

# IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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## **THE POSTAL SERVICE'S PROCUREMENT "REFORM"**

### *Executive Summary*

The Postal Service's purchases of services and property, which totaled \$12.4 billion in 2002, significantly affect its financial health and its ability to perform its government-assigned mission. How it conducts its purchasing is of concern to policymakers, taxpayers, and mail users.

Effective May 19, 2005, the Postal Service scrapped all the regulations it had developed over the years concerning purchases of services and non-real property.

It replaced them with a nine page rule, issued in the *Federal Register* in April, that mainly discusses canceling business relationships, debarring or suspending suppliers, and limiting suppliers' ability to seek redress when disputes or contract claims arise.

Contrary to the Service's claims, neither its own *Transformation Plan* nor the President's Commission on the U.S. Postal Service recommended *abolishing* the Service's procurement regulations or downgrading them to non-binding internal guidance. They recommended *revising* the regulations, which had been an ongoing process with much support in the postal community.

The Postal Service identified neither undesirable "inflexibilities" in the old purchasing regulations nor provided examples of desirable practices being blocked to justify dismantling the regulations. The regulations already gave the agency considerable flexibility and discretion, including a simple means of obtaining approval to deviate from normal procedures when necessary.

Government Accountability Office studies that criticized some aspects of recent supply management initiatives did not identify the old procurement regulations as part of the problem.

The agency's action reduces transparency and accountability. That is a bad business practice at a government enterprise, and contrary to the agency's claim of pursuing best business practices.

The Postal Service's penchant for secrecy is also evident in its largest supply contract, whose details the Service refuses to publicly disclose.

To instill greater financial discipline and permit easier monitoring by citizen/voters, true reform would increase transparency and accountability. The Service is moving in the wrong direction.

The Postal Service should restore its former purchasing regulations. If it does not, Congress should keep very close tabs on what the government agency is doing.

## THE POSTAL SERVICE'S PROCUREMENT "REFORM"

The Postal Service has made a radical change in the ground rules under which the government-owned entity purchases services and property (except real estate). Its plan appeared as a proposed rule in the *Federal Register* in March 2004<sup>1</sup>, and, with minor changes, as a final rule in the *Federal Register* in April 2005.<sup>2</sup> The changes became effective on May 19, 2005.

The Service has scrapped all its existing procurement regulations. A key section of the new rule declares, "All previous Postal Service purchasing regulations, including the *Postal Contracting Manual*, *Procurement Manual*, the *Purchasing Manual* ... and procurement handbooks, circulars, and instructions, are revoked and are superseded..."<sup>3</sup>

The Service replaced those purchasing regulations, including the 500-plus-page Purchasing Manual, with an amended rule that fits on nine pages of the Federal Register and that mainly discusses conditions under which the Service can debar or suspend businesses from being suppliers, conditions under which the Service can cancel business relationships, and new limits on the ability of suppliers and would-be suppliers to seek redress when disputes or contract claims arise.

The agency mentions only two exceptions. The Service says that when it believes a federal law applies to the agency and affects its purchasing activities, the Service will obey that law.<sup>4</sup> The agency also says that the procurement regulations in force when existing contracts were signed will continue to apply to those contracts.<sup>5</sup> The Postal Service does not have much choice in either case. The Postal Service has greater leeway in its purchasing policies than most of the rest of the federal government,<sup>6</sup> but it is still a government entity and faces more statutory restrictions than private-sector businesses. It would also certainly lose in court if it willfully violated a federal law Congress has clearly imposed on the agency or if it tried to break or alter existing contracts on the basis of

regulations it unilaterally adopted after the contracts were signed.

In place of detailed regulations covering most aspects of the purchasing process, the Service intends to prepare a list of "Supplying Principles and Practices". Unlike regulations, however, these "Principles and Practices" will be merely "advisory and illustrative", will be "for internal use only", "may be altered or superseded at any time without notice", "will not have the force or effect of law" — and are not yet written.<sup>7</sup> In the meantime, the Postal Service has issued "Interim Internal Purchasing Guidelines" that are supposed to provide some general guidance, bear many similarities to the old regulations, but that the Service claims have no legal force.

**More power and less disclosure.** The new rule increases the Service's discretion in its purchasing activities. A corollary is that it reduces the agency's need to explain why it made certain procurement decisions if challenged, and diminishes legal protections for suppliers and would-be suppliers. The new rule also provides less guidance for suppliers and businesses thinking of becoming suppliers. The government-owned Postal Service equates the changes with behaving in a businesslike and professional manner and insists they will help the agency better serve the public. "[T]he public will benefit greatly if the Postal Service applies purchasing practices used by leading corporate enterprises."<sup>8</sup>

**Billions of dollars annually.** Although almost 80% of the Postal Service's costs are related to its labor force, its dual government monopolies on non-urgent letter delivery and mailbox access have enabled it to become such a huge organization that its supply purchases amount to billions of dollars annually. The President's Commission On The U.S. Postal Service reported, "The Postal Service spent nearly \$12.4 billion in 2002, purchasing everything from supplies and equipment, to rent and fuel, to construction and mail transport services."<sup>9</sup> Because

supply purchases are many times larger each year than the Service's profit or loss, purchasing decisions have a major impact on the agency's bottom line. The Commission noted quite rightly that the Service "owes ratepayers one of the most efficient and sophisticated procurement efforts in the country today."<sup>10</sup> Because taxpayers are at risk too, due the possibility of having to pay for a government bailout, the Service also owes good purchasing practices to taxpayers. As a government entity, of course, the Service has no shareholders to hold it accountable.

