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THE POSTAL SERVICE'S FINANCIAL PLIGHT AND THE U.S. CREDIT DOWNGRADE

Executive Summary

On August 5, Standard & Poor's downgraded the U.S. government's credit rating. On the same day, the U.S. Postal Service added to the financial gloom by reporting another dismal quarter and warning that it will default on a $5.5 billion payment to the federal government on September 30. Since then the Service has continued to talk of default, escalated its projected loss for fiscal year 2011, and predicted that within a year it will have insufficient cash to fully pay workers and contractors.

In addition to both situations being alarming, the federal government's overall finances and the condition of the government-owned mail service bear many similarities. They both involve federal government operations, are characterized by unsustainably large deficits, have been worsened by the recession and anemic recovery, and would have been almost unimaginable just a few years ago. Another similarity is that they are worse than otherwise because of Congress's behavior, specifically, its reluctance in the past to rein in federal spending or allow the Postal Service more flexibility in reducing operating costs.

Important differences also exist. The Postal Service's finances are terrible, but those of the overall federal government are much worse. The federal government's funding sources are taxes and virtually unlimited borrowing, while the Postal Service primarily relies on receipts from product sales and up to $15 billion of borrowed money. Because the Service cannot continuously accumulate red ink, it has responded more promptly and intelligently to financial problems than the overall federal government, although neither has done enough. The shorter leash also explains why the Postal Service's financial problems, although not as horrendous as those of the overall federal government, are more immediate. Another difference is that while the Postal Service's troubles are economically worrisome, the consequences would be seismic if serious doubts arise about whether the United States can meet its debt obligations.

The comparison shows the value of a moderately short financial leash. It brings near-term pain but provides important budget discipline. There is controversy about whether the bill to raise the federal debt ceiling was the proper tool for shortening the government's financial leash, but the greater fiscal restraint resulting from the accord reduces the odds that the United States will suffer further credit downgrades in the future.

The federal government's gaping deficit hole, which is the core reason for the S&P downgrade, reduces its ability to provide monetary assistance to the Postal Service. A better approach would be for Congress to allow the Service greater operational flexibility to lower costs in ways that would bring large savings relative to the inconvenience for mail users.

THE POSTAL SERVICE'S FINANCIAL PLIGHT AND THE U.S. CREDIT DOWNGRADE

On August 5, Standard & Poor's, the largest of the three major credit rating agencies, reduced the federal government's long-term credit rating from AAA to AA+.[1] The two other major credit rating companies, Moody's and Fitch, have not downgraded the U.S. government's credit rating so far, but some smaller rating agencies have. This is the first credit downgrade for the sovereign debt of the United States of America since Moody's gave it the equivalent of an AAA rating in 1917. S&P wrote that the United States no longer deserves a triple A rating because of its "rising public debt burden" and the increased political risk that "American policymaking and political institutions" will be unable to agree on "a broader fiscal consolidation plan that stabilizes the government's debt dynamics any time soon."[2] S&P also said the long-term financial outlook for U.S. government debt is negative, meaning S&P is more likely to lower the U.S. credit rating in future years than raise it.

On the same day, the U.S. Postal Service, an arm of the federal government, announced it had lost $5.7 billion in the first three quarters of fiscal year 2011, with volume off 1.3% and revenue down 2.4% compared to the same nine months last year.[3] The loss in the third quarter alone was $3.1 billion, marking the tenth consecutive quarter in which the Postal Service has lost money. In announcing these results, the Service reiterated that it is running out of cash and will be unable to meet a statutory requirement to pay $5.5 billion into the Postal Service Retiree Health Benefits Fund (RHBF) by the end of the fiscal year (September 30).[4]

Since then, in a loud, steady drumbeat of press releases, media interviews, and statements to Congress, the Service has continued to say it will default on the $5.5 billion federal payment, described itself as approaching insolvency,[5] said it would already be bankrupt and in reorganization if it were a normal business,[6] and asked Congress to let it tear up its labor contracts and pull its workers out of their existing pension and health benefit plans.[7] Moreover, the government-owned enterprise, which estimated just a few months ago that it would lose $8.5 billion in fiscal year 2011, the same as in 2010, now says its 2011 loss may reach $10 billion.[8] The Service has also issued the doomsday warning that by next summer it may be unable fully to pay employees and contractors and have to shut down, although it has noted less conspicuously that it thinks a shutdown is "unlikely" because it believes Congress would act to prevent that.[9]

Both the S&P downgrade and the Postal Service's woes made front-page headlines and have contributed to the sense that the U.S. economy is heading in the wrong direction. This paper examines some of the similarities and differences between the financial predicaments of the U.S. government and the Postal Service.

