

# IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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## **POSTAL SERVICE'S IMMUNITY FROM ANTITRUST LAWS SHOULD BE RESTRICTED**

### *Executive Summary*

The Supreme Court ruled unanimously this year that the U.S. Postal Service cannot be sued for alleged violations of the antitrust laws (U.S. Postal Service v. Flamingo Industries).

The Postal Service's antitrust immunity is sweeping. It is not confined to the agency's core market, which is sheltered from competition by Congressionally authorized dual monopolies on non-urgent letter delivery and mailbox access, but applies also to the billions of dollars of business the Postal Service does in other markets, where it faces direct competition from private-sector businesses.

The Supreme Court did not pass any judgement on the Postal Service's conduct, on how the Service's conduct affects others in the economy, or on the costs and benefits of the antitrust laws. The Court based its decision on sovereign immunity. According to the Court, the Postal Service's character as a federal government entity provides it absolute immunity from the antitrust laws, unless Congress explicitly waives its government-based exemption from the antitrust laws.

Incentives within government agencies favor expansion, and anticompetitive behavior may be used to support expansion efforts. A particular concern with regard to the Postal Service is that it will attempt to further its expansion ambitions in competitive markets by exploiting the power it derives from its huge monopoly market and from its governmental privileges.

If the Postal Service behaves anticompetitively, its conduct could harm customers within the postal monopoly, taxpayers, the owners and employees of private-sector businesses, government finances, and economic productivity.

Wise public policy calls for reining in the Postal Service's antitrust-law exemption. Congress should pass legislation explicitly removing the Service's antitrust immunity, except on the agency's core activities as delineated by its dual monopolies.

## **POSTAL SERVICE'S IMMUNITY FROM ANTITRUST LAWS SHOULD BE RESTRICTED**

The Supreme Court recently ruled unanimously that the U.S. Postal Service cannot be sued for antitrust violations under the Sherman Act (U.S. Postal Service v. Flamingo Industries)<sup>1</sup>. This reversed a decision by the U.S. Ninth Circuit Court of Appeals that the Postal Service possesses antitrust immunity only when its conduct reflects directives from Congress.<sup>2</sup>

The Supreme Court based its decision on the finding that the Postal Service is a federal government entity. As evidence that the Postal Service is an integral part of the federal government, the Court cited the Postal Service's legal status as an enterprise within the federal government's executive branch, traced the agency's governmental lineage back to Revolutionary War days, and mentioned some of the Service's governmental powers and limitations. The Supreme Court coupled this finding with its judgement that the federal government has sovereign immunity from antitrust liability unless Congress explicitly waives its antitrust exemption.

Although the Postal Reorganization Act of 1970 (PRA) does take away the Postal Service's sovereign immunity to some extent by saying it can "sue and be sued in its official name,"<sup>3</sup> the Supreme Court held, in deference to the Postal Service's governmental status, that a more specific waiver would be needed before the Service could be sued under the antitrust laws. Noting that the Postal Reorganization Act "makes no mention of the Sherman Act or the antitrust laws," the Court concluded that the Postal Service's sovereign immunity from the antitrust laws is intact. The Court wrote, "[A]bsent an express statement from Congress that the Postal Service can be sued for antitrust violations ... the PRA does not subject the Postal Service to antitrust liability."<sup>4</sup>

To be clear, the Supreme Court did not pass any judgement on the Postal Service's conduct, on how the Service's conduct affects others in the economy,

or on the costs and benefits of the antitrust laws. The Court's decision with regard to the Postal Service and the antitrust laws was, in essence, that you cannot sue City Hall unless City Hall gives you permission to do so. A corollary is that if legislation should be enacted in the future explicitly saying that the Postal Service is subject to the antitrust laws, then the government enterprise could be taken to court if it engages in anticompetitive behavior.

### **A very broad waiver.**

The Postal Service possesses government-granted monopolies on the delivery of non-urgent letters to homes and businesses and on access to mailboxes. These dual monopolies give the Postal Service a protected, core market consisting of the delivery of non-urgent letters and periodicals. It would not make sense for Congress to write laws that restrict competition for these core products, thereby handing the Postal Service a huge sheltered market, and then hold the Postal Service liable for the resulting lack of competition.

However, the antitrust exemption claimed by the Postal Service and affirmed by the Supreme Court is sweeping: it applies to *all* Postal Service products and activities, not just those within its core market. Thus, on express mail, packages, mail box rentals, money transfers, e-mail "postmarks", a magazine subscription service, and the other competitive-market products the government agency currently offers, its competitors, suppliers, and other interested parties can seek no redress under the antitrust laws if the Postal Service behaves anticompetitively. Nor would the antitrust laws apply to products the Postal Service may introduce in the future.