**Authorities cited by the Postal Service.** The Postal Service cites two authorities in defending its decision to junk its former procurement regulations: itself and the President's Commission. In its 2002 *Transformation Plan*, the Service pledged to "[r]evise purchasing regulations to allow for acquisition of goods and services in a manner similar to that followed by businesses."<sup>11</sup> It described this as one means of reducing costs through improved operational efficiency.

In 2003, the bipartisan President's Commission wrote:

[I]t is inappropriate to apply regulations and statutes aimed at traditional agencies to a Federal entity required to finance its own multi-billion-dollar operations. The Commission therefore recommends that the Postal Service take full advantage of the flexibility it *is* granted under current law and that Congress strongly support its aggressive procurement reforms in acknowledgment of its substantial benefits to all ratepayers [emphasis in original.]<sup>12</sup>

Neither the *Transformation Plan* nor the Presidential Commission, however, mentioned *abolishing* current purchasing regulations. In its final report, the Commission wrote, based on what the government agency told it, that "the Postal Service is currently working to *revise* its purchasing regulations [emphasis added]."<sup>13</sup> The Commission praised the Service for that effort, but revision is not equivalent to elimination. Many, perhaps most, observers would agree that the procurement rules in force prior to May

19, 2005 could be modified constructively, but would oppose tossing them out altogether.

**Comments responding to the *Federal Register* notice.** In the comment period following the initial *Federal Register* notice, the Postal Service received 20 comments, some from membership organizations representing many suppliers. A few of the comments were favorable. For example, Hewlett Packard "strongly agree[d] with USPS Procurement Changes that allow the USPS to function more as a Corporate Business versus a Government Entity."<sup>14</sup> Foth & Van Dyke described the proposal as "very reasonable" and "a good thing."<sup>15</sup> Most replies, though, were critical.<sup>16</sup>

For instance, one company wrote, "It seems that the Postal Service prefers to be a government agency only when convenient," and went on to describe the proposed rules as "vague", "dictatorial", and "allowing for abuse."<sup>17</sup> The Public Contract Law Section of the American Bar Association expressed concern that the "lack of any defined purchasing policies or procedures in a large government organization" would reduce openness, accountability, and objectivity and "could easily result in fraud, waste, and abuse."<sup>18</sup> The ABA section wrote that it "does not believe that the Proposed Rule will serve the Postal Service, its suppliers, and its customers well..." The ABA Section further warned that the part of the proposed rule authorizing Postal Service buyers "to cease business relations with a person or organization when that person or organization fails to meet reasonable business expectations of high quality, prompt service, and overall professionalism"<sup>19</sup> uses vague and broad criteria to create a "blacklisting rule" that invites abuse.<sup>20</sup>

The Association for Postal Commerce also issued a detailed and thoughtful critique. It wrote that it supported adopting "the best buying practices of the commercial sector, [but] the proposed rules do not accomplish that result."<sup>21</sup> The Service's plan, Postcom continued, does "not identify a single buying practice of the commercial sector that the Postal Service wishes to implement;" would create a "complete void in purchasing policy"; "would abandon years of purchasing experience gained by both the Postal Service and its suppliers" including

many recent changes; and would "strike a heavy blow against accountability and public-policy oversight..." Postcom further warned that the "new blacklisting procedure" would hurt both the Postal Service and suppliers because it is too "broad", "subjective", and "ambiguous".<sup>22</sup>

In its comment, Wickwire Gavin associated itself with the concerns raised by Postcom and similarly warned, "Abolishment [by the Postal Service] of its purchasing rules will also reduce accountability and public oversight of the purchasing process, and would run counter to the recommendations of the President's Commission..."<sup>23</sup> Moreover, the proposal would "send the wrong message" to suppliers. "Suppliers would be less interested in doing business with an agency whose procuring officials are given the freedom to act on whim instead of rules ensuring fairness, consistency, and professional conduct." Wickwire Gavin recommended that the Service "instead identify the best purchasing practices of the commercial and government sector and implement those practices into its purchasing rules." In a note that appeared in *Postcom Bulletin*, David Hendel of Wickwire Gavin reiterated that the new rule will reduce transparency and accountability. "Congress, the mailing industry, suppliers – and even USPS's own Inspector General – will no longer be able to hold the Postal Service accountable to its purchasing regulations, because there will be none to comply with."<sup>24</sup> Hendel surmised that the Postal Service would continue using "its current policies and procedures (with some modifications)", meaning that the real thrust of the rule would be to convert "binding regulations that have the full force and effect of law" into "non-binding guidelines".<sup>25</sup> While this could help the Service "avoid the embarrassment that might arise from the occasional [adverse] court ruling," it would ultimately hurt by making it harder for the agency to be sure it "is actually living up to its desire to employ best commercial purchasing practices" and by shrinking the number of suppliers willing to risk dealing with the agency.

