

IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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October 20, 2005

Advisory No. 194

DISAPPOINTING NEWS (IN A HAND-DELIVERED LETTER) FROM THE POSTAL SERVICE

Executive Summary

In a September 13 letter, the Postal Service's Board of Governors informed Congress that the government-owned enterprise objects to H.R. 22 and S. 662 (both entitled the Postal Accountability and Enhancement Act) in their current forms. The bills would significantly change the laws under which the Postal Service operates. Ironically, the legislative effort had been spurred on by the Postal Service itself, which claims it needs more discretion and less regulatory oversight in setting its prices.

The letter came as a surprise because the Postal Service is only now objecting to an important component of the bills after years of debate. The bills would give the Service greater flexibility in the rate-setting process, while opening up to regulatory oversight other aspects of the Service's operations. The Postal Service now declares that, for good governance, the regulator's authority should not extend beyond limited rate regulation. The Postal Service also believes it should not be held firmly to an inflation-based rate cap.

For comparison, private-sector businesses in regulated industries are normally subject to broader regulatory oversight than the Postal Service wants, and when rate cap regulation is instituted, the cap is usually firmer than what the Postal Service deems acceptable.

The changes the Service claims are essential are not needed and would violate important reform principles. The broadened scope of regulatory oversight contemplated by the drafters of H.R. 22 and S. 662 is one of the bills' best features. In contrast, the weak and narrow regulation that the Postal Service desires would largely undo the checks and balances built into H.R. 22 and S. 662, and would offer less transparency and accountability than does current law.

The Service strongly disagrees with the Administration's position that when the escrow fund created by 2003 postal pension legislation is abolished, all the monies released should be used to begin paying down the Postal Service's unfunded obligation for retiree health-care costs, which is now about \$65 billion. The Administration's plan, however, would better serve the long-term interests of mail users and taxpayers.

One vital point on which the Service is correct, and probably should have been more forceful, is that it needs better cost-control tools from Congress if it is to succeed in its mission of providing high-quality mail service throughout the nation at reasonable cost.

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During most of the summer, the odds had appeared better than even that, soon after Labor Day, Congress would pass legislation significantly changing the rules under which the U.S. Postal Service operates. Since then, two events have changed the odds. Hurricane Katrina has created more urgent problems that will occupy much of Congress's attention this fall. In the Senate, the Committee on Homeland Security and Governmental Affairs, which has primary jurisdiction over postal issues, will be among those most involved in Katrina-related matters. Moreover, on September 13, the Postal Service's Board of Governors raised unexpected objections to the postal reform legislation. In a letter hand-delivered to key members of Congress, the Board expressed opposition to the House and Senate bills in their current forms (H.R. 22 and S. 662, both entitled the Postal Accountability and Enhancement Act).¹ Postmaster General John Potter, Deputy Postmaster General Patrick Donahoe, and the presidentially appointed Governors all signed the letter.

The members of the Postal Service's Board acknowledged that Congress began work in this area largely at the Postal Service's behest² and thanked members of Congress for their efforts, but the Board wrote that the bills as presently drawn would be harmful: "[W]e would be better positioned to build on our recent progress in generating revenue and controlling costs under current law" than under the proposed legislation.³

In February, the Postal Service's Governors had sent a letter to Congress mentioning a number of items they hoped would be included in legislation.⁴ That letter, however, did not raise the possibility that the bills being developed might, in the Governors' view, be inferior to current law. The Postal Service sounded a much louder note of dissatisfaction in August when Richard Strasser, the Postal Service's Chief Financial Officer, told the quarterly meeting of the Mailers' Technical Advisory Committee, "My personal opinion is that the governance structure that

is oriented in the current postal reform legislation is disastrous."⁵ Despite Mr. Strasser's careful disclaimer, knowledgeable observers generally assumed he would not have said this unless many within the government agency felt the same way.

It is regrettable that the Postal Service has waited until now to lay out its position clearly. Congress has held many hearings during the last several years on Postal Service reform at which the Service has testified and could have spoken out. Further, the provisions the Service now deplors have been in H.R. 22 and S. 662 since those bills were introduced and had also been in several predecessor bills in prior years. Although the Service in the past has sometimes opposed specific items in proposed legislation that would let regulators or commissions oversee certain decisions, the Service did not indicate that it would regard those items as deal breakers or that it would not be open to a regulatory-oversight compromise such as is present in H.R. 22 and S. 662.⁶ Elected officials and Capitol Hill staffers, many of whom have been working on this issue for years, have understandably expressed consternation and unhappiness regarding what Senator Susan Collins (R-ME) calls the Service's "eleventh-hour criticisms".⁷

Still, although the Service should not have waited until now, later would be better than never if the federal agency's position has merit. The aim of this paper is to examine that question: Would the changes demanded by the Postal Service advance or interfere with true reform?

