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GOOD AND BAD NEWS IN THE JANUARY 8 POSTAL RATE INCREASE

Executive Summary

In 2005, the Postal Service asked the Postal Rate Commission (PRC), the independent federal agency that regulates postal rates, to approve a rate increase. The PRC held hearings and several months later gave the Postal Service most of what it sought. With only a few exceptions, the rate hike will be approximately across the board and roughly 5.4% for most Postal Service products. The price of a first-class stamp will rise from 37¢ to 39¢.

There are positive aspects to the rate case but also negative ones. The increase is relatively modest, about half the size of general price inflation since 2002, when postal rates last rose. Since the early 1970s, postal rate increases have closely matched the inflation rate. On the other hand, postal rates may soon begin rising more quickly. The Postal Service is already gearing up for the next rate case, which is expected to be a major one, and will probably submit its request in 2006.

The Postal Service releases a great deal of cost data during rate cases. However, the information tends to be of low quality, with numerous shortcomings in how it is gathered and then interpreted by the Service. As a result, the data are poorly suited to determining how the Service's various costs are related to its various products. That makes it difficult for the regulator to ensure that rates on Postal Service products are set efficiently, equitably, and in accord with public policy.

Following a change in the law, the Postal Service needs to contribute much less to finance workers' pensions. The savings are going temporarily into an escrow fund. The Service wants to use the escrow money for various purposes, including holding down rates. When Congress did not quickly go along with that, the Service misleadingly called this the "Escrow Rate Case" (misleading because the escrow expense, under a different name, was already built into the old rate base.) A better use for the escrow money would be to protect the next generation of mail users and taxpayers by gradually paying down the Postal Service's huge – about $65 billion – unfunded retiree health care liability.

Under the leadership of Postmaster General John Potter, the Postal Service has achieved impressive productivity gains and a 10% leaner workforce while maintaining service quality. Unfortunately, higher per-unit input costs, mainly labor-related, have eaten away most of the potential savings from greater productivity. It will be bad news for mail users if the productivity gains slow or reverse. If Congress is to enact meaningful Postal Service reform, one of the highest priorities should be giving the Service better tools to manage its costs.

GOOD AND BAD NEWS IN THE JANUARY 8 POSTAL RATE INCREASE

In April 2005, the Postal Service filed a request for an approximately 5.4%, across-the-board rate increase. After holding hearings, the Postal Rate Commission (PRC), which is the independent federal agency charged with regulating postal rates, approved the request in early November with only minor changes.[1] One of the alterations is that after the PRC determined that certain parcel services (media and library mail) would be priced below cost, it felt compelled to recommend larger rate increases for those parcel categories so that they would cover their expenses (just barely).[2]

The Postal Service quickly accepted the PRC's decision and will raise its rates on January 8, 2006.[3] The price of a First-Class stamp, which is the postage rate most in the public eye, will increase from 37¢ to 39¢.

While no one likes higher prices (and the rate increase's timing would have been less inconvenient for commercial mailers if the Postal Service had waited one more week for the long holiday weekend in mid January), the outcome could have been worse. Only a year ago, top Postal Service officials, including Postmaster General John Potter and Senior Vice President for Government Relations Ralph Moden, were claiming that unless Congress provided legislative relief the rate increase would probably exceed 10%.[4]

This paper will examine the positive aspects of the just-concluded rate case. It will also look at the rate case's shortcomings and some problems that may be on the horizon.

The Good News

On the positive side, the rate increase is relatively modest and two potential mistakes have been avoided, at least for the time being. Moreover, as a backdrop to this rate case, most people currently find mail service acceptable and the Postal Service has recently achieved large productivity gains.

Postal rates versus inflation. The Postal Service last increased its rates on June 30, 2002. Since then, the consumer price index (CPI) has climbed over 10%.[5] Thus, the Postal Service will be raising its prices at only about half the inflation rate. The comparatively small rate hike probably helps explain why mailers have generally been fairly quiet during this rate case.