In October 2004, the Postal Service replied to those who submitted comments by informing them that it was going ahead with its plan, although the Service repeated that the changes would not apply to

existing contracts. The Service continued to describe its plan as a way "to streamline the purchasing process" and "another step" toward "the best practices of the private sector."<sup>26</sup>

**Private-sector purchasing subject to market discipline.** Because carefully developed manuals and guidelines are valuable, most private-sector businesses, except the very smallest, have extensive written instructions, both for those within the business making purchases and for suppliers. Manuals and guidelines give purchasers within a company a checklist of what to look for when evaluating suppliers and buying inputs, and they help suppliers understand how to do business with a company and what is expected from them as suppliers. That leads to better and more consistent supply decisions within a business, greater accountability, and better coordination between the business and its suppliers.

Generally, though, private-sector businesses' manuals and guidelines are not legally binding. If a private business decides to change its purchasing rules or make a purchase based on considerations not in its rules, suppliers normally have no legal recourse. Given that private-sector businesses can easily bend or break their purchasing rules, what assurance is there that they will strive to make good procurement choices? The answer is private ownership combined with the profit motive.

The combination of private ownership and the profit motive automatically subjects private-sector businesses to rigorous market discipline in all their activities, including purchasing. Because the owners of private-sector businesses desire to maximize profits, they will want the firms they own to make as many good purchasing decisions as possible and as few bad ones. Good purchasing choices increase profits by lowering costs, raising productivity, or leading to higher revenues. Bad procurement choices reduce profits. Hence, regardless of whether a private-sector business is following its purchasing rules or bending them, it *always* has a strong self-interest in making the best purchasing decisions it can.

At a publicly traded company, for instance, consistently poor purchasing decisions will depress

the stock price, make it harder to attract new investment funds, increase shareholders' receptiveness to takeover offers, and in extreme cases push the company into bankruptcy. A corollary is that a buyer who regularly makes bad purchasing decisions at a private-sector business will probably quickly become an ex-buyer.

**Reduced market discipline when the government owns an enterprise.** Unlike private-sector businesses, government enterprises do not have private owners and are not expected to maximize profits. They are usually considered financial successes if they merely break even, or at least do not run large deficits. As a result, government enterprises are subject to less market discipline than private-sector businesses, which gives them much more leeway to make suboptimal business decisions in a number of areas, including procurement.

In consequence, clear, detailed, and *legally enforceable* purchasing regulations are desirable and appropriate at government enterprises. By improving transparency and accountability, they partially compensate for the lack of the financial discipline that the combination of private ownership and the profit motive routinely furnishes at private-sector businesses.

There is a second reason why government entities should be subject to tougher procurement regulations with fewer exceptions than private businesses. It has to do with favoritism and the obligations of government. If someone at a private company awards a supply contract to a friend or relative while rejecting another supplier who offers a better price-quality combination, that will cost the business money (which strongly discourages such behavior at private-sector businesses), but it does not violate the public trust. On the other hand, the public trust is violated if a government entity awards a contract to reward friends or punish enemies. Written and enforceable procurement regulations afford some protection against favoritism by injecting more transparency and objectivity into the purchasing process.

Certainly, government enterprises not infrequently have too many regulations, but because

of the factors mentioned above, it is entirely appropriate that they have more purchasing regulations than private-sector businesses.<sup>27</sup> It is important to note that although the Postal Service's old regulations were detailed and legally binding, they also afforded considerable flexibility. For example, the old regulations made provision for special procedures in emergency situations, could be modified when the agency saw opportunities for improvement, and, as discussed later in this paper, were sufficiently flexible to allow the Postal Service to experiment with new and innovative purchasing strategies.

The Postal Service promises to post its "Supplying Principles and Practices" on its website once they are written, has issued interim internal guidelines, and will to continue to provide some guidance in individual solicitations. Nevertheless, these will be informal rules that the Service claims have no legal force and will be deliberately kept loose "to provide for flexibility and discretion in their application."<sup>28</sup> Consequently, they lack the visibility, enforceability, and level of guidance of the regulations being abolished. They will be less effective than the old regulations in informing and protecting suppliers, and in monitoring and holding accountable the Postal Service's purchasers.

**Turning good dispute resolution ideas into bad ones.** As part of its plan, the Postal Service would require that most procurement-related disputes be decided through alternative dispute resolution (ADR) techniques, such as informal negotiation, mediation, or a new supplier ombudsman.<sup>29</sup> Suppliers generally welcome expanded access to alternative dispute resolution techniques because of their speed, cost effectiveness, and flexibility. Sometimes, though, suppliers feel they need to go to court. The Postal Service's new system virtually shuts down court access in many disputes. Even though it is not clear that the Service actually has the authority to block court access to the extent it desires, its unilateral attempt to do so has provoked concern.