Similarities

Consider a few common elements in the S&P downgrade and the Postal Service's huge losses.

- *Both involve the federal government.*

S&P's action pertains to debt issued by the U.S. government and reflects slightly reduced confidence that U.S. government securities are safe from default in the long term. The Postal Service's federal link is that it is 100% government owned and operated. The Postal Reorganization Act of 1970 specifies that the Service is "an independent establishment of the Executive branch of the Government of the United States" and that it is "provided to the people by the Government" for the purpose of supplying postal services.[10]

- *Mammoth deficits fuel the worries.*

The federal government incurred a $1.3 trillion deficit in fiscal year 2010, and has spilled $1.2 trillion of red ink through the first 11 months of fiscal year 2011.[11] The Postal Service's deficit is orders of magnitude smaller than that, being in the billions instead of trillions, but is still enormous. In words that could apply to both deficits, the Postal Service's Chief Financial Officer, Joseph Corbett, candidly said about the enterprise's losses, "This is not sustainable. We can't continue to lose this amount of money."[12]

- *The current deficits and mounting debts of the federal government and the Postal Service would have been almost unimaginable just a few years ago.*

For most of U.S. history, the federal government ran large deficits during wars but paid down its debt in peacetime. The pattern changed after World War II, with federal spending chronically exceeding federal receipts. However, deficits were manageable relative to the size and growth of the economy, until recently. In fact, federal debt held by the public declined from over 100% of gross domestic product (GDP) at the end of World War II to approximately 36% in 2007.[13]

Since then, however, federal deficits and the national debt have exploded. Federal debt held by the public pushed above 62% of GDP by the end of 2010, and gross federal debt, which includes debt held in intra-government accounts such as the Social Security trust fund, hit 93.2% of GDP.[14] Lamentably, federal debt is one of the few parts of the U.S. economy still growing rapidly.

At the old Post Office Department, massive deficits (averaging 26.1% of revenue in the 1950s and 16.4% in the 1960s[15]) were a major failing and one of the primary reasons why Congress transformed the agency into the U.S. Postal Service, which operates according to more businesslike principles. Although the transforming legislation (the Postal Reorganization Act of 1970) directed the Postal Service to break even over time, the agency lost money in more years than it recorded profits. Those losses and concerns about further deterioration persuaded the General Accounting Office (GAO, later renamed the Government Accountability Office) to add the Service to its high-risk list in 2001, prompted the Bush Administration to establish the bipartisan President's Commission on the United States Postal Service in 2002, and spurred the Postal Service to issue its own Transformation Plan in 2002.[16] In a pleasant surprise, the agency then staged a turnaround. Under former Postmaster General John Potter, it made excellent progress in lowering costs and raising productivity (largely by slimming its workforce, mostly through attrition), while maintaining good service quality. By the end of 2006, the Service had more than satisfied its break-even objective: its cumulative surplus since reorganization stood at $3.2 billion.[17] Although it was recognized that the future held risks, the Postal Service seemed to have dodged multiple bullets.

In every subsequent year, however, the Service has lost money. By the end of 2010, it had a cumulative deficit since reorganization of $17 billion,[18] and it is billions of dollars further in the hole now.

- *Efforts were made to anticipate long-term financial dangers, but what actually happened was still a surprise.*

For decades, those who follow the federal budget have been warning about the growing cost and difficulty of supporting federal "entitlement" programs, especially Medicare and Social Security, as the ratio of retirees to workers increases due to smaller family size, greater longevity, and the retirement of the baby-boom generation. For example, in 1993, at the urging of Senator Robert Kerrey (D-NB) and others, President Clinton created the Bipartisan Commission on Entitlement and Tax Reform, which warned of rising entitlement costs that would eventually destabilize the federal budget.[19] Unfortunately, Congress has so far not enacted corrective legislation despite a number of attempts. The entitlement challenge is gradually intensifying, with some strain now but the worst to come in 10-20 years.

