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# Why The U.S. Postal Service Is In Greater Financial Trouble Than Most Foreign Posts — The Role of Postal Rates

## *Executive Summary*

Postal services throughout the world are losing sales to electronic alternatives and the after-effects of the Great Recession. Nevertheless, most foreign posts in developed nations that report their financial results to the Universal Postal Union (UPU) are profitable. Many occasionally lose money, but few stay in the red year after year.

The U.S. Postal Service, in contrast, has lost money continuously since 2007 — $25.3 billion of red ink through 2011 — and it warns of steeper losses ahead. What factors explain why USPS has become one of the developed world's sickest postal services financially?

Earlier papers examined two crucial differences: government micromanagement, which deprives the Service of important cost control tools commonly relied on by foreign posts, and the Service's generous and very expensive retiree health benefits. A later paper will consider whether USPS would be financially stronger (or weaker) if it emulated many foreign posts and diversified into nonpostal businesses.

This study investigates the role of postal pricing.

Postage is inexpensive in the United States by international standards. Compared to the postage required in 40 foreign nations for an ordinary domestic letter, USPS's 45 cent stamp price is below the rates in three-fourths of the foreign countries. USPS's price would have to rise by more than a third, to over 60 cents, before it merely equaled the average charge in the other nations.

USPS is also much lower than average in the extent to which postal rates have changed over the last decade. Deutsche Post found that, across a sample of 29 European nations, the ordinary domestic letter rate rose an average of 32% in inflation-adjusted dollars over the period 2001-2011. In this country, the inflation-adjusted increase was only 3.1%. The real price that USPS charges for a first-class stamp is essentially the same now as it was in 1971.

The amount USPS charges for ordinary domestic parcel post is also below average compared to rates at foreign postal services.

The fact that most foreign postal services are profitable and charge much more than USPS undermines claims that increased prices here would push USPS into a death spiral. Historical evidence, here and abroad, demonstrates that higher postal rates usually raise a postal operator's income.

It is conceivable that at least a few foreign posts have healthier bottom lines than USPS not because they have smarter managers, less expensive workers, better designed networks, or are subject to less government interference, but simply because they charge more.

While much higher prices than those seen here are part of the business plans of many successful foreign posts, this country's low postal rates are highly desirable. Nevertheless, as mail demand plunges, an unpleasant question is whether they are still sustainable.

With falling mail volume, each remaining piece of mail must cover more of the U.S. Postal Service's fixed costs. Consequently, a price per mail piece that once would have been just sufficient for USPS to meet its total costs and break even will now result in a loss. However, many "fixed" costs result from Congressional mandates and political pressure and could be reduced with little adverse impact on the quality of mail service if there were less Congressional micromanagement. Accordingly, as mail volume declines, it becomes increasingly important that Congress let USPS deliver the mail without imposing expensive requirements not closely related to its core mission.

The Postal Accountability and Enhancement Act of 2006 (PAEA) generally bars USPS from raising the prices of its market-dominant products faster than the inflation rate. At this point, the decision as to whether to authorize an above-inflation rate increase rests with Congress.

A special rate increase by itself carries the danger that the money it collects could become an excuse for delaying or watering down urgently needed operational changes at USPS, which is an excellent reason for Congress not to approve a rate increase in isolation. However, a special increase might be helpful as one component of an "all of the above" reform package. In deciding whether a rate increase belongs in a reform package, Congress should recognize that difficult choices are unavoidable and ask if the benefits in the forms of fewer cuts in mail service and improved long-term financial viability are worth the burden of higher postal rates.

Contrary to a Postal Service suggestion, a special rate increase should not apply only to single-piece first-class mail, given first-class mail's already high markup and its importance in terms of government policy. A better choice would be an across-the-board rate increase applying uniformly to all USPS products and services, except for larger increases on "underwater" products whose marginal costs exceed their prices. If Congress decides to enact an across-the-board increase to provide immediate relief, it might also wish to order the Postal Regulatory Commission (PRC) to begin an old-style omnibus rate case (a full-blown review of all rates with formal hearings and extensive testimony) to carefully balance efficiency, equity, and financial self-sufficiency objectives.

