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CONGRESS DELIVERS POSTAL SERVICE LEGISLATION

Executive Summary

Just before it adjourned in December, Congress passed significant Postal Service legislation, the Postal Accountability and Enhancement Act (Public Law 109-435).

The new law gives the Postal Service greater flexibility to adjust postal rates, a power it had long sought; broadens oversight on nonrate issues by its regulator, now called the Postal Regulatory Commission; and resolves two issues regarding the Postal Service's pension contributions.

The pricing discretion, which the Postal Service argues will allow it to operate in a more businesslike fashion, comes with the restriction that rates on market-dominant products are not to increase faster than the consumer price index. Mailers hope the rate cap will hold down future rate increases, and the Administration hopes the cap will promote financial discipline at the government-owned agency. The new rate-setting process will not affect the rate case now pending.

Unfortunately, the legislation does little to relax Congressionally imposed requirements that push up the Service's labor costs. Rate-cap regulation is not a magic bullet. It would work much better if it were coupled with labor compensation reform.

Congress has decided to transform the Postal Service's regulator from mainly a rate regulator to a full-fledged regulator, extending its oversight into areas such as service standards, in order to provide a check on the Postal Service's increased discretion. The regulator has shown itself to be highly competent in the past. The rules it develops in coming months and years to carry out its expanded responsibilities will help determine the new law's effectiveness.

The pension-contribution changes are largely unrelated to the rest of the act and are a follow-up to 2003 legislation. The 2003 law retroactively recalculated – and greatly reduced – the Service's pension liability, but then locked up the annual savings after 2005 in an escrow account. The new legislation justifiably ends the escrow account and prudently directs that the Service use most of the funds to reduce its enormous unfunded liability for retiree health care benefits.

Privatization and de-monopolization were not on the table in 2006. Congress will be loathe to consider these changes as long as the Postal Service delivers reasonable service at affordable prices.

Congress wisely understood that the Postal Service should concentrate on its core mission and not wander into unrelated markets. The Postal Accountability and Enhancement Act removes the Service's authority to introduce new nonpostal products.

CONGRESS DELIVERS POSTAL SERVICE LEGISLATION

Just before it adjourned last year, the lame-duck Congress unexpectedly passed major Postal Service legislation. The new law alters many of the rules under which the government-owned Postal Service operates.

Congress's action was a surprise because, although it had come close to enacting legislation in 2004, 2005, and earlier in 2006, snags had developed on each occasion that prevented final passage. After union objections to one provision blocked Congress from considering the bill in late September,¹ many commentators thought the legislation was dead for 2006 and possibly longer.

Senator Susan Collins (R-ME) continued working to secure passage, however. According to press reports, she was joined by Senator Thomas Carper (D-DE), who helped broker a deal with Representative Henry Waxman (D-CA) on the other side of the aisle.² Representatives Tom Davis (R-VA) and John McHugh (R-NY) also played key roles.

The legislation was originally numbered H.R. 22, but, for parliamentary reasons, it was reintroduced on December 7, 2006 as a new bill, H.R. 6407, the Postal Accountability and Enhancement Act. It passed the House by voice vote and the Senate by unanimous consent. President Bush signed the bill on December 20, 2006, and it became Public Law 109-435.

This paper will review the main provisions of the legislation, as well as several potential changes that were omitted, and offer some thoughts on what they mean.

The final horse trade

The final deal that secured the bill's passage had two elements. The unions objected to a firm cap on future postal rate hikes lest the cap have a restraining

effect on future pay increases. They also objected to a provision that would impose a three-day waiting period before workers would be eligible for benefits on workers compensation claims. Several Senators, however, insisted on the three-day waiting period because it was the only labor reform left in the bill, and a very modest one at that. The compromise was that the Postal Service's regulator will review rate-cap regulation after ten years, with authority to change it, and the three-day waiting period on workers compensation claims will remain in the bill. All parties except the unions had previously made many significant concessions.