The present fiscal crisis, though, mostly originated in unexpected quarters: the collapse of an epic housing bubble, the related bloodbath in financial markets, and an unprecedented jump in peacetime federal spending. (Based on data from the U.S. Bureau of Economic Analysis, federal spending averaged 20.3% of GDP over the period 1950-2008, but has averaged 26.7% from the first quarter of 2009 through the second quarter of 2011, an increase of nearly one third.[20])

At the Postal Service, the long-term danger seen on the distant financial horizon was the feared loss of business to electronic diversion. For instance, a 1982 study by the Office of Technology Assessment (OTA) examined electronic alternatives to mail and predicted, "[T]he volume of USPS-delivered mail is likely to peak in the next 10 years."[21] In reality, mail volume was 62% higher in 1989 than in 1979, and 25% higher in 1999 than 1989.[22] Over the years, several other studies of electronic diversion also came to grim conclusions that were not borne out by later events. Mail volume did dip in the 2001-2003 period, which led to speculation that, at last, hard-copy mail was in permanent decline due to electronic alternatives, but mail use then rebounded to set a volume record in 2006 and a revenue record in 2007.[23] Although first class mail did not participate in the rebound (it has been falling since 2001), other classes of mail grew strongly enough to provide an offset. These facts suggest the 2001-2003 mail decline was mainly due to a weak economy, 9/11, and concerns triggered by the mail-delivered anthrax attacks. By 2006, when Congress last passed major postal legislation, the Postal Accountability And Enhancement Act of 2006 (PAEA, P.L. 109-435), the majority view within and outside the Postal Service was that mail demand was remarkably durable and that electronic diversion, though real, was proceeding slowly. This reassuring view that the Service had time to adjust gradually to slowly declining demand helped shape PAEA.

What happened shortly thereafter, of course, was the unexpected appearance of the Great Recession and the sudden intensification of electronic diversion, both of which caused mail demand to nosedive.

- *Congressional decisions are largely responsible for the federal deficit, and they have substantially increased the Postal Service's deficit.*

Congress affects the federal deficit because it specifies how much to spend on discretionary programs, writes the laws that determine eligibility for entitlement spending programs, and enacts the laws setting taxes and other federal charges and fees.

Congress's actions also have a major impact on the Postal Service's financials. On the one hand, Congress imposes higher costs on the Service due to the Service's universal service obligation (USO) "to bind the Nation together" by furnishing reasonable mail access and delivery throughout the nation. On the other hand, Congress has created an array of government-based advantages for the Postal Service that boost revenue or reduce costs, such as statutory monopolies on letter delivery and mailbox access, exemptions from many of the taxes that normal businesses pay, a low-cost credit line of up to $15 billion at the U.S. Treasury (now virtually maxed out), and the Service's ability to have tort cases against it heard in federal rather than state courts. (Federal rules are generally less favorable to plaintiffs than state rules.) Less obviously, Congress has increased the agency's expenses by billions of dollars annually by micromanaging some of its business operations and by imposing various costly requirements that have little to do with the agency's government-assigned core mission of mail delivery. For example, the law forces on the Service an arbitrator-imposed labor contract whenever the Service and a postal union cannot reach a collective bargaining agreement; requires that fringe benefits, such as health benefits, be at least as good as they were in the early 1970s; insists that the Service continue delivering mail six days a week to most addresses; forces the Service to deeply discount postage rates on billions of pieces of nonprofit mail;

and mandates that the Service comply with the costly Davis-Bacon Act on construction projects. In addition, members of Congress frequently pressure the Postal Service to change course when it tries to save money by, for example, closing or consolidating excess processing plants or contracting out more delivery routes.