### **Economic implications.**

An earlier paper in this series, issued before the Court heard the Flamingo Industries case, provided an economic analysis, without attempting to predict

how the Supreme Court would rule.<sup>5</sup> The study explained that economic efficiency and fairness will be improved if the antitrust laws apply to the Postal Service's commercial activities, although an exception would obviously be necessary for those anticompetitive activities that Congress has authorized via the Postal Service's dual monopolies.

***Incentives within government enterprises often encourage anticompetitive behavior.*** While one would hope that government enterprises would always act transparently and in the public interest and never abuse their governmental powers, their actual performance often falls short of those standards. People within government organizations have strong bureaucratic incentives to favor expansion and to suppress competition. When a government agency enlarges its reach, those within the agency are typically rewarded with greater power, prestige, and more opportunities for advancement. Meanwhile, the risks and burdens that a government agency generates when it expands are largely shifted to others outside the agency: captive consumers if the enterprise has a monopoly market, taxpayers, and those in the private sector competing against the enterprise outside its monopoly. Using a formal economic model to compare how incentive differences between private-sector companies and government enterprises lead to differences in behavior, researchers David Sappington and J. Gregory Sidak reached a similar conclusion, namely that "public enterprises may have stronger incentives to engage in anticompetitive practices and circumvent antitrust laws than their private counterparts..."<sup>6</sup>

A government enterprise can behave anticompetitively in many ways. One technique, which involves leveraging the power derived from a monopoly market, is to tie the quality of service for customers within the monopoly market to what the customers buy from the agency in competitive markets.

Another way to leverage monopoly power is to tie the prices of monopoly market products to purchases of competitive market products. The Postal Service hinted at this possibility in its April

2002 *Transformation Plan*. The agency said that "one of the initiatives likely to be considered" if it is eventually given more price-setting discretion would be to "[d]evelop a bundling price for mailers who use multiple postal products or services."<sup>7</sup> Although the Service did not specify exactly how "bundle pricing" would operate and apparently regards it as an acceptable strategy to pursue if it receives more pricing flexibility, bundling could easily result in anticompetitive behavior. Bundling would reduce competition if the Postal Service offers monopoly-market customers lower prices on the condition that they buy more from the agency, and less from private-sector businesses, in competitive markets.

Another type of anticompetitive behavior is deliberately pricing below cost in order to expand and take business away from competitors. It is ironic that although private-sector companies with market power are sometimes accused of trying to stifle competition through predatory pricing, pricing below cost is actually more of a threat at government enterprises. In the private sector, businesses do not want to sell products at a loss because that diminishes their profits. At a government enterprise, in contrast, selling some products at a loss to fuel expansion is bureaucratically attractive, provided the agency can achieve a politically acceptable bottom line (which usually means breaking even or not running too large a deficit). If a government-owned enterprise possesses a statutory monopoly and also operates in competitive markets, there will be a strong temptation to charge higher prices to customers within the monopoly market and use the extra income to cover losses in other markets, that is, use cross subsidies from the statutory monopoly to support the dumping of goods in competitive markets.

Sappington and Sidak provide an example of such anticompetitive behavior by a government enterprise in a second paper. They cite the case of "Deutsche Post AG, the German postal monopoly now undergoing privatization."<sup>8</sup> In 2001, following an investigation, the European Commission found that Deutsche Post had acted illegally by charging below-cost prices for products in its commercial parcel business, where it sought to dominate the

market, and by using profits from its government monopoly on letter mail as cross-subsidies to cover the losses. (Another sobering lesson from the Deutsche Post experience is that great care must be taken if a government enterprise is gradually and partially privatized lest it misuse the government subsidies and powers that it retains. The threat is especially great because partial privatization is often accompanied by looser regulatory oversight.<sup>9</sup>) Unlike Deutsche Post, of course, the U.S. Postal Service does not have to worry under current law about being taken to court on charges of behaving anticompetitively.

The U.S. Postal Service frequently forms strategic alliances with private-sector firms. As the law now stands, the Service could orchestrate a conspiracy in restraint of trade without any fear of the antitrust laws due to its sovereign immunity (although it is conceivable that some of its private-sector allies could face charges.)

***Anticompetitive behavior is harmful.*** If the Postal Service behaves anticompetitively in order to expand, it will injure many different groups. Customers within the Postal Service's core monopoly market will be hurt if they are forced to support money-losing competitive-market products through cross-subsidies. Taxpayers are threatened because they may have to pay for a government bailout if the losses become big enough. Anticompetitive behavior is unfair to the owners and employees of the private-sector businesses that the government entity seeks to displace. Small businesses are especially vulnerable when the Postal Service flexes its muscles because they often lack the resources to withstand an onslaught from the government. In addition, if the Postal Service behaves anticompetitively in order to support and enlarge its competitive-market operations, that will hurt the economy because government production tends to be less efficient than private-sector production. Further, because of the Postal Service's multiplicity of tax exemptions, its competitive market operations reduce tax revenues at the federal, state, and local levels, with the result that governments must raise taxes elsewhere, cut spending elsewhere, or borrow more.