Governance and the regulator

The Postal Service claims the main problem in H.R. 22 and S. 662 is the power of the Service's regulator. The Postal Service characterizes this as an issue of governance. "Our primary concern is the issue of governance -- that is, the role of the regulator versus that of the Board of Governors."⁸ In the agency's view, the regulator should have

limited supervision over postal rates but almost nothing beyond that. "[T]he appropriate focus of the regulator should be oversight of Postal rates... The [Postal Service's] Board's role should be to oversee the business of the Postal Service. While the legislation was intended to avoid extended rate litigation, both bills create a process that would permit the regulator to hear complaints at any time and on virtually any aspect of postal operations."

The bills make a key trade-off in terms of regulation: looser regulation of rates, more regulation of operations. In evaluating the Service's concerns, two key questions should be kept in mind. Is it desirable to temper the Service's powers with additional regulatory oversight of its operations? Is it reasonable for Congress to delegate some oversight responsibilities to a regulator rather than providing all oversight itself through Congressional hearings, legislation, and inquiries?

A regulatory trade-off. The Postal Service's complaint involves a key trade-off included in the bills. Because the drafters of H.R. 22 and S. 662 have tried to respond to years of complaints from the Postal Service about current-law rate regulation, the centerpiece of the bills is a new, looser system of rate oversight. However, the bills' drafters have coupled that with more regulatory supervision in other areas, out of concerns for transparency and accountability.

In envisioning broader regulation, the bills' authors may have been favorably impressed by the performance of the Postal Rate Commission (PRC), the independent federal agency that currently regulates postal rates. The PRC is generally regarded as a conscientious and fair rate regulator, has demonstrated that it is knowledgeable, and has consistently sought greater transparency from the Postal Service.

Under current law, before the Service can raise rates, it must seek approval from the PRC. The PRC, in accordance with the law, holds formal and open hearings before issuing a decision. The bills would establish a new rate-setting system that would allow the Service to adjust rates quickly and largely

at its own discretion, provided the rate changes meet certain conditions.

For products the bills designate as market-dominant (which are mostly, but not entirely, products sheltered by the postal monopoly), the current rate-setting process would be replaced with price regulation based on a rate cap: the Service would have considerable flexibility in adjusting rates providing it does not increase them faster than the Consumer Price Index (CPI).⁹ For products the bills designate as competitive, the Service would be given even more rate-setting discretion: it could set whatever prices it wants, subject to the provisos that each competitive product at least covers its own costs and competitive products collectively make an acceptable contribution to the Service's overhead costs.¹⁰

A statement in the Board's letter points to one power the Service would lose. "The Board currently has the final authority on rates. The legislation shifts that authority to the regulator." The basis for the statement may be that the Governors have the power to override a PRC decision under current law, but only after the PRC has held hearings and issued a decision and only if the Governors vote unanimously to override the regulator's decision. The Service has exercised this power on rare occasions, but it is not a quick or low-profile procedure and it does require unanimity among the Governors. Contrary to the impression given by the letter, most observers and certainly the authors of H.R. 22 and S. 662 view the bills as shifting a significant amount of rate-setting power *away from* the regulator and *to* the Postal Service.

At present, the PRC is mainly a rate regulator, which is much more limited than what is usually seen in regulated industries. For instance, utility regulators are normally empowered to set minimum service standards, which helps protect consumers when the regulated company is a monopolist. Regulatory oversight of service standards is considered especially important when a monopoly producer is subject to rate-cap pricing because otherwise there would be little to stop the producer from increasing prices at the maximum allowed rate

and then securing the equivalent of additional price hikes by delivering less service. Both H.R. 22 and S. 662 would move in the direction of broader regulation by giving the regulator additional responsibilities and changing its name from the Postal Rate Commission to the Postal Regulatory Commission. (With regard to service standards, S. 662 would direct the regulator to set the standards, while H.R. 22 has the weaker provision that the regulator would hold the Service responsible for meeting standards set by the Service.¹¹)

Why have checks and balances? The Postal Service is a monopolist: it possesses dual statutory monopolies on non-urgent letter delivery and mailbox access. Protecting customers within that large monopoly market is a major reason for regulating the Postal Service. In addition, the government-owned Postal Service has expanded beyond its core monopoly market into competitive markets and in the past has often wanted to push farther into competitive markets. Besides raising concerns about mission creep, such activities create risks for monopoly-market customers, taxpayers, and the overall economy. The danger is that the Postal Service will use its monopoly-market revenues and other government-based powers and advantages to support competitive-market product lines that are uneconomic and that displace more efficient private-sector production.¹² Careful regulation is one means of limiting this kind of undesirable growth.

An opposing position is that because the Postal Service is part of the federal government, it needs only minimal regulation. Instead, it can supposedly be trusted for the most part to police itself. The reasoning is that because government entities are supposed to act in the public interest, they can be counted on to do so. If true, this I'm-from-the-government-so-I'm-here-to-help-you view would be comforting and lead to an administratively simple government structure.