One section of PAEA inadvertently intensified the Postal Service's near-term money problems. Because the Service had not set aside any funds to pay for the future retiree health benefits promised to its workers, it had accumulated a $75 billion unfunded liability for that fringe benefit by the end of fiscal year 2006.[24] Congress became concerned about whether the Service would be able to pay what it promised. Consequently, Congress established the Retiree Health Benefits Fund (RHBF), directed the Service to transfer a large surplus from an unrelated escrow fund into the RHBF, and ordered the Service to make annual contributions, averaging roughly $5.6 billion, into the RHBF over 10 years. The idea of funding fringe-benefit costs as they accrue is sound, but the 10-year contribution schedule has proven unaffordably front-loaded, especially with the plunge in postal volume and revenue.

Differences

A number of differences exist between the financial predicaments of the federal government and the Postal Service. Four will be mentioned here.

- *The Postal Service's deficit is enormous – but the federal government's is much worse.*

The Postal Service's finances are in terrible shape. By the end of fiscal year 2011, the Service will have lost up to $10 billion for the year, exhausted its $15 billion credit line, and spilled approximately $30 billion of red ink over the period 2007-2011.[25] The Service declares, "If we were a private company, we already would have filed for bankruptcy and gone through restructuring—much like major automakers did two years ago."[26] The agency's statement that a private-sector company with its finances would be bankrupt is sobering, and the Service's reference to auto companies that received a massive taxpayer bailout as the centerpiece of their "restructuring" adds to the unease.

Nevertheless, the Postal Service is a model of financial rectitude compared to the overall federal government. In fiscal year 2010, the Service's $8.5 billion deficit equaled 12.7% of its revenue, and its outstanding debt of $12 billion was 17.9% of revenue.[27] Both ratios will be higher this year. For the overall federal government, though, its $1,293 billion deficit in fiscal year 2010 equaled a staggering 60% of federal receipts (no, that is not a misprint), and the gross public debt of $13,529 billion equaled 625% of receipts.[28]

- *Funding Source Differences*

The federal government's main revenue source is taxes. Taxes are compulsory payments forced on individuals and businesses by the government. The Postal Service's primary revenue source is receipts from the sale of its products to willing consumers. With a few minor exceptions, the Service has not directly received tax dollars since 1982. (The exceptions, such as a Congressional appropriation for free mail for the blind, are best thought of as fees for services rendered, not subsidies. The Postal Service does receive various indirect government subsidies, such as assorted federal tax exemptions and a low-interest-rate credit line at the U.S. Treasury.)

The federal government and the Postal Service also obtain funds through borrowing. The Postal Service is on a tighter leash. Its borrowing cap equals about one-quarter of its yearly sales receipts, while the federal government's borrowing cap, the debt ceiling, keeps being raised. It equaled about 660% of yearly receipts at the end of fiscal year 2010 and is higher now.[29]

- *The Postal Service has responded more promptly and intelligently to financial problems than the overall federal government. But both need to do much more.*

The federal government has not yet trimmed its entitlement promises, although they are growing ever harder to support. On the contrary, the government has made costly, new entitlement commitments in recent years, notably in the area of health care. Nor did the federal government begin showing discipline in its discretionary spending until recently. From 2000 to 2005, total federal receipts grew by $128 billion, while total federal outlays increased by more than five times that amount ($683 billion).[30] From 2005 to 2010, federal receipts, weighed down by the recession, rose only $9 billion, but federal outlays mushroomed by $984 billion. Since 2010, however, Congress has, at last, begun taking steps to slow spending growth. For example, as part of the agreement to raise the federal debt ceiling (the Budget Control Act of 2011, P.L. 112-25), Congress agreed to prune discretionary spending by about $90 billion annually compared to the prior rising baseline and to use either the recommendations of a "super committee" or an across-the-board sequestration of discretionary spending to achieve additional deficit reductions of about $120 billion annually. (To put these numbers in perspective, remember the 2010 deficit was $1.3 trillion and the 2011 deficit is expected to be about the same. The reductions are small in comparison.) These initial steps toward spending restraint are welcome. However, a concern is that Congress may choose the "wrong" programs to scale back, or allow a blanket sequestration to trim muscle as well as fat. Ideally, Congress would choose where to trim based on a careful assessment of which programs are most costly relative to their benefits.

