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## **LEGISLATIVE PROPOSALS WOULD MODESTLY TRIM SOME HIDDEN GOVERNMENT SUBSIDIES TO POSTAL SERVICE**

### *Executive Summary*

Because the Postal Service is a government enterprise, it escapes many government-imposed taxes and fees that private-sector businesses must pay and possesses various other governmental powers.

Bills fundamentally changing the laws governing the Postal Service have received unanimous committee approval and been sent to the House and Senate floors (H.R. 4341 and S. 2468). The bills, which have many similarities and some differences, would curtail several of the agency's government-based privileges, particularly in competitive markets beyond the postal monopoly.

The government agency has ventured into many competitive markets, some of which are unrelated to traditional mail service, and has often sought to expand further in competitive markets.

The Postal Service's indirect government subsidies are a drain on government finances, let the Service ignore some socially worthwhile rules of conduct, reduce the economy's efficiency, undercut competition, and lack transparency.

Some of the bills' proposals in this area are to: place an internal charge (misleadingly called an "assumed" federal income tax) on the agency's competitive products; limit the Postal Service's exemption from the antitrust laws and remove its exemption from truth-in-advertising laws; limit its current exemption from zoning laws; and order a study by the Federal Trade Commission to examine remaining indirect government subsidies in the competitive products category.

These proposed reforms would be worthwhile, but they are modest in terms of the Postal Service's current array of indirect government subsidies.

Many additional improvements would be possible. For instance, neither bill touches the Postal Service's exemptions from state and local income taxes, property taxes on its multi-billion-dollar property portfolio, sales taxes on its products, or state motor vehicle fees.

One provision that seeks to limit the Postal Service's subsidized borrowing would likely backfire and is examined in an upcoming paper. Unless that provision is fixed, it could encourage continued Postal Service overexpansion in competitive markets via subsidized interest rates.

## LEGISLATIVE PROPOSALS WOULD MODESTLY TRIM SOME HIDDEN GOVERNMENT SUBSIDIES TO POSTAL SERVICE

This year, legislation has been advancing in Congress that would for the first time in almost 35 years fundamentally change the legal framework under which the Postal Service operates. On May 12, the House Committee on Government Reform unanimously approved and sent to the House floor H.R. 4341, "The Postal Accountability and Enhancement Act", which was primarily developed by Rep. John McHugh (R-NY). On June 2, the Senate Committee on Governmental Affairs unanimously reported out S. 2468, a bill with many similarities but some significant differences, which was introduced by Sen. Susan Collins (R-ME) and Sen. Thomas Carper (D-DE).

The bills are complicated and raise many issues. An earlier IRET study examined whether H.R. 4341 and S. 2468 would reduce statutory and political barriers to better cost management so that the Postal Service could achieve real cost savings.<sup>1</sup> The study's conclusion was that, disappointingly, the bills would do little to assist the agency in lowering its high costs through greater efficiency.

This paper begins to look at how the bills would handle the array of exemptions and powers that act as hidden government subsidies to the Postal Service.<sup>2</sup> The general finding here is that several of the bills' provisions are modestly encouraging, in that they would scale back, although by no means eliminate, the agency's government-based advantages in competitive markets. They are small steps in the right direction.

However, one provision that seeks to limit the Postal Service's subsidized borrowing would likely backfire. It will be examined in an upcoming paper. Unless that provision is fixed, it could facilitate continued Postal Service overexpansion in competitive markets via subsidized interest rates.

***A government agency that has expanded beyond its government mission.*** A key fact about the Postal Service is that it is part of the federal government.

The Postal Reorganization Act of 1970 says in grandiloquent language that the "Postal Service shall be operated as a basic and fundamental service provided to the People by the Government of the United States," and, more technically, that it is "an independent establishment of the executive branch of the Government."<sup>3</sup>

The Postal Service's core mission is the physical delivery of non-urgent letters and periodicals. Congress has reserved that market for the government agency by granting it a monopoly on non-urgent letter delivery, and reinforced that exclusivity by giving the Postal Service a monopoly on access to home and business mailboxes.