One of the reasons for this nation's success, however, is that its Founders took a very different view. They worried that excessive government power would lead to abuses, and tried to limit it through a system of checks and balances.

Broadening the responsibilities of an independent regulator as a means of balancing the Postal Service's power is thoroughly consistent with that spirit.

Based on an examination of the incentives within governments, economic theory strongly supports limitations on government power. For example, economic researchers David Sappington and J. Gregory Sidak concluded that "public enterprises may have stronger incentives to engage in anticompetitive practices and circumvent antitrust laws than their private counterparts..."¹³

Congressional delegation of limited oversight responsibilities. The Postal Service suggests in its letter that while Congress has a right to oversee the agency, it should not be delegating any of that oversight authority to a regulator, except with regard to rate setting. For example, the Postal Service sees room for itself and Congress, but not for a Congressionally designated regulator, when it asserts, "[W]e believe that the Board, in conjunction with Congress as the elected representatives of the people, should have the final authority regarding service standards." In contrast, H.R. 22 and S. 662 would assign limited oversight responsibilities to a skilled regulator in a number of areas. Congress, of course, exercises ultimate oversight over federal agencies, and it takes that power and responsibility seriously. The question raised here is whether it is good policy for Congress to delegate limited oversight responsibilities.

Rather than attempting to carry out all supervision itself, Congress often assigns certain tasks to regulators (FDA, FCC, FTC, SEC, etc.). Such a division of labor can be sensible.¹⁴ When regulation is appropriate, legislatures should set broad objectives and requirements and monitor performance, but filling in the details and monitoring performance in depth can be extremely time consuming and technical. Legislators often find that it prudent to delegate some of the more detailed work to specialized regulators.

Government regulators like those mentioned in the last paragraph usually oversee certain types of

commercial activities in some industries or areas of the economy. Although the Postal Service is part of the federal government, it is deeply involved in commercial activities, which helps explain why Congress originally saw fit to create a regulator for it. As the agency often observes, its annual sales would place the enterprise among the largest Fortune 500 companies if it were privately owned.

In addition, legislatures sometimes delegate limited responsibilities to regulators to improve flexibility: impartial regulators are allowed, within specified statutory boundaries, to approve changes they find justified without having to wait for new legislation. This technique combines continued oversight with greater responsiveness to changing conditions. It further bolsters flexibility because regulators tend to have some insulation from politics, which means that once decisions are made based on merits, they are less likely to be held up by purely political barriers. Postal rate changes before and after the Postal Reorganization Act of 1970 illustrate the value of this approach. Before 1970, Congress set postal rates directly and often hesitated to raise rates because doing so was politically painful. As a result postal rates were artificially low, which contributed to the old Post Office Department's massive deficits. After Congress delegated rate-setting authority to the PRC (checks and balances explains why Congress hesitated to let the Postal Service set rates itself), the rate-setting process became more flexible and rates became better aligned with the Postal Service's actual costs.

Reality checks. Private-sector companies in regulated industries are routinely subject to regulatory oversight on many aspects of their operations. Although the regulations can be burdensome, the managements of private-sector firms in regulated industries are usually able to cope and perform successfully. Their real-world experiences provide evidence that the regulatory system envisioned by H.R. 22 and S. 662 is feasible and would not cripple the Postal Service's management.¹⁵

Further, while the Postal Service claims that matters like service standards, accounting, and cost attribution should be largely or entirely outside the

regulator's purview, the reality is that they are intertwined with rate setting, which the Postal Service says is a proper task for a regulator. The impact of service standards on real postal rates was noted earlier. With regard to accounting procedures and cost attribution, a rate regulator needs to examine them to enforce the requirement that products cover their own costs and make reasonable contributions to overhead costs. The goal is to protect customers within the postal monopoly from having to subsidize the agency's competitive-market ventures. If accounting procedures and cost attribution are flawed, products can appear to pay their way when, in reality, they do not. The Postal Service has often been criticized in the past for opaque accounting and the large share of costs it classifies as overhead rather than attributing to products.¹⁶

Postal Service's position contrary to that of Presidential Commission

The Postal Service claims in its letter that its views regarding service standards and facility-network modernization are similar to those of the bipartisan President's Commission on the U.S. Postal Service, which issued an insightful and widely praised report in 2003.¹⁷ The Boards' letter asserts, "The President's Commission understood these issues... We strongly agree with the President's Commission in this area." The Service's reference to the Commission is puzzling because, in fact, the Commission thought the regulator should oversee *more* areas of the Postal Service's operations. Far from viewing a regulator with wide-ranging oversight responsibilities as a governance problem, the Commission believed that a regulator with a broad mandate would be a governance asset that would improve transparency, accountability, and flexibility. In many areas, the Commission saw a role for the regulator that goes well beyond what is contained in either H.R. 22 or S. 662.