In contrast, as briefly mentioned earlier, the Postal Service has been making a focused effort for the last decade to remove costs from its system. Among its many actions, the most significant has been a sharp reduction in its workforce. The Service's total workforce (career and noncareer) exceeded 900,000 in 2000, but was 98,000 smaller (10.9%) by 2005.[31] That reduction would be an impressive but not unusual occurrence at a private-sector business, but it is an eye-opener at a government enterprise. The Service cautioned by the middle of the decade that it had picked the low-hanging fruit and further savings were becoming more difficult to find. Nevertheless, when the recession hit and mail volume plummeted, former Postmaster General John Potter and his management team quickly recognized the danger, and they skillfully identified and implemented large additional cost savings in many areas. The agency's total workforce declined by another 131,000 between 2005 and 2010, bringing the cumulative reduction since 2000 to 230,000 (25.5%).[32] Postmaster General Donahoe told Congress that the Service's yearly costs are now an estimated $19 billion lower than what they would be if the agency still had as many employees, working as many hours, as in 2000.[33] A significant criticism, however, is that while the Postal Service has been bold in trying to right-size its workforce, it has been slow to seek changes in wages, generous fringe benefits, and restrictive work rules. The Service's likely response would be that it is severely constrained by statutes and political pressure, and that it would have done much more if Congress had allowed it.

The Postal Service would probably also respond that it has launched an aggressive series of initiatives this year to reduce the number of post offices and mail processing plants, along with a proposal to slow first-class mail delivery.[34] It is beyond the scope of this paper to evaluate whether these proposals strike a reasonable balance between saving money and maintaining acceptable service quality, but the Postal Service is clearly pushing harder in these areas than otherwise because they are not explicitly barred by current law, unlike many other potential adjustments.[35] The agency is also asking Congress for special laws allowing it to lay off postal workers despite no-layoff provisions in contracts and to withdraw current and retired postal workers from federal pension and health care plans. (New plans administered by the Postal Service would be substituted.)

Strangely, in one area where the Service could improve its finances without running into Congressional barriers or negatively affecting universal service, the agency appears to be leaving money lying on the table. The Lexington Institute's *Postal TrendWatch* points out, "First Class Mail and Standard Mail typically contribute a substantially greater share of their revenues toward overhead than do competitive products."[36] In 2010, competitive postal products accounted for 12.9% of the Postal Service's revenue and 15% of its attributable costs, but covered only 7.1% of total overhead (institutional) costs.[37] (Counterfactually, if competitive products had achieved the same ratio between attributable costs and overhead contribution as market dominant products, they would have covered 12% of overhead costs.[38]) It has always been troubling on equity grounds that the Service's competitive postal products have much lower markups than First Class Mail, the product at the center of the Service's government-assigned mission. Now, under the regulatory system that PAEA established, the low markups may not even make good business sense.

PAEA prohibits the Service from increasing the prices of market-dominant products faster than the inflation rate, with only a limited exception, but the statutory price cap does not apply to competitive products. It is true that the Service has increased competitive-product prices faster than market-dominant prices, and competitive products satisfy the regulatory requirement that they cover at least 5.5% of the Service's overhead costs. However, the Service has raised its competitive-product prices more slowly than rivals have increased their prices, which suggests it is concentrating too much on sales growth and not enough on net income. Moreover, the Service has considerable room to increase competitive-product prices in many cases and still significantly underprice its rivals. PAEA grants the Service the freedom to experiment with competitive-product rates, and the Service could use that flexibility to adjust competitive-product rates in an effort to increase their contribution to overhead costs. This is an issue the Postal Regulatory Commission (PRC) may also wish consider when it reexamines in the near future how much competitive products should be expected to contribute to overhead.