Further, if suppliers use ADR, they want to be sure the procedures are fairly structured and not stacked against them. The Service's proposed rule offers no such assurance. For example, an

ombudsman must be impartial and evenhanded to be effective. Yet, the new rule specifically says that the Postal Service will unilaterally select the supplier ombudsman, whose mailing address will be Room 4110 in Postal Service Headquarters.<sup>30</sup> That gives the Service ample opportunity to select as supplier ombudsman a person who sees issues from the Service's perspective and is exposed on a continuing basis to the Postal Service's culture. The final rule says nothing about the ombudsman being a person of stature or independence and contains no safeguards assuring the ombudsman that he or she can rule against the agency without fearing reprisals. Moreover, the new rule makes it clear that the ombudsman is not to hold it against the Service if the agency does not follow its Supplying Principles and Practices (when they are written) or its Interim Internal Purchasing Guidelines. Given this institutional setting, suppliers should be very concerned that the ombudsman will not be fair and impartial.<sup>31</sup>

Indeed, even calling the official an ombudsman is somewhat deceptive. Normally, an ombudsman's main role is to make sure an organization treats other parties fairly and to facilitate redress when the organization is not fair. However, the Postal Service describes its supplier "ombudsman" as being there "to assist it in obtaining the best goods and services to meet its needs at the best prices."<sup>32</sup> Fairness is nowhere mentioned. (Fairness may enter indirectly, but only if the ombudsman recognizes that an organization can often obtain the best values, especially in the long run, by treating others fairly.)

**Better procurement requires hard work and more attention to details, not junking all prior purchasing regulations.** The Postal Service defends the revocation of all its prior purchasing regulations as a means of giving it more "flexibility" to follow up-to-date "supply-chain management" practices and "obtain the best value in its acquisitions."<sup>33</sup> Two recent Government Accountability Office (GAO) studies shed light on whether the prior regulations were truly a barrier to modern supply management initiatives. The studies provide an in-depth examination of several Postal Service supply-management initiatives.<sup>34</sup> During the period

examined, the Service operated under the purchasing regulations that are being replaced.

One of the studies concerned a "national-level contract to purchase most office supplies from Boise [Office Solutions]."<sup>35</sup> The GAO found that the Service "has not been successful in implementing its national-level contract" and that although it had projected saving of \$28 million in 2001, it "was only able to provide documentation for \$1 million in savings." Some of the main problems GAO identified were inadequate tracking and monitoring of whether Service employees were purchasing office supplies through the contract and a "carelessly constructed" and ambiguous subcontracting plan.<sup>36</sup> However, nowhere did the GAO report suggest that procurement regulations contributed to the contract's problems. In fact, procurement regulations were sufficiently flexible to allow the contract, with its hoped-for savings, to go forward. The problems involved the contract's design and implementation. Such difficulties will not be cured, and might well be worsened, by discarding prior procurement regulations en masse.

In a later study, the GAO examined three types of initiatives to lower supply costs: a bulk fuel purchasing program, reverse auctions to award some highway transportation contracts, and nationwide supply contracts (which includes the Boise contract).<sup>37</sup> The GAO found the programs were a "mixed success"<sup>38</sup> but was unable to verify most of the savings the Postal Service claimed. The GAO offered many specific recommendations, but, again, it did not identify purchasing regulations as a problem area. The GAO certainly did not suggest throwing out all purchasing rules and starting over.

The Federal Aviation Administration's (FAA) experience with acquisition management, which the GAO recently evaluated, also provides insight applicable to the Postal Service.<sup>39</sup> Since the early 1980s, the FAA's efforts to modernize the nation's air traffic control system have been plagued by delays, cost overruns, and performance shortfalls. After the FAA told Congress that many of its problems were due to inflexible acquisition regulations, Congress passed legislation in 1995

exempting the FAA from most of the legally binding contracting regulations that federal agencies must normally follow. With the new acquisition system now in place for 10 years, the GAO was able to look back to see if it has delivered the promised improvements. The GAO found that the new system "has not resolved longstanding problems it [the FAA] experienced prior to ... implementation."<sup>40</sup> In part, the GAO concluded this is because the old system of legally binding regulations had more flexibility than the FAA admitted. More fundamentally, the new system has little to do with best business practices. "Past GAO reports have demonstrated that the success of an acquisition process depends on good management," not on substituting non-binding guidelines for legally binding regulations.<sup>41</sup>

**A penchant for secrecy.** The Postal Service often vigorously resists providing information to the public about the supply contracts it signs. For example, the Service's largest supplier in 2004 in terms of payments received was Federal Express. The Postal Service paid \$1.2 billion on that contract, which was over 3½ times as much as it paid to its next largest supplier.<sup>42</sup> Yet, the details of that contract have never been made public, nor has the Postal Service ever disclosed for any year since the contract was signed exactly what types and quantities of services it receives for its money. Based on the limited information available, it appears that FedEx is providing the government agency with service of excellent quality, but because the parties have refused to divulge quantity information, it is not possible to determine if the government agency is receiving good value for its money or paying top dollar. (Value for the money depends, of course, on both quality and quantity.)

