership claims that the organization is racing towards financial disaster under its current legal-regulatory framework. To rescue the organization from what it calls the "government agency" model, the "Transformation Plan" insists that the Postal Service needs new powers to alter postal rates and to expand into markets outside its monopoly that are served by private-sector businesses. It dubs this the "government enterprise" model. The "government agency" model, however, is a straw man. It describes fairly well the old Post Office Department prior to the Postal Reform Act of 1970. Over the period 1950-1970, the Post Office Department's deficits (before Congressional appropriations) averaged 22.8% of revenues. But the 1970 legislation enacted many positive reforms, and over the period 1980-2002, with the reforms in place, the Postal Service's deficits (before Congressional appropriations) declined by an order of magnitude and averaged just 2.1% of revenues. While this would be financially disastrous for a private-sector business, it is exceptionally good for a government-owned and run entity. The Postal Service's claim that the current system is about to revert to the bad old days is unrealistic and alarmist.

Regulatory oversight in current law, about which the Postal Service has long complained, is there because the organization has many government-granted powers that could be abused, among them the postal monopoly, an array of tax exemptions, and low-cost credit from the U.S. Treasury. By relaxing regulatory oversight while letting the Postal Service retain most of its special powers, the "government enterprise" model would threaten consumers within the postal monopoly, taxpayers, and the owners and employees of private-sector businesses. The hidden subsidies that the Postal Service receives from its government-based privileges would soar as it broadened the scope of its operations.

Privatization — private ownership and the end of special privileges — would be the best choice economically. If that is rejected for political reasons, the next best choice would be to focus on reducing costs and lifting productivity. The Postal Service's deficits are mainly due to its high costs. Although the Postal Service has recently used better cost management to narrow its deficit, it views this mainly as a near-term fix. The "Transformation Plan" does not include a scenario in which the Postal Service could meet its breakeven target in the short run and the long run through improved cost management. The recently formed Presidential Commission on the U.S. Postal Service should correct this omission when it issues its recommendations later this year.

In the "Transformation Plan" it issued in April 2002, the U.S. Postal Service offers three legal-regulatory models for the Postal Service of the future.¹ One is a privatized corporation. Another is a revised legal-regulatory framework that would give the Postal Service new powers. Under this framework, the government-owned enterprise could set prices with less regulatory oversight and expand more aggressively in markets that are already served by private-sector businesses, while remaining part of the government and keeping many of its government-based privileges (e.g., some form of the postal monopoly, access to credit at the U.S. Treasury, exemptions from most taxes, an implicit government guarantee against bankruptcy, etc.). The Postal Service dubs this the "commercial government enterprise" model and recommends it enthusiastically. A third option, into which the current system will supposedly degenerate if the organization does not receive the new powers, is the "government agency" model. The Postal Service warns that the "government agency" model would suffer from mounting deficits and deteriorating services.

In arguing for greater authority to change postal rates and expand, however, the Postal Service has mischaracterized the consequences of retaining the current system. Its "government agency" model is essentially a straw man that makes almost any alternative look good in comparison, including the model the Postal Service favors.

If the current legal-regulatory framework would actually lead to the dire results that the "Transformation Plan" prophesies, change would seem imperative, and the Postal Service's recommended framework might look like an improvement. But when the current system is assessed realistically, it is found to be sustainable and the Postal Service's favored model appears neither necessary nor desirable. To be sure, the present framework could be improved, but the key is better management of costs, not granting the Postal Service greater power.

The recently appointed presidential advisory commission on postal reform will be studying the

"Transformation Plan", along with much other information about the Postal Service. The commission will be more likely to deliver sound and useful advice if it recognizes that the plan's "government agency" model falsely portrays the consequences of retaining the current legal-regulatory framework.

The Postal Service's warning. The Postal Service argues in its "Transformation Plan" that while its current legal-regulatory system was initially successful, it is now thoroughly outmoded:

The Postal Reorganization Act of 1970 (PRA) [which converted the old U.S. Post Office Department into the U.S. Postal Service] succeeded. It created an independent governmental entity well designed to deliver postal services in a more businesslike manner... [But it cannot] cope with the fundamental changes that are today reshaping the delivery services marketplace. In the long term ... fundamental restructuring of the legislative and regulatory framework for postal services is required.²

According to this scenario, current limits on pricing and expansion must soon be loosened or the organization will quickly deteriorate, harming both postal customers and taxpayers. If the attempt is made to retain the present framework:

[T]he nation would abandon the businesslike experiment begun by the PRA and retreat to a more standard government model... The Postal Service might offer a stripped-down menu of products and services... It appears certain that, as before the PRA, the Government Agency ... would be unable to fund public services entirely through postal revenues. The government would need to directly underwrite this shortfall. Over time ... the subsidy burden on the taxpayer could be expected to intensify under this model, a trend which would increase the pressure on traditional levels of service and access.³

The "Transformation Plan" later repeats its warning of impending disaster under the current framework:

The overall policy goal would simply be to keep the "deliverer of last resort" afloat, likely with government subsidies. Many stakeholders have indicated that the prospect of today's Postal Service degrading into a Government Agency is unappealing.⁴