Prices at the Postal Service have increased at approximately the same rate as inflation since the old U.S. Post Office Department was converted into the U.S. Postal Service in 1971.[6] To put this in perspective, though, Sam Ryan, a Senior Fellow at the Lexington Institute, notes that mail processing has experienced a technological transformation since 1971, with machine sorting largely replacing hand sorting.[7] He further notes that when products such as long-distance telephone service have enjoyed technological transformations, their inflation-adjusted prices have often fallen dramatically. Should one be satisfied, then, that the price of mail service has risen about as fast as inflation?

Absence of contingency allowance. In most rate case decisions, rates are padded by a "contingency allowance" so that they exceed the Postal Service's estimated revenue needs. PRC Commissioner Ruth Goldway explained, "[A]fter the PRC considers all future predicted and explained cost increases, and accounts for them in recommending higher rates, we still have to give the Service a further amount -- a contingency -- for unexpected occurrences."[8] The contingency allowance was 3% in the previous rate case and historically has ranged between 1% and 3.5%. In this rate case, however, the Postal Service did not request a contingency allowance, and the PRC did not award one. If the contingency allowance had remained 3%, the Postal Service's requested rate hike would have jumped to about 8.5% and the Postal Service's customers would have faced over $2 billion yearly in extra charges, which would have produced a significantly more contentious rate case.

The absence of the contingency allowance is a plus. If it were present, it would sharply boost costs for mail users. It would also reduce accountability and financial discipline by, in effect, padding the rate base to accommodate huge cost overruns. Commissioner Goldway commented that since the Postal Service's establishment, "Billions of 'contingency' dollars ... have simply been absorbed into the fat of the system..."[9] In a rate case several years ago the PRC expressed concern that "unreasonably large contingency amounts ... would allow the Service to understate 'inconvenient' costs, (such as costs associated with providing competitive products) and essentially negate the extensive efforts of participants to understand and identify ... expenses."[10]

The Postal Service said it was not requesting a contingency allowance in this case because it wanted to focus on the escrow account and it will soon be filing for another rate hike (more on these issues below). In most rate cases, though, doesn't the Postal Service need a large contingency allowance for protection if costs are higher than expected or demand is lower? The answer is no. Unexpected events should sometimes produce surpluses and sometimes deficits, with the two roughly cancelling out over time. The Postal Service can meet temporary deficits due to unexpected events by drawing on its cumulative surplus (it currently has one) or borrowing on a short-term basis from the U.S. Treasury. As part of the federal government, the Postal Service never has to fear a cash crunch due to a short-term deficit because it has a guaranteed credit line at the Treasury. If a shortfall persists, the Service has the option of filing its next rate case a few months earlier than otherwise.

Escrow account not used to hold down rates. In 2002, at the urging of the General Accounting Office (GAO), the federal Office of Personnel Management (OPM) recalculated the Postal Service's pension liabilities for postal employees hired before the mid-1980s. OPM discovered that the Postal Service's pension contributions in future years would be much smaller if actual market data on interest rates and other variables were substituted for the assumptions contained in the funding method required by statute.[11] In 2003, Congress passed legislation making this change, as part of a legislative package putting the Postal Service's pension contributions on a more sensible basis. During 2003 -2005, under the terms of the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), the found money (i.e., reduced yearly pension contributions) went towards repaying Postal Service borrowings from the U.S. Treasury and keeping down postal rates. Beginning in 2006, though, the money will be held in an escrow account pending further legislative action.

The Postal Service's position, which has much support among large mailers and members of Congress, is that the agency should be allowed to use the annual payments now slated to go into the escrow account for a variety of purposes, one of which is to hold down rates. This approach would be correct if the Service did not have other large, unmet obligations. The problem is that while the Postal Service is out of the woods regarding unfunded pension obligations, it has massive unfunded liabilities elsewhere, notably about $65 billion of unfunded liabilities for retirees' health care costs. As many steel, airline, and auto parts companies have learned to their regret, unfunded liabilities of this magnitude can bankrupt a company. Because the Postal Service is part of the federal government, it will not go bankrupt.[12] However, if its unfunded liabilities are not dealt with in a timely manner, they will cause severe financial problems in the future, leading to some combination of steeply higher future mail rates, especially for customers within the postal monopoly, sharp cutbacks in future mail service, and a taxpayer bailout. For a current example illustrating these dangers, one can look across the Atlantic to the United Kingdom's postal service, Royal Mail, which is using several billion pounds of unfunded pension liabilities to extract money from the U.K. Treasury and to pressure its regulator into approving higher rates.[13]