# Why The U.S. Postal Service Is In Greater Financial Trouble Than Most Foreign Posts — The Role of Postal Rates

Recent years have been financially catastrophic for the U.S. Postal Service. It last earned a profit in 2006.[1] Since then, it has incurred losses totaling $25.3 billion.[2] Looking ahead, USPS projects a $14 billion deficit in 2012 under current law[3] and it warns of worsening losses in future years.[4] In light of USPS's troubles, it might be assumed that postal services in other countries are also struggling. In reality, however, most foreign posts are keeping their heads above water. An earlier IRET study examined postal services that report their financial results to the Universal Postal Union (UPU), an international postal organization.[5] The study documented that, in each year during the period 2007-2010, the majority of foreign posts in the sample were profitable, despite the challenges thrown up by electronic diversion and the last recession. To be sure, many foreign postal services lost money in one or two years, but few stayed in the red throughout the period.

The divergence between the U.S. Postal Service's red ink and the black ink of most reporting foreign posts is surprising. Are there a few key factors that have lifted up foreign posts financially or dragged down USPS? Do those differences offer a guide to stanching USPS's losses and returning it to financial self-sufficiency, perhaps by adopting foreign best practices?

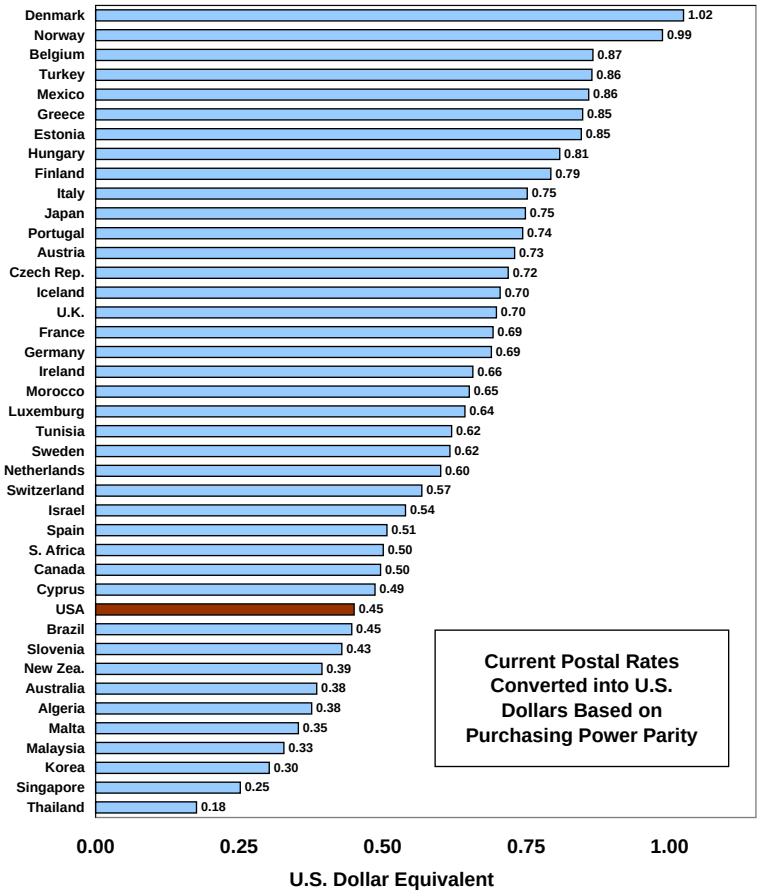
This paper examines one of the most noticeable differences between the U.S. Postal Service and foreign posts: the price of postage. As will be discussed below, postage rates in the United States are an extraordinary bargain compared to those in most other countries. USPS's low prices help explain why Americans send so much mail compared to people in other countries. According to information from the UPU, letter-post volume in the United States exceeded 500 pieces per inhabitant in 2010 (the most recent year in the UPU database), a per capita letter-post volume surpassed only by Liechtenstein and Switzerland.[6] However, notwithstanding the popularity of USPS's low prices, are the Service's bargain rates also partially responsible for the government enterprise's financial woes? Or would USPS be in even worse shape if its prices were higher?