Because the Postal Service is a government enterprise, it escapes many of the government-imposed taxes and fees that private-sector businesses must pay and possesses various governmental powers that are unavailable to private firms and individuals.

If the Postal Service stuck to its core public service mission, its array of government-based privileges would probably draw little attention. For example, no one is particularly disturbed that the U.S. Air Force does not pay the same taxes and fees on its aircraft and fuel that commercial airlines pay on theirs. The story would change dramatically, however, if the Air Force stepped beyond its core military mission and began operating a commercial airline.

Unlike the Air Force, the Postal Service has moved aggressively beyond its basic mission into non-core, commercial markets. In 2003, an examination of the agency's operations provoked the bipartisan President's Commission On The U.S. Postal Service to ask what do Postal Service products like electronic bill presentment and payment services, Internet-based money transfers, certified electronic mail, and on-line greeting cards have to do with the agency's core mission.<sup>4</sup> The President's Commission concluded that such "dubious forays ...

have produced largely disappointing results ...[and] also have drained time and resources that could have been spent improving traditional postal services."<sup>5</sup> Although the Postal Service has scaled back its e-commerce activities after disastrous losses<sup>6</sup>, it continues to offer several e-commerce products and numerous other non-core products.

A strong case can be made that the Postal Service should focus on its core mission and not be in competitive markets at all as long as it remains a government agency.<sup>7</sup> If the government agency does remain in competitive markets, however, why should it receive special government favors in those markets relative to private-sector businesses? There are reasons to believe that efficiency, transparency, and fairness would all be improved if the agency did not obtain hidden subsidies on its competitive-market activities.

***Competitive-market products.*** Beyond the core market delineated by its dual monopolies on non-urgent letter delivery and mailbox access, the Postal Service has entered a number of other markets where it faces direct competition from the private-sector businesses that primarily serve those markets. Some of the agency's non-core products involve the physical delivery of documents and merchandise. Two of the most prominent are express delivery and parcel delivery. Customers in physical-delivery markets outside the bounds of the Postal Service's monopoly are primarily served by private-sector businesses. For example, in the overnight delivery business, the Postal Service only holds about 6% of the market, and it ranks a distant fourth in terms of market share.<sup>8</sup> A number of the Postal Service's other non-core products are completely outside the hard-copy delivery service area. Several current or recent examples of such products, which are often called non-postal products, are prepaid telephone cards, a magazine subscription service, a photography service, a service for processing bill payments for private companies, a program to construct and lease antennas, and the e-commerce products mentioned earlier. When the organization attempts to sell products in non-postal markets, its market share is usually small and, as with e-commerce, it often loses money.<sup>9</sup>

***Special government privileges.*** The Postal Service receives a variety of special government privileges that artificially lower its business costs. Some of the main ones are that the agency is: exempt from federal, state, and local income taxes; exempt from having to collect sales taxes; exempt from property taxes on the properties it owns; exempt from state motor vehicle registration fees and requirements; exempt from parking tickets; able to borrow directly from the U.S. Treasury at a low interest rate (the Treasury's own borrowing rate); exempt from antitrust laws; exempt from truth-in-advertising laws; exempt from Securities and Exchange Commission (SEC) reporting requirements; exempt from zoning laws; able to self-insure for unemployment compensation purposes (probably less costly than paying the unemployment insurance tax); able as a government entity to issue and interpret regulations that sometimes hurt competitors; and able to acquire property through eminent domain. Another advantage is that while equity investors in private-sector firms want at least a market rate of return on their investments (either through dividends or stock appreciation), the Postal Service is not required to pay any return on equity.

Under current law, the Postal Service retains these governmental privileges throughout the full range of its activities. For instance, the government-owned enterprise enjoys the same panoply of exemptions, immunities, and powers whether it is selling a core product like first-class mail or standard mail, or a non-core product like the next-day delivery of a document, a pre-paid phone card, a money wire to Mexico, or the shipping of a package to Europe.