- *The consequences would be seismic if serious doubts arise that the United States will meet its debt obligations, but a Postal Service default would have much less impact.*

The current financial crisis in Greece and several other European states demonstrates how concerns about a possible government default can inflict massive economic damage on a nation and spread the trauma to other countries. The disruptions would be many times greater than those emanating from Europe if investors become worried about the integrity of U.S. government securities, given that Treasury securities are one of the bedrocks of financial markets here and abroad, and that massive quantities of Treasuries are held throughout the world. While the S&P downgrade sounded a warning that should be heeded, the data suggest the downgrade did not, by itself, have much effect on creditors' confidence. It did not change trends in the stock and bond markets. Stocks had fallen 10% (as measured by the Dow) in the two weeks before S&P issued its opinion and kept falling afterward, while U.S. Treasuries, which would be most at risk in the event of a federal default, had been strengthening before the downgrade and continued strengthening.[39] Even with the downgrade, U.S. Treasuries are safer than many European bonds, and Treasuries remain a "safe haven" investment when foreign markets are nervous.

On June 22, the Postal Service announced an action that had the unintended effect of testing how markets would react if it defaulted. The Service declared that it was suspending certain payments (about $115 million every other week) to the Federal Employees Retirement System (FERS), one of the pension funds for its workers, contending that its account is in surplus.[40] Because it had previously been thought the payments are legally required unless Congress changes the law (a view the Service now disputes), the suspension may arguably count as a default. Nevertheless, the Postal Service's action caused no distress and little comment in financial markets. That indicates market participants would not regard a Postal Service default as having any bearing on the safety of U.S. government debt; there would be no contagion effect. The FERS suspension also indicates that defaulting on debts to the federal government would not cause the Service any immediate operational problems. On the other hand, as the Service well knows, some employees and suppliers might withhold their services if they become unsure about being paid. Hence, defaulting on obligations to creditors outside the federal government would disrupt mail delivery and, thereby, hurt the economy.

Conclusion

The Postal Reorganization Act of 1970 deliberately placed the Postal Service on a shorter financial leash than the overall federal government, although a longer financial leash than a normal business. The Postal Service's greater financial accountability has brought short-term pain: the agency must confront the fact that it is almost out of money. However, the Service's greater accountability is also beneficial: it instills a discipline which helps explain why the Postal Service has responded more promptly to financial imbalances than the overall federal government and why the Service's bottom line, although terrible, is not nearly as bad as that of the overall federal government.

This comparison suggests that those concerned about soaring federal spending and unsustainably large deficits are sensible to want to place new limits on federal deficits and debt. It is controversial whether the bill to raise the debt ceiling was the proper tool for shortening the federal government's financial leash. Some have argued for a succession of small debt-ceiling increases, each with a little spending restraint; some believe appropriations bills are the place to take a stand; some advocate a constitutional amendment to limit spending and deficits. Still, the agreement finally reached in the Budget Control Act of 2011 will prevent future federal budget deficits from being quite as large as otherwise and will slow the growth of federal debt. Ironically, although the political acrimony preceding the budget agreement may have been one of the factors S&P considered in its downgrade decision, the greater fiscal restraint resulting from the accord reduces the odds that S&P or other credit rating agencies will lower their ratings for U.S. sovereign debt in the future.

The core reason for the S&P downgrade, of course, is the federal government's financial problems. Those difficulties have direct relevance for the Postal Service.

When the old Post Office Department experienced financial troubles comparable to or worse than those of the Postal Service today, Congress could be counted on to throw the mail service a financial lifeline. However, the federal government is now so overextended itself that Congress has begun looking for places to pare back federal spending, not places to make new financial commitments. The S&P downgrade is likely to make financial aid for the Postal Service an even tougher sell because the downgrade has increased public concern about the government's already dire finances. A further complication is that under the terms of the agreement to raise the debt ceiling, if Congress decides to aid the Postal Service in a way that deepens the federal deficit, the assistance may have to be paid for through spending cuts elsewhere or tax increases. Which programs should be cut, which taxes raised? Paying for expenditures explicitly is always difficult politically.

Fortunately, Congress could quickly take several steps that would have a relatively low impact on its own deficit while giving the Postal Service considerable short- and long-term relief. Congress should reschedule the six massive contributions to the RHBF that are due in 2011-2016, perhaps substituting something like the 30-year term common with home mortgages. (Admittedly, this action would have a budget effect, but the current schedule is arbitrary, front-loaded, and it can't be met.)[41] To verify that the Service's finances are as claimed, Congress should also order that an independent auditor, not selected by the Service, review the agency's books. Most important, Congress should give the Postal Service better cost-management tools.