Praise for the "commercial government enterprise" model. In contrast, the Postal Service describes the proposal it advocates as "a middle ground"⁵, "a new and modern business model"⁶, and a way to help customers while simultaneously being self-financing. The "Transformation Plan" declares:

"Postal Service leadership has concluded that ... a Commercial Government Enterprise offers the best hope for transforming the Postal Service into an enterprise equipped to maintain universal service at affordable prices in the economy of the 21st century.⁷

The straw man. According to the "government agency" model, the Postal Service's current legal-regulatory framework will soon result in enormous deficits. In reality, the Postal Reform Act of 1970 generated dramatic, lasting improvements in the Postal Service's finances and level of service. The "government agency" model ignores the still-in-place reforms that made those gains possible.

Prior to the reform legislation, the old Post Office Department closely resembled the financially dysfunctional entity described in the "government agency" model. Over the period 1950-1970, which preceded the reforms, the Post Office Department's deficits (before congressionally appropriated subsidies) averaged 22.8% of its revenues.⁸ In contrast, over the period 1980-2002, which followed the reforms, the Postal Service's deficits (before congressionally appropriated subsidies) were reduced by an order of magnitude; they averaged just 2.1% of revenues.⁹

Before the reform legislation, the Post Office Department was a huge patronage machine, which handed out on a political basis postmasterships and thousands of other jobs. Now, workers are supposed to be hired because they can do the job. Under the old law, it was Congress's responsibility to raise postal rates, and Congress often found it less politically painful to approve massive cash subsidies than to go on record voting for higher postal rates. Now, an independent, experienced federal regulatory agency, the Postal Rate Commission, rules on postal rate requests and does not keep rates artificially low for political reasons. Moreover, before the 1970 reform act, postal managers lacked the tools or the legislative directive to aim for a financial breakeven target. Now, the law directs them to try to break even, and while postal managers have fewer tools than their private-sector counterparts, they have more than they did under the old system.

As long as these reforms are in place, the Postal Service can avoid the huge deficits that were the norm for the old Post Office Department. Because these reforms are part of the current framework, the warning in the "Transformation Plan" that the current system is about to revert to the bad old days is unrealistic and alarmist.

Kernels of truth. On first glance, the straw-man interpretation of the current system may give the illusion of being plausible because it contains two kernels of truth. It is true that the Postal Service is, in effect, a government agency. (Technically, it is called "an independent establishment of the executive branch" of the federal government.¹⁰) It is also true that although the Postal Service operates in a far more businesslike fashion than most of the government, its financial performance would be unacceptably poor if it were a private-sector business and would have landed it in bankruptcy court long ago.

But these weaknesses do not mean the "government agency" model, with its mushrooming deficits and deteriorating service, is correct. Again, the "Transformation Plan" advanced by the Postal Service's leaders errs in assuming that if the current

legal-regulatory framework — which has produced much improvement — remains in force, the Postal Service's bottom line will quickly revert to how it looked before the current framework was enacted.

The Postal Service would still be a government agency under the "commercial government enterprise" model. If one wants to describe the current Postal Service as a government agency, the same could also be said if the organization became a "commercial government enterprise". The reason is that the proposed entity would remain part of the federal government and keep many of its government-derived burdens and privileges. (Alternatively, the current organization could be called a commercial government enterprise in that it is directed by current law to try to break even and to base its decisions in part on businesslike principles.)

In other words, the difference between the current and proposed entities is not that one would be a government agency and the other something else, but that the government agency/commercial government enterprise advocated by the Postal Service's leaders would be bigger and subject to less regulatory control than the current one.

Why not just give the Postal Service the added powers it seeks? From several perspectives, the proposed increases in size and power are worrisome, rather than advantages. As the government agency/enterprise grew, it would take business away from more efficient private-sector producers, reducing the economy's overall efficiency. In expanding in competitive markets, it would be using its governmental advantages (tax exemptions, cheap credit due to *de facto* federal backing, exemption from motor vehicle licensing fees, etc.) to compete unfairly against private-sector companies that must shoulder those responsibilities.

Nor would being bigger (it is already huge) protect it from losing money. Throughout the world, large government agencies/enterprises routinely suffer enormous losses. If bigger truly were better, the old communist empire with its immense state-owned enterprises would have buried the West by now, instead of performing so poorly

that it collapsed of its own weight. The Postal Service's naive assumption that additional products would let it make money should be replaced by the recognition that more products would give it more opportunities to lose money.

Those bigger losses would threaten both postal customers and taxpayers. The customers most at risk of having to make up for expansion-generated losses are those within the postal monopoly, because they are the individuals and businesses least able to go elsewhere when postal rates increase. Furthermore, while it is true that the Postal Service could help its bottom line if rate regulation were looser and it could more easily push up rates for consumers within its monopoly, that would violate its core mission of working to keep those rates low.

In sum, Congress had many good reasons for limiting the power of an entity that is part of the government and that possesses a huge government-granted monopoly and numerous other government-based favors. Those reasons are still valid today.