The act's main provisions

The bill fundamentally changes the rate-setting process, expands the regulator's role on nonrate issues, and relieves the Postal Service of several billion dollars of annual payments it had been obliged to make to the U.S. Treasury as the result of 2003 legislation.

- *The Postal Accountability and Enhancement Act gives the Postal Service the power to change postal rates, within limits, without seeking prior regulatory approval.* Under old law, the Postal Service had needed to submit proposed rate changes to the Postal Rate Commission (PRC), an independent federal regulatory agency, and wait up to 10 months while the PRC held formal hearings and then issued a decision.

H.R. 6407 divides Postal Service products into what it calls market-dominant and competitive categories. Most products that the bill places on the market-dominant list are sheltered by the Service's statutory monopoly, although some, such as money orders, non-bulk parcels, and non-bulk international mail, are actually in competitive markets.

- For products in the market-dominant category, the legislation allows the Postal Service to

increase rates on its own authority, provided rates do not rise faster than the Consumer Price Index (CPI). In "extraordinary and exceptional circumstances", H.R. 6407 permits the regulator to authorize rate increases that exceed the cap. The new law does not affect the rate case now pending, and postal rates are expected to rise in May. (The legislation also lets the Postal Service file one more rate case under the old rules in 2007.)

- For products in the competitive category, the Postal Service may set whatever prices it wishes, provided that each product covers its own costs and that competitive products collectively make an "appropriate" contribution (as determined by the regulator) to the Service's overhead, or "institutional", costs. The intent is to "prohibit the subsidization of competitive products by market-dominant products."

- **Congress broadens the regulator's responsibilities.** The PRC's jurisdiction had previously been fairly narrow; it mainly regulated postal rates. The Postal Accountability and Enhancement Act converts it into a full-fledged regulator and changes its name to the Postal Regulatory Commission. Several of the PRC's responsibilities (by no means a complete list) are blowing the whistle if competitive-market products receive subsidies from market-dominant products or fail to make appropriate contributions to overhead costs; making sure that market tests of new products meet certain conditions, such as not unfairly disadvantaging private-sector businesses, especially small businesses; and protecting consumers by monitoring whether the Postal Service meets service standards that the bill instructs the Service to develop with the PRC's assistance. H.R. 6407 gives the regulator clear statutory authority, including subpoena power, to obtain financial data and other information that it needs from the Postal Service.

- **Congress ends an escrow account it created in 2003, which turns over billions of dollars to the**

Postal Service. In 2003, based on advice from the General Accounting Office and the Office of Personnel Management, Congress decided that the statutory formula used to calculate how much the Postal Service had to contribute to fund certain workers' pensions (workers covered by the old Civil Service Retirement System, CSRS) was flawed. In the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), Congress retroactively changed the formula, which greatly reduced the Postal Service's pension contributions. Congress directed that, after 2005, the Service's annual "savings" go into an escrow account pending further legislative action. As part of the same legislation, in an action to which the Service later objected, Congress shifted from the U.S. Treasury to the Postal Service responsibility for the increased CSRS pensions received by certain Postal Service retirees who had also served in the military. The net effect of the two changes was to reduce the Postal Service's pension contributions by several billion dollars annually.

The 2006 legislation terminates the escrow account, and shifts back to the Treasury (i.e., taxpayers) responsibility for the higher CSRS pensions received by certain Postal Service retirees who had also served in the military. The Postal Accountability and Enhancement Act directs that most of the savings to the Postal Service be used to pay down the Service's enormous unfunded liability for retiree health care benefits.

Effects of major changes

For the past 35 years, the Service has complained that the old rate-setting process prevented it from being able to adjust prices quickly and by the right amount in response to market forces. If the Service's complaint is correct, rate-cap regulation will give it the pricing flexibility to better serve its customers and operate in a more businesslike manner. The legislation will also allow the Service to introduce new and modified postal products without extensive prior regulatory deliberations.