There is another reason for stripping the Postal Service of its sweeping antitrust immunity. When an organization has to comply with the antitrust laws and must try to avoid anticompetitive activities, that effort instills a discipline for honorable dealing in commercial activities that adds economic value.

***Should government enterprises be exempted from the antitrust laws because compliance is costly?*** The argument is sometimes made that the Postal Service should be exempt from the antitrust laws because they are too burdensome. Many in the private sector would agree that the antitrust laws are overly burdensome and that excessively aggressive antitrust litigators often perceive monopolies and restraints of trade where none exist. However, the appropriate remedy for these problems is to reform the antitrust laws, not to give government enterprises blanket exemptions while continuing to apply flawed laws with full force to private-sector producers.

#### **A huge enterprise.**

Are the Postal Service's competitive-market operations large enough to worry about? The answer is yes. The Postal Service is an enormous organization. Although most of its revenues and an even larger share of contributions to overhead are from its protected market, it does billions of dollars of business every year in competitive markets. If the Service were a private company, the revenues of its competitive-market operations would, by themselves, place it midway on the list of the nation's 500 largest corporations, exceeding the revenues of such companies as Campbell Soup, Amazon.com, and Charles Schwab. Moreover, in public statements and documents like its *Transformation Plan*, the Service's leaders have frequently declared that they want to deepen their involvement in competitive markets.<sup>10</sup>

#### **The Postal Rate Commission.**

To be sure, the Postal Service's ability to engage in anticompetitive behavior is reduced because the agency must go through a regulator, the Postal Rate Commission (PRC), when setting prices. Indeed, the

Supreme Court mentioned the role of the PRC as an example of how the Postal Service differs from private-sector businesses. The PRC could offer better protection against cross-subsidization, though, if the Postal Service's cost accounting were more transparent and were subject to independent verification. At present, for instance, the Service attributes only about 60% of its costs to products while claiming the other 40% or so is for overhead. The low rate of attribution to products raises questions about whether the Service is measuring product costs accurately and whether there are inter-product subsidies hidden in the approximately \$25 billion of yearly costs that the Service lists as overhead. Moreover, the Postal Service has long argued that it should be able to change rates without first seeking the PRC's approval. If the Postal Service gains this authority, and the Service has considerable support in Congress for what it dubs "pricing flexibility" or "streamlined rate setting", the PRC's ability to block anticompetitive behavior would be reduced.

Writing for the Court, Justice Kennedy noted that the Postal Service operates some nonpostal lines of business on which it sets prices without requesting PRC approval. Their presence did not alter the Court's opinion, however, which was based on the Postal Service's governmental status. Justice Kennedy mentioned in passing that on its nonpostal products the Service "may seek profits to offset losses in the postal business." In reality, though, the usual pattern is just the opposite. The agency's nonpostal lines have generally performed dreadfully, with the result that the agency has frequently used income from its monopoly business to offset losses on nonpostal products.

### **Recommendations.**

The Supreme Court has delivered a forceful reminder that the Postal Service is not a normal business; it is a government institution. Under current law it is also entirely beyond the reach of the antitrust laws. Two public policy recommendations follow from the Court's decision.

- ***Congress should pass legislation explicitly removing the Service's antitrust immunity, except on the agency's core activities as delineated by its dual monopolies.***<sup>11</sup> If the Postal Service remains in competitive markets, its behavior there should be subject to the antitrust laws. The Postal Service's status as a government institution does not alter the fact that it will cause economic harm if it engages in anticompetitive behavior.

- ***Congress should pass legislation requiring the Postal Service to focus on its core market, that is, its governmental function.*** As the Supreme Court pointed out, the Postal Service is a government institution. Government enterprises in this country and throughout the world have shown themselves to be costly, inefficient, and poor at responding to consumers' preferences compared to private-sector businesses. A nation's economy is best served when government enterprises are few, are confined to their core missions, and are not allowed to go on fishing expeditions elsewhere in the economy. At a minimum, Congress should prohibit the Postal Service from launching new forays in the future in competitive markets. It would be even better if Congress also orders the Postal Service to wind down some of its current, non-core activities in competitive markets.