With regard to service standards, the Commission suggested letting the Postal Service continue to make minor adjustments without consulting its regulator. Maybe that is why the Service insists it agrees with the Commission. However, the Commission was very concerned about

the potential for abuse and concluded that the Postal Service should not "continue to have unlimited ability to change service standards" but should be required to seek a binding decision from an independent regulator before undertaking any change having "a substantial and negative impact on national service standards."¹⁸ The Commission warned, "Given the economic pressures facing the Postal Service, the temptation for management at some future time to turn *first* to lower service standards as a means of reducing costs, rather than as a *last* resort, might prove irresistible [emphasis in original]."¹⁹

As for modernizing the Postal Service's network of facilities, the Commission urged the Service to continue its work in that area but recommended augmenting the Service's efforts with a Postal Network Optimization Commission, modeled on successful military-base realignment panels.²⁰ The Service strenuously opposed the Network Optimization Commission, and it is not included in either H.R. 22 or S. 662.

In general, the bipartisan Commission concluded that a balance could be achieved between extensive regulatory oversight and effective internal management. Indeed, the Commission believed that the transparency and accountability flowing from open and impartial regulation would promote *better* management within the Postal Service. Judging by its September 13 letter, the Postal Service strongly disagrees with that approach.

Postal Service seeks to uncap the cap

The Postal Service likes the part of rate-cap regulation that would expedite postal rate changes. However, it is worried about being denied further rate increases after it hits the cap. (As mentioned earlier, the cap would apply to the class or subclass of mail, meaning that price increases for some products within the class or subclass could actually exceed the inflation rate.) Fearing that its costs will grow faster than the inflation rate, the Service wants an easy way to break the cap. On several prior occasions the Service has warned Congress that it might not be able to stay within an inflation-based cap unless it is given more command over costs.²¹

In the context of the current bills, the Service proposes that "reasonable and necessary" be the regulatory standard for allowing above-cap rate increases, rather than "unexpected and extraordinary" events. In effect, the cap would become either inflation or costs, whichever is rising faster. The House bill comes close to having the language the Postal Service wants, but S. 662 contains the words it opposes.²² Even if granted this escape hatch, the Service writes in its letter that it would only accept what it describes as a "hard" rate cap if it is "given significantly greater ability to control its infrastructure and growing labor costs." (As a matter of nomenclature, a cap with the Service's preferred escape clause should probably be called a soft rate cap.)

The Service may be complaining too much about a price cap that uses the inflation rate as its ceiling. The cap in H.R. 22 and S. 662 is already relatively lenient compared to how price-cap regulation is often implemented. When rate-cap regulation is applied to private-sector companies in regulated industries, the cap is frequently set at *less than* the inflation rate. In earlier sessions of Congress, some predecessors to the current bills had called for a rate cap set below the inflation rate²³. The use of inflation, rather than a lesser amount, as the cap in H.R. 22 and S. 662 suggests that the writers of those bills did hear the Service's warnings and have already softened the cap in response. Nor is inflation an especially demanding cap in terms of the Postal Service's past performance. As the Service's Governors noted in a letter to Congress last February, "Historically, postage rates have stayed within increases in the Consumer Price Index (CPI)."²⁴

Nevertheless, the Service's objection does point to a genuine weakness in the bills. The agency's fundamental problem is high and rising costs (often a problem at government enterprises). Many of its costs are locked in by statutes or informal political barriers (again, a common occurrence at government enterprises.) For instance, a number of studies have concluded that postal workers, on average, receive much higher wages and fringe benefits than comparable workers in the private sector, which helps explain why nearly 80% of the Service's costs are

labor related.²⁵ One factor leading to high and rising labor costs is that a number of expensive fringe benefits are set by statute and are beyond the Service's control. Another constraint is that when a postal union and the Service cannot reach a collective bargaining agreement, the dispute goes to binding arbitration, and the law does not instruct arbitrators to factor into their decisions the Service's financial health. Although Postmaster General Potter and his management team have made remarkable strides in reining in costs since 2001, they could do much more if they had better cost-management tools.²⁶

Regrettably, H.R. 22 and S. 662 contain few cost-control reforms despite recommendations from the bipartisan Presidential Commission, the Administration, and the Postal Service. The bills' centerpiece is rate-cap regulation.

One reason the bills tread lightly with regard to cost-management reforms is that enacting such reforms would be politically difficult. Charles Guy, former Director of the Postal Service's Office of Economics, Strategic Planning, points to a second reason. "[L]awmakers have misdiagnosed" the agency's basic problem by "attributing the Postal Service's financial woes to a fall-off in the volume of mail ... You can hardly blame the lawmakers, though, since nearly every recent analysis of the Postal Service has cited a drop in mail volume as a major factor in the organization's decline."²⁷ Guy observes that while "the Postal Service is afflicted with several serious problems" related to costs and productivity, "none of these are new or a consequence of declining mail volume."²⁸

The Postal Service's September 13 letter continues to emphasize volume, with a prominent warning that weak mail volume is one of the primary reasons why the Service expects to "face significant and increasing challenges". Because the Postal Service has repeatedly cited mail volume as its basic problem and claimed that rate-cap regulation would let it adjust prices to boost mail volume, the authors of H.R. 22 and S. 662 may (mistakenly) believe that moving to rate-cap regulation would resolve the Service's core problem without the need to deal much with cost issues.