There would still be (hidden) subsidies — probably larger than before. When the Postal Service says it wants to avoid government subsidies, it defines subsidies narrowly to mean only direct cash subsidies legislated each year as part of the federal budget. In common usage, though, most people define government subsidies more broadly to mean special government rules that favor one individual, organization, or group over others. The Postal Service is not volunteering to forgo its indirect subsidies. Indeed, the actions the Postal Service would like to take as a "commercial government enterprise" would expand these indirect subsidies enormously.

Consider just four of the very valuable hidden subsidies.¹¹ As a federal entity, it is exempt from paying local property taxes on the billions of dollars of land, buildings, and equipment it owns. It never has to collect and remit sales taxes to lower levels of government on the products it sells. It avoids state motor vehicle licensing requirements and registration fees because it is a federal entity. When it borrows, it pays interest at a preferential government-related rate, instead of the much higher

interest rate that a private-sector company in its financial condition would have to pay. These hidden subsidies are worth, at a minimum, hundreds of millions of dollars annually. (Of course, its most valuable subsidy is that, thanks to federal law, it monopolizes the market for non-urgent letter delivery.)

These subsidies would not go away under a "commercial government enterprise" model, unless the enabling legislation specifically limited them. To the contrary, if the Postal Service expanded, most of its hidden subsidies would increase as the organization had more sales, acquired more property, and borrowed more. In particular, insofar as its expansion took business away from private-sector firms that now pay federal, state, and local taxes, those tax receipts would be lost, constituting an open-ended, hidden subsidy to the Postal Service from taxpayers at all levels of government throughout the country.

A missed opportunity: the model that should be in the "Transformation Plan" but is not. The Postal Service's leaders claim that their recommended model "carries the businesslike transition initiated by the PRA to the next level".¹² In truth, better cost control is what the Postal Service most needs if it is to become more businesslike.

Since 2001, the Postal Service has worked especially hard to prune its costs. The result was a smaller loss in 2002 than many had expected. That effort was highlighted in the April 2002 "Transformation Plan", which said that the Postal Service would begin addressing its financial problems in the short run through better cost management. For the medium- and long-runs, however, the "Transformation Plan" shifts the emphasis from cutting costs to expansion and rate setting. That is a mistake. Cost management will

be most successful if it is a top priority all the time, instead of being brought to the fore as a temporary fix.

The "Transformation Plan" should have included a model that focused on how the Postal Service could meet its breakeven target through improved cost management in the short run **and** the long run, within the current scope of operations. One of the most useful features of such a model would be highlighting areas where the Postal Service knows how to reduce its expenditures and improve its productivity but is prevented from doing so by Congressional directives in current law. Relaxing some of those directives is the best way Congress could help the Postal Service bring its financial house into better order.

Conclusion. The most effective reform to make the Postal Service more businesslike would be to privatize the organization, and to cancel its special privileges in order to put it on an equal footing with other private businesses. If that is rejected for political reasons, the next best choice would be for the organization to focus on reducing its costs and lifting its productivity. Regrettably, the "Transformation Plan" fails to include a business model based on improved cost control. The recently formed Presidential Commission on the U.S. Postal Service should correct this omission when it issues its recommendations later this year. Contrary to assertions in the Postal Service's "Transformation Plan", the current legal-regulatory framework is viable if it is complemented by better cost management. The "Transformation Plan's" supposed solution of expansion and increased rate-setting powers would create new problems while failing to force the organization to act more like a true business.

Michael Schuyler
Senior Economist

Endnotes

1. United States Postal Service, United States Postal Service Transformation Plan, April 2002, accessed on the Internet at <http://www.usps.com/strategicdirection/transform.htm>.
2. *Ibid.*, p. i-ii.
3. *Ibid.*, p. viii.
4. *Ibid.*, p. 60.
5. *Ibid.*, p. iii.
6. *Ibid.*, p. 76.
7. *Ibid.*, p. 71.
8. U.S. Post Office Department, *Annual Report Of The Postmaster General*, various issues.
9. U.S. Postal Service, *Annual Report*, various issues. The old Post Office Department computed its deficits without counting Congressional appropriations in revenues. For consistency, the Postal Services deficits are reported here on the same basis. That is, the Postal Service's deficits before appropriations are measured relative to its revenues before appropriations. This differs from how the Postal Service reports deficits in its financial statements. The Postal Service includes Congressional appropriations in revenues before computing its deficits. With Congressional appropriations included in revenues, the Postal Service's deficits over the period 1980-2002 averaged 0.3% of revenues.
10. 39 USC, Sec. 201.
11. For rough estimates of the dollar magnitude of several of the Postal Service's hidden subsidies, see Michael Schuyler, *The Anti-Competitive Edge: Government Subsidies To Government Businesses: Case Studies Of The Postal Service, TVA, And Amtrak*, IRET Fiscal Issues, No. 11 (Washington, DC: Institute For Research On The Economics Of Taxation, 1999).
12. *Transformation Plan, op. cit.*, p. viii.