The U.S. Bureau of Transportation Statistics (BTS), which gathers revenue and volume statistics from airlines on the cargo, mail, and freight they carry, inadvertently stepped into this matter when it demanded revenue and volume data from FedEx regarding the mail it carries under its Postal Service contract.<sup>43</sup> The company has resisted the demand, citing both technical problems in providing the data and commercial sensitivity. What is surprising is that the Postal Service also sent a letter to the BTS citing commercial sensitivity and opposing disclosure. The

Service expressed concern that the "segregated mail volume data" being requested would allow other suppliers to deduce the "pricing arrangements" in the contract and "undercut" those prices "in the event there are future mail transportation contract negotiations with the Postal Service."<sup>44</sup> In fighting disclosure on the theory that disclosure would *reduce the agency's future supply costs* by encouraging more vigorous competition among suppliers, the Postal Service is placing *secrecy ahead of its own financial health*, the mission Congress gave it, and the interests of postal consumers and taxpayers.

Further, in the rate case the Postal Service has just filed with the Postal Rate Commission (PRC) seeking a 5.4% rate increase, the Service again insists that the details of its largest supply contract should be kept from the public, calling them "commercially sensitive" and "proprietary".<sup>45</sup> This time, the Postal Service has changed its argument and asserts that hiding the information will somehow help it "obtain the best prices possible" from suppliers and make it harder for the agency's competitors" to compete unfairly against the Postal Service."<sup>46</sup> When the Service mentions its competitors, it is referring to products it sells in markets outside its monopoly and beyond its core mission. Many of the private-sector businesses in those markets believe it is the government-owned Postal Service that is competing unfairly against them.<sup>47</sup>

In one of the Service's supply initiatives mentioned earlier, however, a key feature is that suppliers bidding on contracts "can see one another's bids in real-time."<sup>48</sup> The Service believes that letting contractors see each other's bids saves it money by more effectively pitting suppliers against each other and spurring them to submit lower bids than otherwise. But if pitting suppliers against each other is good for the Postal Service in one case, why is it bad in another?

The Postal Service has a history of invoking commercial sensitivity as a rationale for withholding financial information from the public. An earlier IRET study examined the commercial sensitivity argument and found that it has little merit at government entities, such as the Postal Service.<sup>49</sup> Except when there are compelling special

circumstances, government entities should reveal their finances to citizen/voters to the maximum extent possible. An entity that is ultimately owned by the public has no intrinsic right to conceal its finances from the public. Moreover, transparency and the accountability it brings are especially important at government entities because they lack the financial discipline that the market system imposes on private-sector enterprises.

To improve transparency and accountability, the Postal Service should reveal *more* about its procurement activities than it does currently. Instead, the Service's proposed purchasing rule would cut in the other direction.

Transparency is especially desirable in the case of sole source contracts, like those with FedEx and Boise. Sole source procurement contracts often arouse suspicions, especially if some of their terms are shrouded in mystery. Nevertheless, they can be an intelligent business practice — if they save money. To diffuse suspicion and improve accountability, the Postal Service would be smart voluntarily to disclose the terms of its sole source contracts. Further, to be sure it really is getting the best deal available, the Postal Service should, as a matter of standard policy, open sole source contracts to competitive bidding.<sup>50</sup>

**Conflicting positions.** Although the Postal Service now insists that its purchasing rules should be those of a private business, it took the opposite position in a legal case the Supreme Court decided in 2004 (Flamingo Industries), when the Service argued that its purchasing activities are those of the federal government. A supplier had sued the agency under the antitrust laws, alleging that the Service in some of its activities as a purchaser of mail sacks had participated in a conspiracy in restraint of trade. The Service responded that it cannot be sued for an alleged antitrust violation because it is part of the federal government and, as such, enjoys total immunity from the antitrust laws (unless Congress were to pass legislation explicitly removing its immunity).

In its decision, the Supreme Court agreed with the Service, ruling that the agency "remains part of the Government", has been charged with carrying out

"nationwide, public responsibilities", and "has different goals, obligations, and powers from private corporations." The Court concluded, "The Postal Service in both form and function ...is part of the Government of the United States and so is not controlled by the antitrust laws."<sup>51</sup> (An earlier IRET study examined the implications of the Supreme Court decision, and concluded that it would be good public policy for Congress to remove the Service's exemption from the antitrust laws.<sup>52</sup>)

The Supreme Court's decision, which emphasizes that the Postal Service really is *not* a private-sector business, is highly relevant in evaluating the Service procurement policies. Echoing one of the comments cited earlier, there is an inconsistency that may cause economic harm, as well as raising fairness concerns, if an agency with governmental powers can opt selectively to be treated either as part of the government or as a private business, based on what is most convenient for it at the time. In terms of the Service's purchasing activities, many suppliers feel they are at a legal disadvantage when selling to the agency because it is part of the government and view binding procurement rules as a partial offset giving them much needed protection. Also, given that the Service, unlike private-sector businesses, is exempt from the antitrust laws in its purchasing activities (and other activities), binding procurement regulations are valuable as a partial alternative that places some restraints on the Postal Service's behavior.