While this paper tries to understand the Postal Service's lagging financial performance by looking at the revenue side, two earlier papers investigated the cost side. One of them dealt with government micromanagement. Through statutes and informal political pressure, Congressional micromanagement has deprived the U.S. Postal Service of the operational flexibility it needs to manage costs properly.[7] In other countries, governments, despite frequent political grumbling, usually give their postal services considerable discretion to make operational adjustments when costs threaten to outstrip revenues. This difference in cost-control tools is a major reason why foreign posts have shown more financial resiliency in recent years than USPS. Another paper discussed an additional cost pressure on USPS compared to foreign posts: the generous retirement health benefits it promises its workers and the high cost of paying for those benefits.[8] The front-loaded contribution schedule for funding those promised benefits should be stretched out. Unfortunately, the underlying benefits are so expensive that they will continue to place a heavy financial burden on USPS unless some adjustments are made to the benefits themselves.

An upcoming paper in this series will examine another difference between USPS and most foreign posts: nonpostal diversification. The issue of nonpostal diversification involves both cost and revenue considerations. Proposals that the financially troubled U.S. Postal Service venture into nonpostal

commercial markets like banking, logistics, insurance, and Internet services are controversial. Some people believe it would aid the Service's bottom line, while others claim it would hurt both USPS and the overall economy.

**Chart 1 Cost Of A Domestic Letter In The USA And 40 Other Nations**




Sources: Described in text. Prices as of March 2012.

## Postal rates in the United States and foreign nations

Postal rates in the United States are some of the lowest in the world. Chart 1 shows the price of a first-class stamp in the United States compared to the rates in 40 other countries.[9] Foreign prices have been converted into U.S. prices based on how much of each currency would be needed to buy a common market basket of goods and services (purchasing power parity).[10]

As can be seen from the chart, three-fourths of the foreign posts in the sample charge more for an ordinary domestic letter than does USPS, and one-fourth charge less. The rate for an ordinary domestic letter averages over 60 cents in the foreign countries. In some nations, an individual mailing an ordinary domestic letter must pay more than twice as much as the U.S. Postal Service charges here. Even if the U.S. rate were 10% or 15% higher than it is now, it would still be lower than the rates in two-thirds of the foreign countries. The price here would have to rise by more than one-third before it reached the average rate in the other countries. The U.S. Postal Service's low rate is especially impressive because the United States is geographically huge, with many pieces of U.S. domestic mail traveling distances that would take them across national borders if mailed in other countries and require there the purchase of expensive international postage.

Another way of looking at the price of a first-class stamp in the United States is to ask how it has varied over time. Like most things, its nominal price has risen. However, in inflation-adjusted dollars, the first-class postage rate has not changed much in 40 years. As shown in Chart 2, the real price of a first-class stamp is about the same now as it was in 1971, when the old Post Office Department was converted into the U.S. Postal Service.[11]

For an international comparison of how postal rates have moved over time, consider changes in inflation-adjusted postal rates on domestic first-class letters in the United States and European. Deutsche Post, the former German postal monopoly operator, publishes that information for a large number of European postal services.[12] As Chart 3 shows, households and businesses sending ordinary domestic letters suffered much larger real rate increases in most European nations than in the United States over


the period 2001-2011. From 2001 to 2011, the real postage rate for an ordinary domestic letter in the 29 European nations in Deutsche Post's sample rose by 32 percent, on average. In the United States, meanwhile, the price of a first-class stamp rose from 33 cents at the very start of 2001 to 44 cents at the end of 2011. In inflation-adjusted dollars, the rate increase was 3.1 percent.[13]