The Service's unfunded liabilities are too huge to be paid down all at once, but the annual amounts now scheduled to go into the escrow account offer an ideal means to pay them down gradually and avoid sticker shock. The Bush Administration has taken essentially this position, namely that the escrow account should be ended and every cent of that money should be used to reduce the Postal Service's unfunded health care liabilities. (The Administration also likes this approach because it would not raise the federal budget deficit within the budget window. The analysis in this paper, though, focuses solely on the long-term well-being of mail users and taxpayers.)

Congress has not yet decided what to do with the escrow account. Hence, it was not used in this rate case to hold down short-term postal rates. Accordingly, the possibility still exists that the escrow money will eventually be used to defuse the long-term crisis posed by the Postal Service's enormous unfunded liabilities.

Other favorable developments. During the last rate case in 2001-2002, major uncertainties clouded the Postal Service's future. Some analysts thought it possible that the Internet's growth would produce a sudden, drastic, and permanent drop in mail volume and relevancy. The anthrax attacks that followed 9/11 had a dramatic negative effect, causing many people to hesitate before touching their mail. Some observers feared the Postal Service had a very large unfunded liability for employee pensions, but no one knew for certain. Despite large investments in automation and increased worksharing with mailers, the Postal Service's workforce expanded from one year to the next and crested at almost 906,000 in 1999[14]. Although the agency's workforce declined slightly in 2000, it seemed possible that it would quickly resume its upward march. A related problem was that productivity at the agency had languished, sometimes rising and sometimes falling. In 1999, total factor productivity was barely higher than it had been in 1978, with seemingly little to show for the billions of dollars spent on automation.[15]

Since then, the Postal Service has done well in all these areas. Mail volume dipped (and has shifted more towards advertising) but did not collapse. Newly released Postal Service data shows that total mail volume reached an all time high in fiscal year 2005, jumping by 6 billion pieces compared to the previous year.[16] While one does not know the eventual impact of the Internet on mail use, it has so far slowed mail growth but has not led to a mass defection. (Many people are reluctant to use the Internet, particularly for certain types of transactions, and activities conducted largely on the Internet sometimes generate new business for the Postal Service.) Most mail users today barely think of the anthrax attacks when opening their mail. The Postal Service dodged a bullet when its unfunded pension liabilities proved to be small (although, as mentioned above, it does have massive unfunded retiree health care liabilities). The agency has continued to make progress on the efficiency front. Much of the credit goes to Postmaster General Potter and his management team for responding decisively and with considerable operational skill to 9/11, the anthrax attacks, and the Postal Service's chronic financial problems. By 2004, the Postal Service's workforce was almost 11% below its 1999 peak, even though mail volume and the amount of work performed by the agency were about the same.[17] Reflecting improved use of labor and capital, productivity has risen each year and is now about 10% higher than it was in 1999.[18] Moreover, public opinion surveys indicate that service quality has been maintained and is deemed satisfactory by most mail users.

The Bad News

The just decided rate case also had shortcomings. Moreover, the rate case points to vexing problems the Postal Service may face in the future. For a balanced perspective, the negatives about the rate case must be considered along with the positives.

No progress in reducing disproportionate burden on first-class mail users. First-class mail is hit with an unusually high price markup and bears an outsized share of the Postal Service's overhead costs.[19] First-class mail users are vulnerable to paying elevated prices because first-class mail is the mail category most firmly within the statutory monopoly that the government has given to the Postal Service.

Because the rate case features approximately across-the-board rate increases for all mail categories and services, with just a few exceptions, it does nothing to ease the unusually heavy burden on first-class mail users. The PRC estimates that the price markup on a first-class letter will be 111.3% in 2006, compared to an average price markup on all mail and services of 77.0%.[20] Due to that disproportionately high markup, the PRC estimates that first-class letters will comprise 42.5% of mail volume in 2006 but provide nearly 60% of total overhead contributions. To reduce that markup and the monopoly-influenced pricing directed against first-class mail users, first-class mail rates should have increased by less than the average rate increase.