### **Conclusion.**

If the Postal Service remains wholly beyond the reach of antitrust law, it will have a major advantage in competitive markets that it can misuse in ways harmful to the public. Wise public policy calls for reining in the Service's antitrust-law exemption. Given the Postal Service's governmental character, which the Supreme Court's highlighted in its decision, the agency's extensive operations in markets where aggressive private-sector competition exists should also ring alarm bells. Government entities can cause much damage when they stray beyond their core missions.

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## *Endnotes*

1. United States Postal Service v. Flamingo Industries (USA) Ltd. et al., Supreme Court of the United States, Case No. 02-1290, decided February 25, 2004, accessed on the Internet at <http://supremecourtus.gov/opinions/03pdf/02-1290.pdf>.
2. Flamingo Industries (USA) Ltd. And Arthur Wah v. United States Postal Service, U.S. Court of Appeals for The Ninth Circuit, Case No. 01-15963, 2002, accessed on the Internet at [http://www.ca9.uscourts.gov/ca9/newopinions.nsf/d971661c3ce8df6488256c1e00030fef/\\$file/0115963.pdf?openelement](http://www.ca9.uscourts.gov/ca9/newopinions.nsf/d971661c3ce8df6488256c1e00030fef/$file/0115963.pdf?openelement).
3. Public Law 91-375, Sec. 401, August 12, 1970.
4. Supreme Court, Flamingo Industries Decision.
5. See Michael Schuyler, "Antitrust Law And The Postal Service," *IRET Congressional Advisory*, No. 159, August 25, 2003, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-159.PDF>. Although the paper emphasized antitrust, it examined several other areas where economic efficiency and fairness would also be improved if the Postal Service can be taken to court should it violate rules of proper conduct. For example, the Postal Service should always obey truth-in-advertising laws so that consumers can make informed choices about what products best suit their needs. Congress should make clear that normal truth-in-advertising laws apply to all the agency's products, including those within its monopoly.
6. David E. M. Sappington and J. Gregory Sidak, "Incentives for Anticompetitive Behavior by Public Enterprises," *Review of Industrial Organization*, vol. 22, pp. 183–206, 2003, accessed on the Internet via [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=269489](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=269489). This paper is also valuable because it provides references to earlier economic studies examining incentives within government agencies and departments and how those incentives often conflict with the public interest.
7. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. L15, accessed on the Internet at <http://www.usps.com/strategicdirection/transform.htm>.
8. David E. M. Sappington and J. Gregory Sidak, "Competition Law for State-Owned Enterprises," *Antitrust Law Journal*, vol. 71, 2003, pp. 479-523, accessed on the Internet via [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=357720](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=357720).
9. The Deutsche Post problem was explored in Michael Schuyler and Stephen J. Entin, "Government-Sponsored Enterprises Are A Global Problem," *IRET Congressional Advisory*, No. 113, April 5, 2001, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-113.PDF>. For another example of the pitfalls of a partial privatization that loosens regulatory oversight of an enterprise's activities while letting it keep some of its government subsidies and powers, consider the mortgage giants Fannie Mae and Freddie Mac, both of which are government sponsored enterprises. Because credit markets are convinced that Fannie and Freddie enjoy an implicit Federal guarantee against default, the companies can borrow virtually unlimited amounts at only slightly above the Treasury interest rate. This interest-rate subsidy, which the U.S. Congressional Budget Office estimates had a gross value of about \$20 billion in 2003 alone, has enabled them to dominate the secondary residential mortgage market in the United States. The enterprises receive additional government support because they are exempt from some of the regulations that normal private-sector businesses must obey and also enjoy some tax exemptions. Fannie and Freddie have grown so big and are so highly leveraged that, according to Federal Reserve Chairman Alan Greenspan, they pose a "systemic risk" to U.S. financial markets. (See Congressional Budget Office, "Letter to the Honorable Richard C. Shelby Regarding Updated Estimates Of The Subsidies To The Housing GSEs," April 8, 2004, accessed on the Internet at <ftp://ftp.cbo.gov/53xx/doc5368/04-08-GSE.pdf>; and Alan Greenspan, Chairman, Federal Reserve Board, "Government-Sponsored Enterprises," Testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, February 24, 2004, accessed on the Internet at <http://www.federalreserve.gov/boarddocs/testimony/2004/20040224/default.htm>.)
10. An earlier paper in this series discussed those efforts. See Michael Schuyler, "Empire Building At The Postal Service," *IRET Policy Bulletin*, No. 87, May 19, 2003, available on the Internet at <ftp://ftp.iret.org/pub/BLTN-87.PDF>.
11. If one is truly concerned about the ill effects of anticompetitive behavior, it would make sense to trim or eliminate the Postal Service's government-granted monopolies. However, there is currently little sentiment in Congress or the Administration for bold action on that front.