The lack of substantial cost-management reforms in the bills creates a dilemma with regard to enforcing a rate cap. On the one hand, if costs rise faster than inflation, they would put the Service in a financial vise if the cap is firm. On the other hand, a loose cap would not give much protection to customers within the postal monopoly and would short-circuit the financial discipline that some people hope a firm cap would instill. The best way to resolve the dilemma — and produce stronger reform legislation — would be to add more cost-management tools to the bills.²⁹

To improve its odds of being able to live within an inflation-based price cap, the Postal Service should also make the fullest use of the cost-management tools it has under current law. The agency claims it is working very hard on this, and its success in reducing its workforce by over 10% since 2000³⁰ (through attrition, not layoffs) while maintaining service levels shows it has made considerable progress. However, the organization's frequent lack of transparency raises questions about whether it could do better.

For example, the bipartisan President's Commission advised, "[T]he adoption of innovative private-sector strategies could likely deliver significant additional savings, particularly in the areas of procurement reform and more active management of the Postal Service's substantial real estate portfolio."³¹ With regard to real estate, the Service reports that for the last several years "revenue from disposal and leasing of postal properties has averaged about \$65 million annually."³² Although that may look good on the surface, it is a small amount compared to the giant agency's huge real estate portfolio and is far below the agency's disposal and leasing revenues in 1998, 1999, and 2000.³³ The agency should disclose why its real estate revenue has fallen. Perhaps there is a reasonable explanation, but perhaps, as the President's Commission hinted, the agency is sitting on untapped revenues of several billion dollars in excess real estate holdings.³⁴

Turning to procurement, the Postal Service purchases billions of dollars of supplies annually. The agency is so large that even a minor change that

raises or lowers per-employee supply costs by only a few dollars annually will change the agency's total costs by millions of dollars. Earlier this year the Service abolished its legally binding purchasing regulations and replaced them with nonbinding "interim internal" guidelines that are quite similar but are nonbinding.³⁵ Although the Service touts this as a reform that follows the Commission's recommendation, the Commission had expected that the Service would continue revising the prior binding regulations, not make them nonbinding. David Hendel, a former Postal Service attorney who is now active in this area, commented, "The primary change is USPS telling suppliers, in essence, 'We don't have to follow our own rules – or be fair.'"³⁶ Because the elimination of binding regulations reduces the Service's transparency and accountability, a serious concern is that the new procurement regime will *increase* the Service's procurement costs, not reduce them, by making it harder to bring irregularities and mistakes to light and by causing suppliers to be more reluctant to deal with the government agency.

The Postal Service and the Administration

The current Administration has been the most active in a generation in pushing for Postal Service reform. It supports the Postal Service's desire to move to rate-cap regulation. Like the Service, it has concluded that the law should be reformed to give the agency more ability to control its costs. Moreover, in 2003, the Bush Administration supported a retroactive recomputation of the agency's pension liabilities that sharply reduced the agency's liabilities because it thought the new computation method is more accurate than the old.

The Postal Service's letter, nevertheless, is highly critical of the Administration. The Administration thinks all savings from the pension recalculation should be applied toward paying down the Postal Service's unfunded obligation for retiree health-care costs, which is now about \$65 billion, whereas the Service wants to use the funds for multiple purposes. Starting in 2006, the savings will be held in an escrow fund until legislation specifies how the money will be used.³⁷ Also, the Administration does not want to reopen the terms of

the 2003 pension deal in a way that would shift further costs from the Service to the U.S. Treasury, but the Service and many in Congress favor doing so. The Service charges in its letter that if it does not get its way on these matters, its "ability to maintain universal service at reasonable rates could well be jeopardized."

With regard to the escrow money, the Administration's plan would actually be better in the long term for the mail service's continued health than what the Service demands. The agency's massive unfunded health-care liability is a threat to future mail users and taxpayers. The Administration's plan would largely defuse that financial time bomb, while the agency's proposal would do less to protect future mail users and taxpayers. It should be understood that the Administration is not trying to deny the escrow money to the Postal Service, but it is concerned by the agency's unfunded obligations.

The Administration's plan would also maintain tighter financial discipline in the short term. Under the Service's plan, in contrast, the agency would suddenly have billions of extra dollars over the next few years to spend in various ways, which would tend to make it less watchful of costs. It is true, of course, that mail users would experience lower rates for several years if some of the escrow money were used to hold down rates temporarily and not used to pay down the Service's unfunded liabilities. Certainly, that would feel good in the short term. But it would be less financially responsible than the Administration's plan.