Congress expects the Postal Service to at least break even but saddles it with numerous costly requirements. The Service claims it could shave billions of dollars from yearly expenses if Congress allowed it more operational flexibility, especially with regard to the labor-related expenses that comprise nearly 80% of its costs. Until recently, the postal monopoly was sufficiently valuable that the government enterprise could bear the extra costs, but that is no longer the case. Congress should acknowledge this reality by removing special requirements that do not advance the Service's government-assigned mission of supplying reliable, economical, nationwide mail service. For instance, along with rescheduling the RHBF contributions, Congress should eliminate the statutory requirement that prevents the Service from offering less generous health benefits to future retirees. Some of the Service's proposals would lower service quality. Instead of reflexively blocking those, however, Congress should ask whether the proposed changes would do less harm than the alternatives, such as different adjustments also affecting service quality, higher postal rates, or a massive taxpayer bailout. The proposals most likely to pass this test are those that would generate large savings relative to the burden on mail users. Because the Service's financial hole is so deep, Congress should also consider whether to follow the lead of some foreign posts and grant a one-time, above-inflation postal rate increase. U.S. postal rates would still be among the lowest in the world. However, because of the value of the rule of law in terms of efficiency and equity, Congress should be cautious about some recent Postal Service proposals that call for reneging on existing contracts.

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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 currently employs about 25% of the federal government's civilian workforce. For many years – but fortunately much less so in recent years – it was also notable for aggressively trying to expand beyond its core mission into nonpostal commercial markets.

Endnotes

1. Standard & Poor's, "United States Of America Long-Term Rating Lowered To 'AA+' On Political Risks And Rising Debt Burden; Outlook Negative," August 5, 2011, accessed at http://www.standardandpoors.com/ratings/articles/en/us/?assetID=1245316529563. The two other major credit rating companies, Moody's and Fitch, have not downgraded the U.S. government's credit rating so far, but some smaller rating agencies have.

2. *Ibid*.

3. U.S. Postal Service, Form 10-Q, Quarter III FY2011, submitted to Postal Regulatory Commission, August 5, 2011, accessed at http://www.prc.gov/Docs/74/74520/Qtr3.FY11_10Q_Final.pdf.

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8. Patrick Donahoe, "Statement," before the Senate Committee on Homeland Security and Governmental Affairs, September 6, 2011, accessed at http://hsgac.senate.gov/public/index.cfm?FuseAction=Files.View& FileStore_id=87a1a612-6413- 4872-a92f-1544c9ae1608.

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14. *Ibid*.

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16. See U.S. General Accounting Office, "Major Management Challenges and Program Risks: U.S. Postal Service," GAO-01-262, ,January 2001, accessed at http://www.gao.gov/pas/2001/d01262.pdf; President's Commission on the United States Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, originally accessed at http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf; and U.S. Postal Service, *United States Postal Service Transformation Plan*, April 2002, originally accessed at http://www.usps.com/strategicdirection/transform.htm.

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18. *Ibid*.

19. See Bipartisan Commission On Entitlement And Tax Reform, "Final Report To The President," December 1994, accessed via http://www.ssa.gov/history/reports/KerreyDanforth/KerreyDanforth.htm. For an IRET paper on the issues, see Bill Modahl, "Pay-As-You-Go Entitlements, The Baby-Boom, And The Federal Budget – Facing Up To Reality," *IRET Policy Bulletin*, No. 64, November 7, 1994, available at http://iret.org/pub/BLTN-64.PDF.

20. The ratios were computed by the author using the latest quarterly data from the U.S. Bureau of Economic Analysis, accessed via http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1. The recession deepened the federal deficit by simultaneously reducing federal receipts and raising federal spending. An analysis of the nine other recessions since 1950 indicates that the jump in federal spending was far greater than would have been expected based on the downturn. It is that extraordinary escalation in spending which has converted the deficit from a serious problem into an black hole that weakens this country's long-run future. For a fuller discussion, see Michael Schuyler, "Past Recessions Offer Perspective On The Federal Government's Deficit And Debt Problems," *IRET Congressional Advisory*, No. 276, July 6, 2011, available at http://iret.org/pub/ADVS-276.PDF.