***The Postal Service's indirect government subsidies cause problems.*** When the Postal Service engages in commercial activities that would otherwise have been carried out by the private sector, federal, state, and local governments lose revenues due to the Service's many exemptions from normal taxes and fees. Because of that hit to their treasuries, federal, state, and local governments must raise taxes and fees for remaining taxpayers, make cuts in their spending programs, or borrow more. Hence, one problem with the Postal Service's indirect

government subsidies is that they weaken the government sector financially.

Another difficulty relates to the Postal Service's exemptions from assorted government rules and regulations. If these government regulations have value and benefit the public, then the Postal Service's exemptions must injure society. For example, if the Postal Service engages in deceptive advertising and then invokes sovereign immunity to shield itself from legal action, consumers will suffer the types of harm that the truth-in-advertising laws are meant to prevent.<sup>10</sup>

A third concern involves fairness. It arises when the Postal Service operates in a competitive market alongside private-sector firms that are subject to taxes, fees, and government regulations from which the Service is exempt.

Another problem has to do with efficiency. Government enterprises are notorious for failing to match the efficiency and vigor of the free enterprise system. The nation's productivity and the levels of income and output it achieves suffer when the Service uses its government subsidies to take business away from more efficient private sector firms in competitive markets.

A further concern is lack of transparency. Government enterprise expenses are partially masked by indirect government subsidies, and are actually higher than they appear to be. The costs of government should be as visible as possible in order that citizens can make informed decisions about the appropriate level of government. To that end, indirect subsidies should be held to a minimum. Indirect subsidies, and the resulting loss of transparency, are especially hard to defend when a government agency is not performing a government function but is engaged in commercial ventures.

*Some steps to scale back the Postal Service's hidden government subsidies.* H.R. 4341 and S. 2468 would reduce several of the Service's exemptions, immunities, and other special privileges. The curtailment of subsidies would apply mainly to the government agency's competitive-market

products, that is, to products which are beyond the Postal Service's core governmental mission. The bills would also commission a potentially useful report examining the many other government subsidies that would remain in place. H.R. 4341 and S. 2468 would not finish the task of curtailing hidden subsidies, but the provisions discussed here would be a start.

"Assumed" federal income tax. Both bills would place an "assumed Federal income tax on competitive products income".<sup>11</sup> Although this provision is often highlighted in discussions of the bills, it is much less impressive than it seems.

First, it would not be a real income tax in that it would never require the Postal Service to make net payments to the U.S. Treasury. Instead, it would merely call on the Postal Service to transfer funds between two accounts that would both belong to the Postal Service. The "assumed tax" would be debited from a newly created Postal Service Competitive Products Fund and credited to the Postal Service Fund that for the most part would reflect core operations. Any number of firms and individuals would be delighted if they could pay such an "assumed" tax, which merely involves shifting funds internally instead of having to pay real money to the government.

It is true that the forced internal transfer would show up as a cost if one looks solely at the Postal Service's competitive products (and does not look elsewhere on the agency's books where the internal transfer would appear as a credit.) Hence, the transfer would serve the useful function of removing at the competitive products level the hidden subsidy arising from the federal income tax exemption (again ignoring the credit elsewhere on the agency's books).

However, a second point is that the "assumed income tax" would be small if competitive products' net income is properly measured, which means measuring attributable costs accurately and including as a cost a reasonable share of overhead. Because the Postal Service typically has little net income, its income tax exemption is one of its least valuable tax exemptions. The provision would be more

impressive if it affected taxes that would be large for the Postal Service, such as sales or property taxes.

Antitrust. In February, the Supreme Court ruled that the Postal Service, as an integral part of the federal government, enjoys sovereign immunity from the antitrust laws in all its activities, unless Congress issues explicit instructions to the contrary.<sup>12</sup> Even in markets outside its statutory monopoly, there is now no legal recourse if the Postal Service behaves anticompetitively; the Postal Service can carry out with impunity actions that would bring down on a private-sector company the full weight of the antitrust laws.<sup>13</sup>

H.R. 4341 would remove the Postal Service's antitrust immunity on products that the bill classifies as competitive, but would permit only injunctive relief, not monetary penalties.<sup>14</sup> The Senate bill differs in that it would allow monetary penalties, as well as injunctive relief, for antitrust violations involving products it classifies as being in competitive markets.<sup>15</sup> (In addition, the Senate bill would provide limited antitrust coverage, injunctive relief only, for certain other products. This limited antitrust coverage would apply to products such as periodical mail that the Senate bill does not classify as being in competitive markets but that are outside the non-urgent letter monopoly.)