Commercial mailers are enthusiastic about rate-cap regulation because they believe it will prevent postal rates from rising as fast as otherwise. The Administration has supported the combination of pricing flexibility and a firm rate cap on the theory that the duo will give the Service the opportunity to act entrepreneurially while providing the financial discipline to strive for greater efficiency. One hopes these predictions prove correct.

There are some reasons to be cautious, however. Many companies in markets not subject to any rate regulation do poorly or go broke, which suggests that pricing flexibility, by itself, is not as beneficial as the Postal Service has often claimed. The Postal Service has already experienced this to a limited degree. Because of special rules in old law, international mail was not subject to rate regulation by the PRC, but that did not stop it from being one of the Service's weaker performers. If the Service eventually encounters financial problems despite gaining the pricing flexibility it has long sought, the rate cap may not hold, which will disappoint its customers. (More on this below.)

Fairness is another concern. Under old law, the PRC took fairness into account when recommending rates. Under the new procedure, the Service will have a free hand to raise the prices of some products more than others, provided revenues cover costs and the rate cap is not violated. The Service is likely to respond by raising rates more for products securely within the postal monopoly than for products with good non-Postal-Service alternatives. The Service could practice further price discrimination within its sheltered market because the rate cap applies to mail classes. For instance, it could raise rates faster than the CPI for some subclasses of first-class mail, as long as the average rate change for first-class mail is within the cap.

Congress's strategy of broadening the PRC's role while giving the Postal Service more power can be thought of as an application of checks and balances in government. Congress believes that the Service, with its enhanced powers, is most likely to follow the

rules laid down in H.R. 6407 if a skilled regulator oversees its behavior. Congress is also delegating some technical decisions to the PRC, as well as a few potentially controversial decisions.

In expanding the PRC's responsibilities, Congress is expressing confidence in the regulator, which in the past has shown itself to be technically proficient, concerned about mail users, and also concerned about the Postal Service without becoming a rubber stamp. Of course, the new responsibilities are a challenge, and only time will tell how well the PRC performs. One of the most important tasks that lies ahead for the PRC will be to develop the regulations and procedures needed to carry out its new oversight responsibilities.

It is encouraging that the act's statutory language gives the PRC clear authority to obtain the financial and other information it believes it needs from the Postal Service. That should strengthen transparency and accountability, and is an overdue reform. In the past, the Service's cost accounting has often been murky. (For example, the Service claims about 40% of its costs are for overhead, which many observers believe is improbably high.) The bill's establishment of service standards that are subject to regulatory supervision is also promising. Service standards are common at public utilities as a means of protecting the public, although they have not previously been applied to the Postal Service. Quality standards are especially important when a monopolist (such as the Postal Service in its core market) is subject to rate-cap regulation. Otherwise, the monopolist could easily stay within the cap simply by slashing service quality.

The Service has a different attitude toward regulation. It contends that Congress has created an overly strong regulator that will be making decisions which should be left in the hands of Postal Service management. However, the Service's statutory monopoly and numerous governmental powers are persuasive arguments in favor of regulation. Although the government often regulates American businesses too heavily, regulation in this case appears

fully justified. Moreover, Congress was solicitous of past Postal Service complaints in that the new rules usually allow the Service to act first, subject to later regulatory review, instead of having to wait for prior regulatory approval. On that matter, a question that should be asked after the new system has been tested in operation is whether after-the-fact regulatory review provides adequate safeguards for mail users, especially those within the postal monopoly. A related question is whether the Service's new ability to change rates without much prior regulatory scrutiny will interfere with attempts elsewhere in the legislation to improve transparency.

With regard to the escrow account, its termination was fully justified. Once Congress had decided in 2003 that the Postal Service should make smaller pension contributions, it was not good public policy to take the resulting savings away from the Postal Service. A related plus is the bill's requirement that most of the pension savings be used in a financially prudent way: to begin paying down the Service's massive unfunded liability for retiree health care costs. If not dealt with now, those unfunded liabilities would be a financial time bomb for the Postal Service and future mail users.