21. U.S. Office of Technology Assessment, "Implications Of Electronic Mail And Message Systems For The U.S. Postal Service," NTIS order #PB83-265017, August 1982, p. ix, accessed at http://www.fas.org/ota/reports/8214.pdf.

22. U.S. Postal Service, *Annual Reports*, various issues.

23. U.S. Postal Service, *Annual Report, 2010*, *op. cit.*, pp. 82, 85.

24. U.S. Postal Service, *Annual Report, 2007*, p. 26, originally accessed at http://www.usps.com/financials/_pdf/AR2007_final.pdf.

25. U.S. Postal Service, *Annual Report*, *2010*, *op. cit*., p. 85; and Donahoe, "Statement," *op. cit*.

26. U.S. Postal Service, "Mandatory Stand-Up Talk: USPS Exploring Additional Legislative Proposals; Financial Crisis Calls For Significant Actions," *op. cit.*

27. U.S. Postal Service, *Annual Report*, *2010*, *op. cit*., pp. 75 and 85.

28. *U.S. Budget*, *Historical Tables*, *op. cit.*, Tables 1.1 and 7.1. The federal deficit and debt are often expressed as shares of GDP, but it is appropriate to present them here as shares of receipts in order to compare them to the deficit and debt ratios at the Postal Service.

29. *Ibid*., Tables 1.1 and 7.3.

30. *U.S. Budget*, *Historical Tables*, *op. cit.*, Table 1.1.

31. U.S. Postal Service, *Annual Reports*, various issues.

32. *Ibid*.

33. Donahoe, "Statement," *op. cit*.

34. In July, the Service released a list of 3,652 post offices that are being studied for possible closure. (See Lisa Rein, "Postal Service Names 3,700 Post Offices That Could Be Closed," The Washington Post, July 26, 2011, accessed at http://www.washingtonpost.com/politics/postal-service-names-3700-post-offices-that-could-be-closed/2011/07/26/gIQARk3tbI_story.html.) With 728 other post offices already being examined for closure, the total number of post offices that may be shuttered is 4,380, or 13.5% of USPS-owned post offices (including post offices, stations, and branches) in operation at the end of fiscal year 2010. In September, the Service announced that it will review 252 of its 487 processing plants for possible closure or consolidation. (See Siobhan Hughes, "Cost Cuts Would Slow First-Class Mail," The Wall Street Journal, September 16, 2011, accessed at http://online.wsj.com/article/SB10001424053111903927204576572571491624628.html.)

35. Alan Robinson argues convincingly that the network rationalization plan is also "second best" because of "pricing, financial, [and] labor contract constraints." See Alan Robinson, "The Proposed USPS Network: A Second Best Solution," *Courier, Express, and Postal Observer*, September 16, 2011, accessed at http://courierexpressandpostal.blogspot.com/2011/09/proposed-usps-network-second-best.html.

36. See The Lexington Institute, "Postal TrendWatch Q3 2011," September 20, 2011, accessed at http://www.lexingtoninstitute.org/library/resources/documents/PostalReform/Q3FY2011PostalTrendWatchFinal.pdf.

37. U.S. Postal Service, "Public Cost And Revenue Analysis, Fiscal Year 2010," accessed at http://about.usps.com/who-we-are/financials/cost-revenue-analysis-reports/fy2010.pdf.

38. Calculated by author from *Ibid*.

39. For the underlying data, see Yahoo Finance, accessed at http://finance.yahoo.com.

40. U.S. Postal Service, "U.S. Postal Service Institutes Cash Conservation Plan; Payment To FERS Suspended," Release No. 11-074, June 22, 2011, accessed at http://about.usps.com/news/national-releases/2011/pr11_074.htm.

41. If this paper had been written several months earlier, another suggestion would have been that Congress allow the Service to reduce its payments to FERS. The Office of Personnel Management (OPM), which administers the retirement pensions of federal workers, estimates that the Service's account at FERS is more than 100% funded, and OPM's Inspector General agrees. Nevertheless, it is troubling that the Postal Service has unilaterally suspended some of its payments to FERS without waiting for a legal green light.