Narrowing the Service's antitrust-law immunity is good economics.<sup>16</sup> Because expansion and the exercise of power often bring bureaucratic and other rewards, those within government agencies have powerful incentives to behave anticompetitively. According to a study by economists David Sappington and J. Gregory Sidak, incentives to behave anticompetitively can actually be stronger at government-owned enterprises than at private-sector businesses.<sup>17</sup> In another study, economist Rick Geddes documented a number of instances where the U.S. Postal Service and foreign posts have behaved anticompetitively.<sup>18</sup> Hence, applying the antitrust laws to the Postal Service is useful in order to provide a bit of a counterweight to the incentives that encourage government-owned enterprises to behave anticompetitively. The Senate version is

preferable to the House version because it is slightly stronger.

Based on the Supreme Court decision, the Postal Service also has immunity at present from most laws barring deceptive advertising and various other unfair or deceptive practices. H.R. 4341 and S. 2468 would remove that immunity.<sup>19</sup> It appears from the bills' language that this provision would apply to all the Postal Service's products, which is appropriate; the Service should not be deceiving the public about any of its products, including those within its monopoly. This reform would help address long-standing concerns that some Postal Service advertising, most notably for priority mail, may be deceptive. The complaint there is that the Service depicts priority mail as a premium, 2 or 3 day delivery service, without adequately explaining that 2 or 3 day delivery, although usually achieved, is only a target and is not guaranteed, and, besides which, ordinary mail might have been there just as fast.<sup>20</sup>

The bills would also place some restrictions on certain anticompetitive practices, such as obtaining information from a would-be supplier that could not be obtained otherwise and then using the information without paying compensation, or issuing a rule or standard that gives the Postal Service an unfair advantage over competitors.<sup>21</sup>

Equal treatment by Customs of international mail, whether shipped by the Postal Service or a private-sector company. The Postal Service enjoys a government-related advantage in the international mail business because its shipments may receive preferential treatment at customs.<sup>22</sup> H.R. 4341 would try to remove that bias by requiring that the customs laws be applied equally to all international mail shipments, whether carried by the Service or a private-sector business.<sup>23</sup> The Senate bill lacks this provision.

Zoning and land use laws. The Postal Service is currently exempt from zoning and land use laws. Unlike firms and individuals in the private sector, the agency does not have to obey local zoning and land use rules when it constructs or alters buildings,

although it usually does consult with local officials. H.R. 4341 and S. 2468 would not remove the Service's exemption, but they would require greater attention to local rules.<sup>24</sup> The Postal Service would have to consult with appropriate state or local government officials, submit plans if requested, and allow inspections. The agency would have to "give due consideration" to the recommendations it receives. In addition, the Service would have to seek local community input.

The phrase "give due consideration" suggests that the bills would not force the agency to follow local zoning and land use laws that it views as impractical or excessively onerous. The impression that the final say would remain with the Postal Service is also supported by the instruction in the two bills that the agency's building construction and alteration projects would have to comply with a nationally recognized code "to the maximum extent feasible *as determined by the Postal Service.*" [Emphasis added.] Nor would the Service or its contractors have to pay any of the inspection, permit, and other fees that local governments normally charge. Thus, the Service would retain substantial advantages with regard to zoning and land use requirements relative to those in the private-sector.

*Federal Trade Commission (FTC) study of the Postal Service's hidden government subsidies.* Both bills would order the FTC to look at the Postal Service's competitive products and identify federal and state laws that treat the Postal Service and its competitors differently with regard to those products.<sup>25</sup> As part of the report, the FTC would suggest how the laws could be changed to apply more equally, where the FTC thinks that would be advisable.