Some other rates are also out of line. A uniform rate increase means that other products subject to unusually high price markups also did not receive relief. For example, a category of standard mail known as enhanced carrier route (ECR) mail has had an extremely high markup for years, and after this rate case its markup will remain very high: an estimated 146.5% in 2006, which tops even that on first-class letters.[21]

A uniform rate increase also implies that no adjustment is made for changes in the relative costs of various products. Instead, a product whose cost has risen sharply will be subject to the same rate change as a product whose cost has risen slowly. In a normal rate case, a product's rate would rise more (or less) than average depending on whether the product's cost had risen more (or less) than average. Because this is the second across-the-board rate case in a row, several years have gone by since product-specific rates have been realigned with product-specific costs.

One can see why this is a problem by looking at worksharing discounts. Worksharing discounts are supposed to be set equal to the costs the Postal Service avoids when mailers perform certain preliminary mail preparation work. Doing this accurately produces incentives that lower costs, lift productivity, and produce a more vibrant economy.[22] Unfortunately, the PRC has not rebased worksharing discounts to reflect the latest data on avoided costs in either of the last two rate cases. As a result, some discounts have become too small (which tends to leave work at the Postal Service that mailers could do more efficiently) and some too large (which is inefficient for the opposite reason and costs the Postal Service money). Certain worksharing discounts are several times bigger than avoided costs.[23]

A less open rate-setting process. In this and the prior rate case the PRC closely followed the lead of the Postal Service. In both instances the Postal Service portrayed the situation as unusual (which was certainly true during the 2001-2002 case that immediately followed 9/11 and the anthrax attacks) and noted that a number of mailers had agreed to its terms. PRC Commissioner Ruth Goldway issued a Concurring Opinion in this case in which she supported the PRC's decision but cautioned that the regulator should return in the next rate case to its "traditional" and "more open" rate review process, in which greater weight is placed on the evidence developed during the rate case hearings.[24]

Commissioner Goldway wrote, "[T]he continuing reliance on [proposed Postal Service] settlements in major rate cases may lead to unfair rates and reduced efficiency within the Postal Service and, equally important ... to a diminution of the transparency and accountability in the operations of the Commission and the Postal Service."[25] In other words, she recognizes the danger that efficiency and fairness will suffer if products' rates are out of balance with their costs. Because the nearly uniform rate increases proposed by the Postal Service and agreed to by the PRC are not grounded on cost-based evidence for each subclass of mail, "they will not produce the economic benefits of efficient component pricing or most fairly divide institutional cost burdens between mailers." She is also warning that a less open rate process in which the "outcome seems predetermined" could quickly erode transparency and accountability.

This should not be labeled the "Escrow Rate Case". The Postal Service has called this the

"Escrow Rate Case"[26], and the PRC accepted the Postal Service's argument in its decision.[27] That designation is misleading.

The key to evaluating the claim is realizing that the escrow account consists of the savings due to the legislation enacted in 2003 that reduced the Postal Service's required pension contributions. (For example, if required pension contributions would be $4 billion lower under new law than under old law in some year after 2005, the $4 billion is what would go into the escrow account that year.) The prior rate case, which was held in 2001-2002, computed the Postal Service's revenue needs under old law. Therefore, it set rates high enough for the Postal Service to pay the escrow expense, although the expense was classified at the time as part of required pension contributions rather than a separate escrow account. In other words, the escrow fund is an old expense – allowed for in the old rate base – that has been reclassified. The problem for the Postal Service is not that the escrow account is a new expense (because it's not) but that costs throughout the agency (mainly labor but also equipment, transportation, miscellaneous supplies, etc.) have risen since 2001-2002.