It is not clear whether to reopen the 2003 pension deal; the Postal Service has a reasonable case but so does the Administration. It would be financially prudent, however, that if the Service receives additional relief, every cent be earmarked for paying down its billions of dollars of unfunded liabilities.

The Postal Service and Administration also seem at odds regarding the role of the regulator. The Administration is very concerned about transparency and accountability. It correctly sees them as two of the core principles of Postal Service reform.

Unfortunately, the weak and narrow regulator that the Postal Service demands would be too constrained in its oversight to provide much transparency and accountability.

The PRC responds to the Postal Service's letter

At the request of several key members of the House Government Reform Committee, the PRC has prepared its own evaluation of the Board of Governors' letter, which it provided to the lawmakers on October 12.³⁸ Like many others, the PRC is "surprised" that the Postal Service's Board, whose members had been "longtime apparent supporters" of legislative efforts to revise the rules under which the Postal Service operates, is now demanding "massive changes" in the proposed legislation.³⁹ Referring to the tradeoff in H.R. 22 and S. 662 that attempts to give the Service more pricing flexibility while improving regulatory oversight in other areas, the PRC notes that the Postal Service's September 13 requests "would drastically alter the carefully balanced responsibilities of our two agencies."

The PRC takes issue with two accusations in the Board's letter. In the regulator's view, the bills would "not require the Postal Service to obtain PRC permission to modernize its network" and would not cause the PRC to "interfere in the day-to-day management of the Postal Service." Contrary to the Board's accusations, the PRC finds, "There is nothing in the language or the legislative history of these bills that support [such] suggestions..."

The PRC acknowledges that the bills would empower the independent regulator "to consider complaints that the results of Postal Service actions conflict with the policies established by Congress" and that on occasion the "Service may have to adjust some practice" if the regulator determines through hearings that the practice "leads to a result that is contrary to public policy." However, the PRC points to its record of restraint under current law whereby it tries "to limit itself to issues of substantially nationwide impact." More important, the PRC explains that regulatory oversight is good public policy when a government-owned enterprise possesses dual statutory monopolies:

The Commission does not believe that a government monopoly with the essential responsibilities and vast economic power of the Postal Service should function largely free from continuing regulatory oversight. Management does not need to be totally insulated from effective critical review in order to operate effectively.... [W]hen managers of a government monopoly are granted broad authority, it is necessary that the public have an avenue that allows effective pursuit of complaints relating to the exercise of that authority.

This Advisory has examined some of the other issues the PRC touches on, and the findings here support the PRC's conclusions. The PRC correctly observes that cost attribution and accounting are closely associated with responsible rate regulation. "If the Postal Service is given the authority to decide what costs (if any) are caused by its various postal products, neither mailers nor competitors will be able to have confidence that prohibitions on cross-subsidization and predation are meaningful." The PRC is also correct when it warns that the elastic rate cap sought by the Postal Service would undercut the financial discipline that some hope might flow from a firm price cap.

Conclusion

Virtually since the ink was dry on the Postal Reorganization Act of 1970, the Postal Service has resented having a rate regulator, complained that regulation interferes with its business plan, and sought to diminish the regulator's authority. If Congress were to enact legislation acceding to the Service's newest demands, as laid out in the September 13 letter, the agency would at last succeed in crippling its regulator.

The Service writes in its letter that it would rather stay with current law than accept either H.R. 22 or S. 662, unless the bills are changed in the way the Service has stipulated. H.R. 22 and S. 662 would reduce the regulator's control over rates but expand it in other areas. The Postal Service wants the regulator's role further limited in the rate-setting

process and not expanded elsewhere. The regulator that the Postal Service envisions would have little power to insist on transparency and accountability. That would be a threat to mail users, taxpayers, and the general efficiency of the U.S. economy. Current law would be better than the legislation that the Postal Service is seeking. Congress would be wise to reject the Service's demands.

The Postal Service's hostility to regulation suggests that one type of change may be needed in the bills' regulatory provisions: the statutory language should clearly and unambiguously give the regulator whatever authority Congress believes the regulator should have. For example, under current law the Service and the PRC frequently spar about whether the public should be able to see detailed cost and revenue information on the Service's various products, with the Service often demanding the information be kept under wraps and the PRC pushing for greater disclosure to promote openness and accountability.⁴⁰ If new legislation were to say

the regulator can decide what information to make public but then give the Service broad authority to block release, the actual result might be reduced transparency, which would be the opposite of what Congress probably desires.

The Service is not offering good advice, either, regarding to the escrow account. The long-term interests of mailers and taxpayers would be better served by the Administration's plan, which is to use every cent of the escrow money to begin paying down the billions of dollars of health care benefits the Service has promised to retirees but not yet funded.

The Postal Service is on stronger ground when it calls for better tools for managing its costs. Unlike its proposals regarding regulation, better control of costs is an essential component of true reform.