**If the government thinks transparency and accountability are good business practices, shouldn't it practice what it preaches?** Following the Enron and WorldCom collapses, Congress enacted the Sarbanes-Oxley Act of 2002<sup>53</sup>, which sets very rigorous disclosure and accountability requirements for publicly traded companies. One of the beliefs motivating the act is that disclosure and accountability are desirable business practices that help identify mistakes more quickly and protect investors.<sup>54</sup> By that standard, the former purchasing regulations that the government-owned Postal Service carefully developed over time were a good business practice. The regulations made the procurement process much more open than otherwise and, by holding the agency to clear written purchasing standards, promoted accountability.



Although the Postal Service insists that the wholesale jettisoning of the regulations is a best business practice, the reduction in transparency and accountability suggests it is really an asking-for-trouble business practice. Also, if the government demands greater disclosure from publicly traded companies, shouldn't it lead the way at its own enterprise, rather than moving in the opposite direction?

As part of the government, of course, the Postal Service does not have individual investors who would be harmed if problems are concealed and allowed to fester. Instead, customers within the mail monopoly, the overall mailing industry, and taxpayers are all at risk. Protecting those groups by requiring high levels of transparency and accountability at the Postal Service is very much in the public interest.

**Shooting itself in the foot.** Flexibility and discretion can be helpful in moderation by reducing paperwork, allowing decisions to be made more quickly, and curbing frivolous complaints. The Postal Service's procurement plan, however, carries flexibility and discretion to excess. That has costs for the Postal Service that are likely to outweigh any benefits.

- Fewer suppliers may be willing to do business with the agency because they will have less protection in the regulations if the agency makes unwarranted demands or bases procurement decisions on favoritism and administrative convenience rather than merits. Some potential suppliers may be intimidated by the vagueness and severity of the "blacklisting" rule.
- Those suppliers still willing to deal with the agency may demand higher prices to compensate for the added risk due to less regulatory protection.
- The reduced protection may also cause suppliers to think twice about making investments or long-term commitments on their own to serve the agency better.
- Accountability will suffer because there will be fewer clear standards to use as a benchmark in evaluating the behavior and decisions of purchasers within the Postal Service. Reduced accountability

will make it harder for the Service to determine whether it is receiving the best available combination of price and quality on its supply purchases.

- Accountability will also suffer because the proposed restrictions in the dispute process will often prevent suppliers or potential suppliers from bringing problems to light.

**Need for follow-up monitoring.** Given that the Postal Service's new purchasing regime is likely to reduce transparency and accountability, Congress would be wise to monitor how the new system works in practice. For example, Congress might request annual or semiannual assessments for the next several years from the Postal Service's Office of the Inspector General regarding what benefits the new purchasing regime delivers and what problems it creates. Of particular interest on the plus side would be whether the Service is able to document any cost savings that it could not have achieved under the old regulations, and on the negative side whether it becomes harder to determine if the Service is dealing with suppliers objectively and obtaining the best value for its money. Congress might also wish to have the GAO examine the new system in operation and the effects it has on transparency and accountability.

**Conclusion.** The U.S. Postal Service enjoys considerable flexibility and discretion in its purchasing activities. Although it is subject to some restrictions that do not apply to private-sector companies, it has much more freedom of action than is typical in other parts of the federal government.

The Postal Service has used its flexibility to launch a number of supply-related initiatives in recent years, and it claims they have delivered cost savings. The Postal Service's flexibility is also evident in the many changes it has made over the years to its purchasing regulations, including its recent release of Issue Three of its Purchasing Manual.

Those in the postal community are sympathetic with such efforts and have generally supported the initiatives and revisions just described. Regulations and paperwork that are unnecessary (more precisely, that have costs exceeding benefits) should be

eliminated or reformed. However, the wholesale junking of prior regulations and their replacement with a terse rule that shifts more power to the Postal Service while offering suppliers little guidance or protection is not good business practice.

If the Postal Service wants the power to tell suppliers, "We don't have to follow our own rules," it should justify why it needs that power. So far, the Service has not made that case.

From a broader public policy perspective, government enterprises should operate according to rules and procedures that afford the highest levels of transparency and accountability. Transparency and

accountability help citizen/voters monitor whether government enterprises are fulfilling the missions they were assigned, are reasonably efficient in terms of their costs and what they accomplish, and are behaving honestly and fairly. Transparency and accountability are also important because government entities lack the financial discipline that the combination of private ownership and the profit motive routinely provides at private-sector businesses. The Postal Service's new rule is directly contrary to efforts to increase transparency and accountability.