Blaming higher postal rates on the escrow account is harmful at several levels. First, it diverts attention away from the real source of the Postal Service's financial strain: higher costs throughout the agency. Second, the claim that the rate case was due solely to a lump of money being owed to the escrow fund made it easier to rationalize an across-the-board rate hike. The efficiency and fairness problems of an across-the-board rate hike were discussed above. Third, although it was never stated explicitly, the Postal Service may have hoped that by filing a rate case linking higher rates to the escrow fund, it could prod Congress into allowing the Service to use the escrow money for various purposes. The harm in this is that any escrow money used to hold down rates in the short term will become unavailable to meet the Service's unfunded retiree health care obligations, thereby increasing the odds in the longer run of much higher rates and an emergency taxpayer bailout.

The Postal Service insisted it really hated to raise rates and would have postponed the rate case in a heartbeat if only it were given access to the escrow money. But if it wanted to postpone the rate case so badly, it could easily have done so. The PRC's Office of the Consumer Advocate (OCA) calculated that the Postal Service could have delayed the rate hike until August 15, 2006 by drawing on the earnings it has retained from the profitable years of 2003-2005.[28] Several weeks after the rate case was decided and the January 8 rate increase was approved, the Postal Service officially reported a profit of $1.4 billion in fiscal year 2005.[29] That positive income at an agency which is only supposed to charge mail users enough to break even strengthens the OCA's argument that the rate increase is premature. Of course, following the OCA's advice would have reduced the Postal Service's leverage with Congress.

Unsatisfactory cost data. Under current law the PRC evaluates cost data during rate cases to determine the costs of various Postal Service products and the division of total costs between those attributable to products and those that are overhead. However, it is the Postal Service, not the regulator, that collects the underlying data. Further, the Postal Service decides what data to collect and how to collect it.

In this rate case, as in virtually all previous ones, the regulator found serious problems with the cost data. The OCA documented numerous shortcomings in how the Postal Service collected the data, flaws in the statistical methods it used to process the data, and anomalies in the end results.[30] For example, the Postal Service's study of letter carrier delivery times implausibly estimates that carriers find it slightly easier at the margin to deliver big, heavy flats than regular-size letters[31], and the study was restricted to a short time interval, which tends to misclassify as fixed costs many expenses that are actually variable over time.[32] In its Opinion, the PRC indicated that while some of the data may be better than in previous rate cases, major defects remain. The PRC criticized the Postal Service for using "[l]ow-cost data collection methods that emphasize quantity over quality" and expressed concern that "[t]he underlying data ... contain a wide variety of errors and anomalies that are often a significant percentage of total observations."[33] For instance, according to Postal Service data that the PRC cited as clearly erroneous, some city carrier street deliveries supposed had less than zero pieces of mail, some deliveries supposedly had "volumes that would fill a tractor trailer", and the quantity of mail collected at some stops would supposedly stretch "nearly a mile".[34]

Unreliable and misleading cost data set back efforts to price the Postal Service's various products efficiently and fairly. The lack of better cost data also reduces transparency and visibility, and it deprives the Service of a valuable management tool.

Another rate increase will soon follow this one. The Postal Service has already begun preparing for the next rate case. Current expectations are that it will submit its request sometime in 2006. This is not welcome news for the Postal Service's customers. Back-to-back rate increases that cumulatively reach double digits will create greater financial strain than would a 5.4% increase followed by several years of rate stability.

The prospect of above-inflation rate hikes in the future also spells trouble for efforts by some members of Congress to revamp the Postal Service's regulatory oversight. Those legislative proposals (H.R. 22 and S. 662 in the 109th Congress) would let the Postal Service change its rates with less regulatory oversight, in return for a price cap that would limit postal rate increases to no more than the inflation rate. This would be more lenient than how rate-cap regulation has often been implemented at private-sector companies in regulated industries and at some foreign postal services, where the cap is set ***below*** the inflation rate. Nevertheless, the Postal Service strongly objects that a rate cap pegged to inflation would be too tight, although it likes the idea of less regulatory oversight. The Postal Service wants an escape clause that would have the effect of allowing the agency to increase its rates based on the ***higher*** of general price inflation or increases in the agency's costs.[35] Unfortunately, such an escape clause would threaten mail users, particularly those within the postal monopoly, and would also undermine the financial discipline that the supporters of rate-cap regulation hope to achieve.