Michael Schuyler
Senior Economist

Endnotes

1. The letter can be seen at <http://www.postcom.org/public/reform/BoG%20Letter%20091305.pdf>. The information that the letter was hand-delivered rather than mailed is from NAPUS, *e-NAPUS Legislative Newsletter*, September 16, 2005, at http://www.napus.org/govrelations/E-NAPUS_09-16-05.pdf.
2. "The United States Postal Service has sought postal reform legislation for more than a decade..." (*Letter, op. cit.*)
3. *Ibid.*
4. See U.S. Postal Service, Governors, Letter to Senator Susan M. Collins, February 24, 2005, accessed on the Internet at <http://www.postcom.org/public/2005/Scan058,%20February%2024,%202005.pdf>.
5. See PostalWatch, PostalWatch News Archive - August 2005, at http://www.postalwatch.org/newslink2005/news_2005_08.htm, citing *DMNews*, at http://www.dmnews.com/cgi-bin/artprevbot.cgi?article_id=33809.
6. For example, Senator Thomas Carper (D-DE) introduced S. 1285, a predecessor to S. 662, in 2003. Among its many provisions, S. 1285 would have directed the Postal Service's regulator to establish service standards, and S. 1285 would have created a Postal Network Modernization Commission to help rationalize the Service's network of facilities. In 2004, the Service responded with 54 pages of proposed amendments. (U.S. Postal Service, "Proposed Amendments to the Postal Accountability and Enhancement Act S.1285, 108th Cong.," originally accessed via <http://www.postcom.org>.) The Service's 16th proposed amendment out of 28 recommended striking both service standard regulation and the network modernization commission. Because of the proposed amendment's position midway on the list and the absence of a statement of priorities in the Service's document, a thoughtful observer might reasonably have concluded that this was only one item on a long list, not a top agency priority. The Service's September 13 letter, however, declares that service standard oversight is totally unacceptable. The letter is especially surprising because S. 662 meets the Service's earlier objection partway by omitting the network modernization commission.
7. See Dan Davidson, "USPS Raises Objections To Reform Bills," *Federal Times*, Sept. 29, 2005, accessed on the Internet at <http://www.federaltimes.com/index2.php?S=1130137>.
8. *Letter, op. cit.* In the remainder of this paper, endnotes will be omitted for further quotes from the letter.

9. The bills would apply the cap by comparing the CPI to the *average* increase for the subclass of mail (H.R. 22) or class of mail (S. 662). That would give the Postal Service additional discretion in altering prices within the mail category, even permitting the agency to raise rates for some products within the subclass or class *faster* than the CPI.
10. The two bills differ somewhat in their particulars. For details on how the bills would regulate the prices of products they classify as market-dominant, see H.R. 22, sec. 201 and S. 662, sec. 201. For details on regulation of products they list as being in competitive markets, see H.R. 22, sec. 202 and S. 662, sec. 202.
11. See S. 662, sec. 301-302 and H.R. 22, sec. 204.
12. For a fuller discussion of Postal Service forays into competitive markets and the hazards they present, 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>.
13. See 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. Also see a second paper in which they use the German postal monopolist, Deutsche Post, as a case study: 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.
14. This is not to say that government regulation is necessarily justified. When competition and the market system are allowed to operate, they often produce far better results than government regulation.
15. To be sure, government regulators sometimes make unreasonable demands on private-sector businesses, which harm the businesses and often hurt the customers they are trying to serve. However, the Postal Service has less to fear on this score than do private-sector companies. The current-law PRC is mindful of the government connection and wants the Postal Service to succeed. While striving to regulate rates fairly and as directed by law, it has frequently expressed the desire to take actions that will meet the Service's legitimate needs and not cause it unnecessary problems.
16. Several papers in the IRET series have discussed this issue in greater detail. See, for example, Michael Schuyler, "Uneven Price Markups Distort Postal Service Mission," *IRET Congressional Advisory*, No. 165, December 11, 2003, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-165.PDF>.
17. 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. 64, accessed on the Internet at <http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf>.
18. *Ibid.*, p. 64.
19. *Ibid.*
20. *Ibid.*, p. 80.
21. For two examples of emphatic warnings delivered to Congress, see John E. Potter, Postmaster General/CEO, U.S. Postal Service, Testimony, Before a Joint Hearing of the House Committee on Government Reform and the Senate Committee on Governmental Affairs, March 23, 2004, esp. pp. 9-10, accessed on the Internet at <http://reform.house.gov/UploadedFiles/USPS%20-%20Potter%20Joint%20Testimony.pdf>; and John E. Potter, Postmaster General/CEO, U.S. Postal Service, Testimony, Before the Committee on Homeland Security And Governmental Affairs, April 14, 2005, esp. p. 8, accessed on the Internet at http://www.usps.com/communications/news/speeches/2005/sp05_0414pmg.pdf.
22. H.R. 22, sec. 201 and S. 662, sec. 201.
23. See, for example, the versions of H.R. 22 introduced in the 105th Congress, 1st Session and the 106th Congress, 1st Session (section 201 of both bills).
24. U.S. Postal Service, Governors, Letter to Senator Susan M. Collins, *op. cit.*
25. For an earlier paper in the IRET series discussing those studies, see Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No. 131, July 24, 2002, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-131.PDF>.
26. The Postal Service's recent belt tightening would not be out of the ordinary if it were a financially troubled private-sector business. Belt tightening is common in the private sector. It is much rarer at government enterprises.