This could be an informative study, and the FTC is an excellent choice for conducting the work because of its experience and its independence from the Postal Service. If nothing else, the report could shed more light on the nature and size of the Service's indirect government subsidies. Of course, a study of differences in legal treatment is relatively weak in terms of reform because it does not, by itself, remove any of the differences it finds. For

that to occur, Congress would have to include some of the study's recommendations in future legislation.

**Conclusion.** An earlier paper in this series had found that H.R. 4341 and S. 2468 would be quite weak with respect to helping the Postal Service better control its costs. This paper examines an area where the bills would be stronger: beginning to roll back the exemptions from taxes, fees, and regulations that constitute indirect, hidden government subsidies for the Postal Service.

Those who think that the Postal Service's indirect government subsidies are bad economic policy have generally had to content themselves with isolated gains. For example, in 1998, Congress removed a regulatory exemption so that the Service is now treated like other employers with regard to OSHA workplace safety rules.<sup>26</sup> In contrast, H.R. 4341 and S. 2468 would roll back at once several of the Service's special privileges.

The provisions examined in this paper for curtailing the Postal Service's tax, regulatory, and other privileges are sensible. Probably the most helpful is the provision that would apply the antitrust laws to the Service in some cases, given the recent Supreme Court decision that the Postal Service is now totally exempt from the antitrust laws.

To be sure, much more should be done to curtail the Postal Service's indirect government-based subsidies. For instance, neither bill would touch the Postal Service's exemptions from state and local income taxes, property taxes on properties it owns, motor vehicle licensing and registration fees, parking tickets, and sales taxes on products it sells.

One provision that is not discussed here tries to remove an interest rate subsidy when the agency borrows funds for its competitive product activities. Unfortunately, that provision could inadvertently cause serious problems, and should be corrected. It will be the subject of the next paper in this series.

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## *Endnotes*

1. Michael Schuyler, "Would Proposed Postal Service Legislation Help Bring Down Costs?" *IRET Congressional Advisory*, No. 175, June 8, 2004, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-175.PDF>.
2. To put the two papers in perspective, controlling costs and limiting indirect government subsidies are both important but for different reasons. Managing costs is vital if the Postal Service is to be financially viable while charging reasonable rates and delivering acceptable service in its core monopoly market. Indirect subsidies do not hurt the Postal Service, but they cause problems elsewhere in the economy, as explained in this study. Reining them in is desirable in order to ease those other problems.
3. Postal Reorganization Act Of 1970 (P.L. 91-375), sec. 101(a) and 201.
4. President's Commission on the United States Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, p. 27, accessed on the Internet at <http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf>.
5. *Ibid.*
6. David Fineman, the Chairman of the Postal Service's Board of Governors, recently testified to Congress that, as of early 2001, the Postal Service's spending on e-commerce products "was \$33 million annually, producing gross revenue of only about \$2 million." (David Fineman, "Statement Of David Fineman, Chairman, United States Postal Service Board of Governors," before the Special Panel on Postal Reform and Oversight, Committee on Government Reform, U.S. House of Representatives, January 28, 2004, accessed on the Internet from <http://www.usps.com/communications/news/speeches/welcome.htm>.)
7. For a fuller discussion and economic analysis, 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>. A strong case can also be made for complete privatization of the Postal Service (i.e., private-sector ownership and no special government privileges), in which case it could compete in private-sector markets to its heart's content.
8. See Matthew Karnitschnig, "Deutsche Post Girds For Battle," *Wall Street Journal*, October 6, 2003, p. A14.
9. For instance, a General Accounting Office (GAO) study issued in late 1998 reported on 19 competitive-market products, most not involving physical delivery, that the Postal Service introduced or was developing in the mid 1990s. (U.S. General Accounting Office, "Development and Inventory of New Products," GAO Report No. GAO/GGD-99-15, November 1998.) The GAO found, based on numbers supplied by the Postal Service, that the products lost money through fiscal year 1997, with cumulative losses of \$88 million on revenues of \$234 million, and that in the first three quarters of fiscal year 1998, only 4 of the 19 new products had revenues exceeding costs. (*Ibid.*, p. 4.)
10. To be sure, if a government rule is undesirable, allowing the Postal Service to ignore it may be a good thing. But in such a case it would be better to remove the requirement altogether so that no one has to follow it, instead of exempting only the Postal Service.
11. This section refers to H.R. 4341, sec. 302 and S. 2468, sec. 402.
12. *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://supremecourt.us.gov/opinions/03pdf/02-1290.pdf>.
13. An earlier paper in this series examined the Supreme Court's decision from an economic perspective. See Michael Schuyler, "Postal Service's Immunity From Antitrust Laws Should Be Restricted," *IRET Congressional Advisory*, No. 172, April 21, 2004, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-172.PDF>. For another economic analysis of the Flamingo decision, see Rick Geddes, "A New Antitrust Paradox: *Flamingo Industries* and the Future of the Postal Service," American Enterprise Institute, Postal Reform Paper, No. 5, July 2004, accessed on the Internet at [http://www.aei.org/docLib/20040702\\_%2317027graphics.pdf](http://www.aei.org/docLib/20040702_%2317027graphics.pdf).
14. H.R. 4341, sec. 304.