Higher costs have eaten up productivity gains. One might have expected that after reducing its workforce by more than 10% and registering its largest productivity gains since it was created, the Postal Service would be in excellent financial shape and could hold postal rates steady or even reduce them. The reason why the agency is poised to seek a second rate increase on top of the one that will take effect in January is that higher per-unit input costs have offset most of the cost savings. In effect, the Postal Service has been running very hard for the last several years just to stay even financially.

This is primarily due to labor costs, which are a surprisingly large share of the Postal Service's total expenses, about 80%. Per-worker expenses have been growing rapidly, and are expected to continue climbing. Fringe benefits are the main cost driver. The Postal Service released data during the 2005 rate case showing that over the last decade cash wages per workyear rose at about the same rate as inflation, but fringe benefits rose much faster.[36] Current law limits the Postal Service's ability to control its workers' wages and benefits. For example, the Service must provide several very expensive fringe benefits as a matter of federal statute.

The knowledge that higher per-unit input costs have largely absorbed the savings from the recent productivity spurt is unsettling because there will be more pressure on postal rates in the future if productivity growth slows but the growth of per-unit input costs does not. The pressure will be even worse if the Postal Service follows a pattern commonly seen in past decades in which efficiency gains cannot be sustained and several years of rising productivity are followed by several years of dropping productivity.

Conclusion

Coming after several years in which postal rates have remained constant, the rate increase that will occur on January 8 will be relatively modest compared to intervening inflation. The rate case did highlight the fact that although the Postal Service releases voluminous information about costs during rate cases, most of it is poorly suited to answering questions about the specific costs of the Postal Service's various products and the division of the agency's total costs between general overhead and product-related costs. The lack of better cost information handicaps the regulator in trying to set rates that are efficient and equitable.

A concern for mail users is that the Postal Service may submit a request in 2006 for another rate increase. Two rate increases in a row would cause much more pain for those who rely on the mail than just one. If the Postal Service does soon file for another rate hike, it will be due to rising input costs, mainly for labor. This emphasizes that one of the highest priorities in designing meaningful Postal Service reform legislation should be giving the Service better tools to control its costs.

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This is another of a continuing series of IRET papers examining the U.S. Postal Service. IRET began its work in this area in the mid 1990s. Norman Ture, the organization's founder, believed that growth and prosperity are advanced by restricting government to a limited set of core functions. From this perspective he was concerned about the activities of government owned and sponsored businesses. The Postal Service stands out among government businesses because of its size — it employs nearly one third of the federal government civilian workforce — and its efforts over the years to expand.

Endnotes

1. For the PRC's decision, see Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2005-1, November 1, 2005, accessed at http://www.prc.gov/docs/47/47278/R2005-1Op.Rec.Dec.pdf.

2. *Ibid.*, pp. ii and 99-100.

3. See U.S. Postal Service, "Notice Of The United States Postal Service Of Decision Of The Governors," Docket No. R2005-1, November 15, 2005, accessed at http://www.prc.gov/docs/47/47365/GovsDecisionFiling.pdf.

4. See Denise Kersten, "Postal Service, Mailing Industry Hope For Overhaul By Spring," *GovExec.com*, November 24, 2004, accessed at http://www.govexec.com/dailyfed/1104/112404dk1.htm. Also see Alyson Klein, "Postmaster General Warns Of Rate Hike If Reform Bill Stalls," *GovExec.com*, September 20, 2004, accessed at http://www.govexec.com/dailyfed/0904/092004cdpm2.htm.

5. The U.S. Bureau of Labor Statistics provides inflation data at http://www.bls.gov/bls/inflation.htm.

6. The Postal Reorganization Act of 1970 authorized the conversion.

7. Sam Ryan, "Proposed Rate Increase Illustrates Why The Postal Service Should Be Privatized," Lexington Institute, *Issue Brief*, February 28, 2005, accessed at http://www.lexingtoninstitute.org/postalreform.asp?aid=524.

8. Ruth Y. Goldway, Commissioner, Postal Rate Commission, "Comments To The President's Commission On The United State Postal Service," February 3, 2003, accessed at http://www.postcom.org/public/2003/ goldway_statement.htm. The Postal Reorganization Act, 39 U.S.C., sec. 3621, provides for the inclusion in the rate base of a contingency allowance that the PRC judges to be reasonable.