27. Charles Guy, "The Postal Service Has Bigger Problems Than E-Mail," *Federal Times*, Sept. 16, 2005, accessed on the Internet at <http://federaltimes.com/index2.php?S=1108089>.
28. *Ibid.* Guy provides a more detailed analysis of what he concludes is the Postal Service's wrong-headed business strategy in Charles Guy, "The Postal Service Business Model: Broken Or Poorly Managed?" Statement Submitted To The President's Commission On The United States Postal Service, February 2003, accessed on the Internet at http://www.treas.gov/offices/domestic-finance/usps/comments/organizations/comments_LexingtonInstitute.pdf.
29. Several previous IRET papers have questioned whether moving from the current rate-setting process to rate-cap regulation is needed or would be helpful. (See, for instance, Michael Schuyler, "Rate-Cap Regulation Will Not Deliver Real Postal Service Reform," *IRET Congressional Advisory*, No. 188, June 20, 2005, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-188.PDF>.) However, a legislative package that includes a firm rate-cap, broader regulatory oversight (already in H.R. 22 and S. 662), **and** improved cost-control tools such as those recommended by the bipartisan Presidential Commission would be positive reform legislation.
30. U.S. Postal Service, *Annual Report, 2004*, p. 54, accessed on the Internet at <http://www.usps.com/history/anrpt04/anrpt04.pdf>.
31. President's Commission, *op. cit.*, p. xiv.
32. U.S. Postal Service, *Strategic Transformation Plan, 2006 – 2010*, September 2005, p. 32, accessed on the Internet at http://www.usps.com/strategicplanning/stp2006_2010/STP05R.pdf.
33. U.S. Postal Service, *Comprehensive Statement On Postal Operations*, various issues. See p. 27 of 1998 issue, p. 30 of 1999 issue, and pp. 28-29 of 2000 issue.
34. For a fuller discussion of this issue, see Michael Schuyler, "The Postal Service's Surplus Real Estate," *IRET Congressional Advisory*, No. 155, June 24, 2003, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-155.PDF>.
35. An earlier IRET study examined this issue in greater depth. See Michael Schuyler, "The Postal Service's Procurement 'Reform'," *IRET Congressional Advisory*, No. 186, June 1, 2005, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-186.PDF>.
36. David Hendel, "Highlights Of USPS's Interim Internal Purchasing Guidelines," *The Star Carrier*, July 2005, pp. 6-7, accessed on the Internet at <http://www.wickwire.com/files/thelegalcorner07-05.pdf>. Mr. Hendel is a shareholder in the law firm of Wickwire Gavin. The Wickwire Gavin website (www.wickwire.com) has much useful information regarding Postal Service procurement and the new purchasing rules. Mr. Hendel cautions that although the Service claims the guidelines derived from its old regulations are nonbinding, its claim remains to be tested in court.
37. The previous paper in this IRET series reviewed the Administration's involvement in efforts to reform the Postal Service and evaluated changes it is seeking in H.R. 22 and S. 662. See Michael Schuyler, "Administration Seeks To Uphold Five Principles Of Postal Service Reform," *IRET Congressional Advisory*, No. 193, August 31, 2005, available on the Internet at <ftp://ftp.iret.org/pub/ADVS-193.PDF>. That paper examines more fully the pension issues briefly discussed in this section.
38. Postal Rate Commission, Response to USPS Board of Governors' Letter, October 12, 2005, accessed on the Internet at <http://www.postcom.org/public/reform/McHughLetter.pdf>. The PRC sent the letter to Rep. Tom Davis (R-VA), chairman of the House Government Reform Committee, Rep. John M. McHugh (R-NY), the main developer of H.R. 22, Rep. Henry A. Waxman (D-CA), the committee's ranking member, and Rep. Danny K. Davis (D-IL).
39. PRC Response, *op. cit.* All subsequent quotes in this section are from the PRC letter.
40. The Service does release considerable data during rate cases but objects to doing so at other times. Even in rate cases, it refuses to release detailed financial information on some products. Also, because of the Service's opaque accounting, questions have often been raised about the accuracy of the cost numbers that are released. For a detailed examination of the Postal Service's fondness for financial secrecy and an analysis of why such secrecy is unjustified at a government-owned enterprise and makes for bad public policy, see 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 on the Internet at <ftp://ftp.iret.org/pub/ADVS-184.PDF>.