15. S. 2468, sec. 404. In addition, the Senate bill would provide limited antitrust coverage, injunctive relief only, to certain other products. This limited antitrust coverage would apply to products the Senate bill does not classify as being in competitive markets but that are outside the non-urgent letter monopoly. (An example would be periodical mail.)
16. For a fuller discussion, see Schuyler, "Postal Service's Immunity From Antitrust Laws Should Be Restricted," *op. cit.*
17. David E.M. Sappington and J. Gregory Sidak, "Anticompetitive Behavior By State-Owned Enterprises: Incentives And Capabilities," in R. Richard Geddes, ed., *Competing With The Government; Anticompetitive Behavior And Public Enterprises* (Stanford, CA: Hoover Institution Press, 2004), pp. 1-25.
18. R. Richard Geddes, "Anticompetitive Behavior In Postal Services," in R. Richard Geddes, ed., *Competing With The Government; Anticompetitive Behavior And Public Enterprises, op. cit.*, pp. 85-112.
19. H.R. 4341, sec. 304 and S. 2468, sec. 404.
20. For example, the Postal Rate Commission's Office of the Consumer Advocate (OCA) reported in 2002 that based on an "investigation of the advertisements and information disseminated about Priority Mail ... [OCA] has determined that the Postal Service is misleading the public about the quality of service it is likely to receive upon purchase of Priority Mail." The OCA also concluded that "the Postal Service appears to be withholding information from consumers, leaving them unequipped to make an informed choice between First Class and Priority." (Office of the Consumer Advocate, Postal Rate Commission, "Report Of The Consumer Advocate On Quality Of Services Provided By The Postal Service To the Public," Docket No. R2001-1, March 6, 2002, accessed on the Internet at <http://www.prc.gov/OCA/papers/quality/oca-quality-report.pdf>.) Although the OCA has since observed a substantial improvement in the quality of priority mail, which suggests its critical report had a positive effect, consumers would be better protected if the Postal Service were also subject to truth-in-advertising laws.
21. This paragraph refers to H.R. 4341, sec. 303 and S. 2468, sec. 403.
22. Several years ago, the private research firm Wirthlin Worldwide tested customs-law enforcement by sending a number of packages from foreign countries into the United States. It sent about half the packages via the Postal Service and the rest via private-sector delivery companies. When private-sector companies moved the packages, Customs inspected and collected duties on the packages 90% of the time. When the packages traveled via the Postal Service, however, Customs *failed* over 90% of the time to inspect the packages and collect required duties. (See Peter J. Ferrara, "Post Office Smuggling," Americans for Tax Reform, *Policy Brief*, March 2001, accessed on the Internet at <http://www.atr.org/pdffiles/091601pb.pdf>.)
23. H.R. 4341, sec. 305.
24. This section refers to H.R. 4341, sec. 304 and S. 2468, sec. 404.
25. This section refers to H.R. 4341, sec. 703 and S. 2468, sec. 703.
26. P.L. 105-241, The Postal Employees Safety Enhancement Act, sponsored by Senator Michael Enzi (R-WY).