9. *Ibid.*

10. Postal Rate Commission, "Opinion And Further Recommended Decision," Docket No. R2000-1, February 9, 2001, p. 7, accessed at http://www.prc.gov/docs/26/26439/reconsideration-decision.pdf.

11. For a detailed explanation, see General Accounting Office, "Review of the Office of Personnel Management's Analysis of the United States Postal Service's Funding of Civil Service Retirement System Costs," GAO-03-448R, January 31, 2003, accessed at http://www.gao.gov/new.items/d03448r.pdf.

12. The Government Accountability Office's (GAO) high-risk list is the closest thing to bankruptcy in the federal government. Of course, it differs from bankruptcy because GAO cannot shut down or restructure any of the troubled federal entities on its high-risk list; GAO can only monitor them more closely. The Postal Service has been on GAO's high-risk list since 2001. (See David M. Walker, Comptroller General of the United States, "U.S. Postal Service: Transformation Challenges Present Significant Risks," Testimony Before the House Committee on Government Reform, GAO-01- 598T, April 4, 2001, accessed at http://www.gao.gov/new.items/d01598t.pdf.)

13. See "Royal Mail Bankruptcy Threat," *This is Money*, November 17, 2005, accessed at http://www.thisismoney.co.uk/news/article.html?in_article_id=405121&in_page_id=2; and Tom McGhie, "Royal Mail Grabs £2bn Lifeline," *This is Money*, November 20, 2005, accessed at http://www.thisismoney.co.uk/news/article.html?in_article_id=405155&in_page_id=2&ct=5.

14. U.S. Postal Service, *Annual Report, 2003*, p. 58, accessed at http://www.usps.com/history/anrpt03/2003ar.pdf. Total employees includes career and non-career employees.

15. Postal Service, "USPS Annual Tables, GFY 2004 TFP," November 24, 2004, tbl. 42, accessed at http://www.prc.gov/docs/44/44408/TFP_Annual_Table_FY_2004.pdf. Total factor productivity (TFP) is more inclusive than labor productivity because it accounts for all factor inputs, not just labor. TFP is similar in concept to the U.S. Bureau of Labor Statistics' measure of multifactor productivity. TFP also adjusts for worksharing (mailers doing more to help process their mail in return for discounts), which is an important adjustment to make given the impressive growth of worksharing.

16. U.S. Postal Service, "FY 2005 Audited Financial Statements," December 6, 2005, accessed at http://www.usps.com/financials/_pdf/FY05-AUDITED-F1NANCIAL-STATEMENTS-120605.pdf.

17. The employment and mail volume data are from Postal Service, *Annual Report*, various issues. The data on the agency's workload (which adjusts for mail composition, worksharing, number of addresses, and other factors affecting the amount of work performed) are from Postal Service, "USPS Annual Tables, GFY 2004 TFP," *op. cit.*, tbl. 42.

18. Postal Service, "USPS Annual Tables, GFY 2004 TFP," *op. cit.*, tbl. 42.

19. An earlier IRET study examined more fully the outsized burden on first-class mail users. See Michael Schuyler, "Uneven Price Markups Distort Postal Service Mission," *IRET Congressional Advisory*, No. 165, December 11, 2003, accessed at ftp://ftp.iret.org/pub/ADVS-165.PDF. A few words should be said about terminology. The Postal Service's costs are divided into what are called attributable costs, which are costs attributed to specific products, and what are called institutional costs, which are costs not attributed to products. The term overhead costs is used here to refer to institutional costs. The term price markup is used here to refer to the percent by which the price charged on a type of mail exceeds the per unit costs attributed to that type of mail. For example, the PRC estimates that the average revenue per first-class letter will be 39.691 cents in 2006. It estimates that attributable costs on the average first-class letter will be 18.785 cents. Thus, the estimated price markup is 111.3%. (See PRC, R2005-1, *op. cit.*, pp. 1, 36 of Appendix G.) The PRC also uses the related measure of cost coverage, which is the price charged on a type of mail divided by the per unit costs attributed to that type of mail. Thus, the estimated cost coverage in the above example is 211.3%.