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### *Endnotes*

1. *Federal Register*, vol. 69, no. 57, March 24, 2004, pp. 16786-13793 (39 CFR Part 601).
2. *Federal Register*, vol. 70, no. 74, April 19, 2005, pp. 20291-20299 (39 CFR Parts 211 and 601).
3. *Ibid.*, sec. 601.102, pp. 20294. As mentioned shortly in the text, there is an exception for existing contracts.
4. *Ibid.*, sec. 601.100, p. 20294. The rule specifically mentions 39 U.S.C. 410, which lists several federal laws the Service must observe, such as the Davis-Bacon Act (which increases labor costs on government construction projects.)
5. *Ibid.*, sec. 601.103, p. 20294.
6. For example, although the Service has programs to encourage business relationships with small businesses, it is explicitly exempted from the requirements of the Small Business Act (15 U.S.C. 632(b)).
7. *Ibid.*, pp. 20291-20292.
8. *Ibid.*, p. 20291.
9. President's Commission on the U.S. Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, p. 94, at <http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf>.
10. *Ibid.*
11. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. v, accessed at <http://www.usps.com/strategicdirection/transform.htm>. The Service quotes this passage in its *Federal Register* notice.
12. President's Commission on the U.S. Postal Service, *op. cit.*, p. 95.
13. *Ibid.*
14. Ginny Stominski, HP USPS Program Manager, Hewlett-Packard Company, Comment to U.S. Postal Service on proposed purchasing rule, April 7, 2004, at <http://www.wickwire.com/postal/Postal%20Comments/Hewlett%20Packard%20Comments.pdf>. The law firm of Wickwire Gavin has posted all comments online. They can be downloaded from <http://www.wickwire.com/postal/postal.php>. Wickwire Gavin does legal work in several areas including Postal Service supply contracting. It has criticized the Service's proposed rule and some of the agency's procurement practices.
15. Frank Reichert, Project Director, Foth & Van Dyke and Associates, Inc., Comment to U.S. Postal Service on proposed purchasing rule, April 23, 2004, at <http://www.wickwire.com/postal/Postal%20Comments/Foth%20%20Van%20Dyke%20Comments.pdf>. Mr. Reichert notes in his letter that the Service asked him to review the proposal.

16. In this author's judgment, 4 were positive, 1 was mixed, and 15 were negative. The few favorable comments were quite short. The much larger number of negative comments were longer and more detailed.
17. Jill Farris, Vice President, Foreman Bros. Inc, Comment to U.S. Postal Service on proposed purchasing rule, April 21, 2004, at <http://www.wickwire.com/postal/Postal%20Comments/Foreman%20Brothers,%20Inc.%20Comments.pdf>.
18. Hubert J. Bell, Jr., Chair, Section of Public Contract Law, American Bar Association, Comment to U.S. Postal Service on proposed purchasing rule, April 22, 2004, accessed on the Internet at <http://www.wickwire.com/postal/Postal%20Comments/ABA%20Comments.pdf>.
19. *Federal Register*, Proposed Rule, *op. cit.*, sec. 601.105, p. 13788.
20. ABA Section, *op. cit.* In the final rule issued in April 2005, the Postal Service has changed the words "cease business relations" to "cease accepting or considering proposals". The revised wording clarifies that the Postal Service is not talking about existing contracts, but it still sounds like a blacklisting rule on future work, as the ABA alleges.
21. Gene Del Polito, President, PostCom, Comment to U.S. Postal Service on proposed purchasing rule, April 20, 2004, accessed on the Internet at <http://www.wickwire.com/postal/Postal%20Comments/PostCom%20Comments.pdf>.
22. *Ibid.*
23. David P. Hendel, Shareholder, Wickwire Gavin, Comment to U.S. Postal Service on proposed purchasing rule, April 23, 2004, at <http://www.wickwire.com/postal/Postal%20Comments/Wickwire%20Gavin,%20P.C.%20Comments.pdf>.
24. David P. Hendel, "USPS Proposes To Abolish Its Purchasing Rules And Replace Them With Non-Binding Guidelines," *Postcom Bulletin*, April 13, 2004, accessed on the Internet at <http://www.wickwire.com/postal/Postcom%20article%20on%20USPS%20proposed%20new%20purchasing%20regs%20-%20WG%20website.pdf>.
25. In reaching this conclusion, Mr. Hendel apparently drew on his experience in this field, including his prior work as an attorney in the Postal Service's Office of Contracts and Property Law.
26. Keith Strange, Vice President, Supply Management, U.S. Postal Service, Letter replying to Comments, October 21, 2004, accessed on the Internet at <http://www.wickwire.com/postal/Strange%2010-21-04%20ltr.pdf>.
27. The President's Commission produced a generally outstanding report. However, after rejecting privatization as politically unfeasible at present, the Commission often assumed that the best business practices at private-sector companies would also be the most desirable practices at the government-owned Postal Service. As explained here, that is not quite true. It is prudent to have more regulations at a government entity than at a private company.
28. *Federal Register*, Final Rule, *op. cit.*, p. 20292.
29. *Ibid.*, sec. 601.107-601.108, pp. 20294-20295. As a matter of terminology, the Postal Service does not include the ombudsman in what it calls "alternative dispute resolution (ADR) procedures". Hence, in sec. 601.107, the Postal Service encourages but does not require ADR to settle procurement-related disputes. However, in sec. 601.018, the Postal Service declares that when disputes cannot be quickly resolved through discussions or (non-ombudsman) ADR, the ombudsman will be the "sole and exclusive procedure" used for settling most types of procurement-related disputes.
30. *Ibid.*, p. 20295.
31. One improvement over the initial proposal, though, is that the final rule clearly requires the Service to obey the ombudsman's decisions, even when the Service does not like them.
32. *Ibid.*, p. 20292.
33. *Ibid.*, pp. 20291-20292.
34. GAO, *Postal Service: Progress In Implementing Supply Chain Management Initiatives*, GAO-04-540, May 17, 2004, accessed on the Internet at <http://www.gao.gov/new.items/d04540.pdf>; and GAO, *Contract Management: Postal Service's National Office Supply Contract Has Not Been Effectively Implemented*, GAO-03-230, Jan. 17, 2003, accessed on the Internet at <http://www.gao.gov/new.items/d03230.pdf>.
35. GAO, *Contract Management: Postal Service's National Office Supply Contract Has Not Been Effectively Implemented*, *op. cit.*, cover page.