The issue of who should pay the higher CSRS pension benefits received by some postal retirees who are also military veterans is convoluted.³ Like most other pension questions, Congress decided it in the Postal Service's favor. The bill's pension provisions help the Postal Service financially by tens of billions of dollars.

Some other provisions

A much longer paper would be needed to fully describe a bill that ranges from broad issues to minutia like the ZIP code in Bradbury, California and retail hours at a branch post office in Painesville, Ohio. Just a few additional provisions will be mentioned here.

The Postal Accountability and Enhancement Act defines what constitutes postal services, which prior law had not done. Simultaneously, the legislation removes the Postal Service's authority to offer new nonpostal services. It also orders the PRC to determine, for each existing nonpostal service, whether or not it should continue. In light of the financial failure of many past nonpostal ventures by the government enterprise, these limitations will have the benefit of forcing the Service to stay focused on its core assignment: traditional, hard-copy, non-urgent mail delivery. Because Postmaster General John Potter and a Board of Governors led by James Miller have done a superb job of concentrating on the agency's core mission, and have generally de-emphasized nonpostal forays, the new limitations are most valuable as a check on future, less clear-sighted executives.

Another provision in the legislation applies the antitrust laws to the Postal Service, to a limited degree, if the Service engages in anticompetitive behavior outside its monopoly market. This furnishes a marketplace protection that had been lacking. Previously, the Service enjoyed total immunity from the antitrust laws.⁴

Features omitted

The Postal Accountability and Enhancement Act does not take any steps toward privatizing the Postal Service. Nor does it include any significant scaling back of the Postal Service's statutory monopoly. As Sam Ryan of the Lexington Institute points out, this is in contrast to reforms elsewhere in the world.⁵ Japan and several European nations have privatized their posts, in whole or part, or are planning to do so. A number have narrowed the scope of their postal monopolies. The results have been encouraging and support the thinking of most economists that private ownership and competitive markets produce greater efficiency and more innovation than government ownership and monopolized markets. These good

outcomes have persuaded the European Commission to announce a plan to abolish postal monopolies in Europe by 2009.

The main reason privatization and de-monopolization were not on the table in this country is that most people are relatively happy with the Postal Service. The Postal Reorganization Act of 1970, which converted the old, dysfunctional Post Office Department into today's Postal Service, has proven remarkably successful, as evidenced by the fact that the Postal Service now scores above most other federal agencies in public opinion surveys. The impetus for privatization and de-monopolization is further reduced because worksharing, in which mailers do some preliminary mail processing in return for reduced postage rates, has the effect of indirectly offering partial privatization for some upstream mailing steps. In the absence of loud calls for privatization and de-monopolization, Congress listened to the Postal Service and postal unions, which adamantly opposed those changes. Congress probably will not consider reform in these areas as long as the Postal Service delivers reasonably good service at affordable prices. Of course, the Internet and other electronic alternatives to mail are wildcards. If they eventually cause a sharp decline in mail volume (mail use has so far held up well), Congress may feel compelled in the future to reexamine the Postal Service's mission and structure.⁶

Regrettably, H.R. 6407 is nearly devoid of provisions to help the agency to better manage its high and rising labor costs. The sole provision, which was mentioned above, is the sensible but small one of a three-day waiting period on workers compensation claims. (Workers can still receive pay for those days by using vacation or sick leave, and the waiting period will be waived if disability lasts more than 14 days.) The legislation does not change key limitations Congress has placed on the Service's ability to control its labor costs: Congress requires that postal workers receive several very expensive fringe benefits, and arbitrators with no responsibility for the Postal Service's financial health determine