20. See PRC, R2005-1, *op. cit.*, pp. 1, 36 of Appendix G.

21. *Ibid.* The PRC Decision lists attributable costs for the sum of enhanced carrier route mail (ECR) and lower-priced nonprofit enhanced carrier route mail (NECR). To calculate the price markup on ECR mail, the author assumed that attributable costs are the same on a piece of ECR mail as on a piece of NECR mail. The price markup for ECR and NECR mail, together, is 137.8%.

22. For an informative discussion of worksharing at the Postal Service, see Robert H. Cohen, Matthew Robinson, Renee Sheehy, John Waller, and Spyros Xenakis, "Postal Regulation And Worksharing In The U.S.," December 2004, published in Proceedings of Wissenschaftliches Institut für Kommunikationsdienste GmbH (WIK), 8th Köenigswinter Seminar on "Regulating Postal Markets – Harmonised Versus Country Specific Approaches," February 16-18, 2004, accessed at http://www.prc.gov/tsp/130/Worksharing%20Paper%20sent%20to%20WIK1.pdf.

23. See Postal Rate Commission, "Presiding Officer's Information Request No. 3," Postal Rate And Fee Changes, Docket No. R2005-1, April 29, 2005, accessed at http://www.prc.gov/docs/43/43802/POIR_No._3.pdf.

24. Ruth Goldway, "Concurring Opinion Of Commissioner Goldway," in PRC, R2005-1, *op. cit.*

25. *Ibid.* Other quotes in this subsection are also from Commission Goldway’s Concurring Opinion.

26. The Postal Service used this term on its website (web page originally accessed at http://www.usps.com/ratecase). For an elaboration of the Service’s argument, see John E. Potter, "Direct Testimony Of John E. Potter On Behalf Of United States Postal Service (USPS-T-1)," before the Postal Rate Commission, Docket No. R2005-1, Submitted April 8, 2005, accessed at http://www.prc.gov/docs/43/43435/Potter-Finale.pdf.

27. See PRC, R2005-1, *op. cit.*, pp. i-ii.

28. The Office of the Consumer Advocate, Postal Rate Commission, "Initial Brief Of The Office Of The Consumer Advocate (Revised)," Docket No. R2005-1, September 27, 2005, esp. pp. 5-31, accessed at http://www.prc.gov/docs/46/46927/Brief_final_draft_14.pdf. The OCA argues that because the law (39 U.S.C., sec. 3621) says rates should be set so that the Postal Service can break even, not earn a profit, a reasonable interpretation of the law is that the retained earnings resulting from the Service’s profits in 2003-2005 should have been used to delay the rate hike or reduce its size.

29. Postal Service, "FY 2005 Audited Financial Statements," *op. cit.*

30. OCA, "Initial Brief," *op. cit.*, esp. pp. 36-90.

31. *Ibid.*, p. 81.

32. *Ibid.*, pp. 67-69.

33. PRC, "Opinion And Recommended Decision," R2005-1, *op. cit.*, p. 1 of Appendix I.

34. *Ibid.*, p. 16 of Appendix I.

35. For a recent statement of the Postal Service's objections to this and other features of H.R. 22 and S. 662, see Board of Governors, U.S. Postal Service, Letter dated September 13, 2005, accessed at http://www.postcom.org/public/reform/BoG%20Letter%20091305.pdf. In general, the Service wants a freer hand in setting rates, and it opposes giving its regulator enhanced authority in other areas, such as regulating service quality. The Service objects more strongly to the provisions in S. 662 than those in H.R. 22. For an analysis of the Postal Service's objections, see Michael Schuyler, "Disappointing News (In A Hand-Delivered Letter) From The Postal Service," *IRET Congressional Advisory*, No. 194, October 20, 2005, accessed at ftp://ftp.iret.org/pub/ADVS-194.PDF.

36. William P. Tayman, Jr., "Direct Testimony Of William P. Tayman, Jr. On Behalf Of United States Postal Service (USPS-T-6)," before the Postal Rate Commission, Docket No. R2005–1, Submitted April 8, 2005, esp. pp. 12-15, accessed at http://www.prc.gov/docs/43/43436/USPS-T-6.pdf.