36. *Ibid.*, p. 2. In defense of the Service, most of GAO's criticism of the subcontracting plan was directed at declines in participation by small businesses and women- or minority-owned businesses, not at pricing or product quality.
37. GAO, *Postal Service: Progress In Implementing Supply Chain Management Initiatives*, *op. cit.*
38. *Ibid.*, p. 3.
39. See Government Accountability Office, *Air Traffic Control: FAA's Acquisition Management Has Improved, But Policies And Oversight Need Strengthening To Help Ensure Results*, GAO-05-23, November 2004, accessed on the Internet at <http://www.gao.gov/new.items/d0523.pdf>.
40. *Ibid.*, cover page.
41. *Ibid.*, cover page.
42. See <http://www.wickwire.com/postal/2004USPSTopSuppliers.pdf>. David Hendel of the law firm of Wickwire Gavin compiled the information from Postal Service data that he obtained through a Freedom of Information Act request.
43. See Angela Greiling Keane, "FedEx Sealing Letters," *Traffic World*, February 28, 2005, reprinted on the Internet at <http://www.lunewsviews.com/fedexletters.htm>.
44. Paul Vogel, Vice President for Network Operations Management, Postal Service, Letter to BTS, dated February 8, 2005, quoted in *Traffic World*, *op. cit.*
45. U.S. Postal Service, "Motion Of United States Postal Service For Waiver And For Protective Conditions For Library Reference That Includes Costs And Other Data Associated With The FedEx Transportation Agreement," Submitted to Postal Rate Commission, Docket No. R2005-1, April 8, 2005, accessed on the Internet at [http://www.prc.gov/docs/43/43407/MotProtCon\\_w\\_Atts.pdf](http://www.prc.gov/docs/43/43407/MotProtCon_w_Atts.pdf).
46. *Ibid.*
47. Earlier papers in this series evaluated the Postal Service's competitive-market activities and concluded that they harm customers within the postal monopoly, threaten taxpayers, weaken the overall economy, and are contrary to the Postal Service's own financial interests. See, for example, 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>.
48. This is the Service's reverse auction process for awarding emergency highway transportation contracts. See GAO, *Postal Service: Progress In Implementing Supply Chain Management Initiatives*, *op. cit.*, p. 6.
49. Michael Schuyler, "Should the Postal Service Be Able To Withhold Some Of Its Financial Results From The Public?" *IRET Congressional Advisory*, No. 184, March 16, 2005, available at <ftp://ftp.iret.org/pub/ADVS184.PDF>.
50. I am indebted to Don Soifer of the Lexington Institute for this suggested reform. More generally, Soifer recognizes that sole source contracts are sometimes desirable or necessary. He urges that they be avoided, though, in cases where there are no good reasons for having them. In addition, to promote transparency and accountability, Soifer sees much value in having independent audits of no-bid contracts and sole source contracts.
51. *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 at <http://supremecourtus.gov/opinions/03pdf/02-1290.pdf>.
52. See Michael Schuyler, "Postal Service's Immunity From Antitrust Laws Should Be Restricted," *IRET Congressional Advisory*, No. 172, April 21, 2004, accessed on the Internet at <ftp://ftp.iret.org/pub/ADVS-172.PDF>.
53. P.L. 107-204.
54. A strong case can be made that Sarbanes-Oxley is a flawed law because it ignores the vigorous discipline that the market already exerts on publicly traded companies and has high compliance costs. (See, for example, Alan Reynolds, "The Sarbanes-Oxley Tax," *Investor's Business Daily*, March 14, 2005, accessed on the Internet at <http://www.cato.org/research/articles/reynolds-050313.html>.) However, government enterprises like the Postal Service lack normal market discipline, as explained earlier in the text. Hence, government enterprises are actually *more* in need of something like Sarbanes-Oxley to provide external discipline than are private-sector businesses.