wages, certain benefits, and various work rules when the Postal Service and a postal union cannot reach a collective bargaining agreement. These anti-cost-control limitations help explain why labor-related expenses remain close to 80% of the Postal Service's total expenses, despite the billions of dollars the agency has spent on automation, and why many economic studies have found that postal workers, on average, receive substantially higher wages and benefits than comparable workers in the private sector. The Postal Service and commercial mailers understand the importance of reform in this area, but they regard it as a lost cause politically and have been unwilling to fight for it, or educate Congress on its significance. Murray Comarow, who contributed greatly to the transformation of the old Post Office Department into the modern Postal Service, reasoned perceptively that H.R. 6407's rate cap, which helped sell the legislation, may prove in the long run to be "a pipe dream" without labor-cost reform.⁷

The bill also has some omissions for which reformers should be thankful. In the 1990s, the Postal Service frequently claimed that although it was having problems carrying out its core assignment, everything would be fine if it could just expand in competitive markets. In response, some predecessors to H.R. 6407 (e.g., the 1998 and 1999 versions of H.R. 22) would have let the Postal Service create a wholly owned subsidiary through which it could readily enter nonpostal markets. If that proposal had become law, the Service's ventures in non-core markets would have distracted it from its basic mission, disrupted competitive markets, and hurt the economy's efficiency. Congress wisely dropped that provision from subsequent versions of the bill. In 2004, the Administration spotted a provision that would have allowed the Service to borrow in private credit markets. Although the Service's debt would have carried no explicit government guarantee, lenders would have assumed there was an implicit guarantee, and would have lent to the Service without exercising normal market diligence. After the Administration explained the moral-hazard problem, the provision was modified and the danger removed.⁸

Conclusion

The new Postal Service law is essentially two bills wrapped in a single package. One of them is pension legislation. The other is limited reform of the legal framework under which the Service operates.

The pension changes will clearly benefit the Service financially. The impact of the other changes

is harder to predict. Much will depend on how the Postal Service and its regulator respond to their new powers and responsibilities. The legislation's most serious weakness is that it removes almost none of the Congressionally imposed restrictions that limit the Service's ability to manage its labor 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 an examination of how union opposition delayed the bill and weakened its reform elements, see Michael Schuyler, "Union Demands Hurt Postal Service Reform," *IRET Congressional Advisory*, No. 210, October 11, 2006, available at <ftp://ftp.iret.org/pub/ADVS-210.PDF>.
2. See Stephen Barr, "Lawmakers Unexpectedly Take Up Postal Service Overhaul," *The Washington Post*, December 8, 2006, D03, accessed at http://www.washingtonpost.com/wp-dyn/content/article/2006/12/07/AR2006120701961_pf.html.
3. Both sides make plausible cases. For an overview, see Michael Schuyler, "Would Proposed Postal Service Legislation Help Bring Down Costs?" *IRET Congressional Advisory*, No. 175, June 8, 2004, pp. 5-6, available at <ftp://ftp.iret.org/pub/ADVS-175.PDF>.
4. In 2004, the Supreme Court affirmed the Postal Service's antitrust exemption under old law. See *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>.
5. Sam Ryan, "Letter From Europe," *New York Times*, December 6, 2006, accessed at <http://lexingtoninstitute.org/1020.shtml>.
6. A longshot possibility is that Congress may act if the Postal Service's special protections run afoul, in the future, of international trade agreements.
7. See Murray B. Comarow, "How Not To Reform Government," National Academy of Public Administration, March 2006, accessed at <http://www.postcom.org/public/articles/2006articles/How%20Not%20To%20Reform%20Government%20by%20Murray%20Comarow.doc>.
8. For a fuller explanation, see Michael Schuyler, "Limiting The Postal Service's Interest Rate Subsidy; A Lesson From Fannie Mae And Freddie Mac On What Would Work And What Would Not," *IRET Congressional Advisory*, No. 178, August 10, 2004, available at <ftp://ftp.iret.org/pub/ADVS-178.PDF>.