Postal products today can be grouped into two broad categories: letter mail, whose volume is declining in many countries, and package services, which are growing rapidly in most nations. The same Internet that is a powerful substitute for letter mail encourages households and businesses to order merchandise online, and most of those orders require physical delivery. The comparisons presented so far have related to first-class letter mail. Because of packages' rising importance to the U.S. Postal Service, it would also be worthwhile to know if USPS's package service rates are low, average, or high relative to those of other postal services.

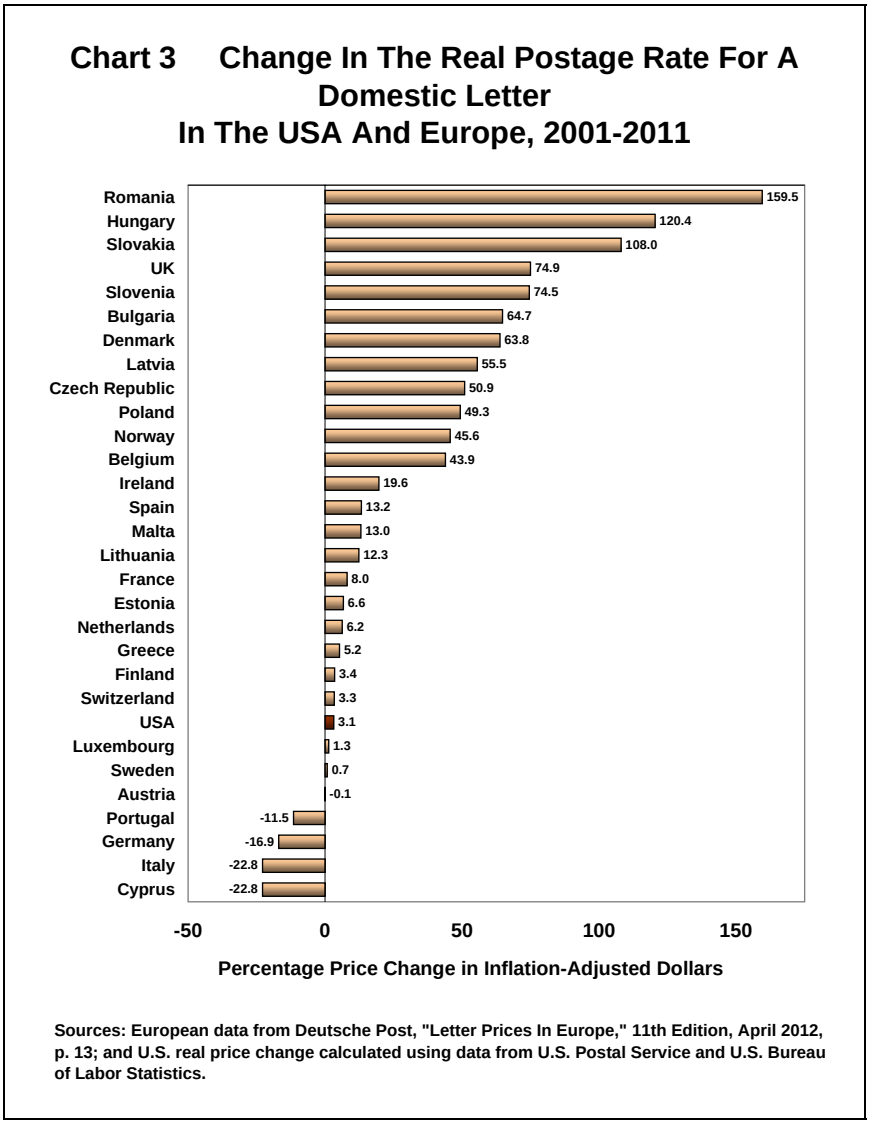
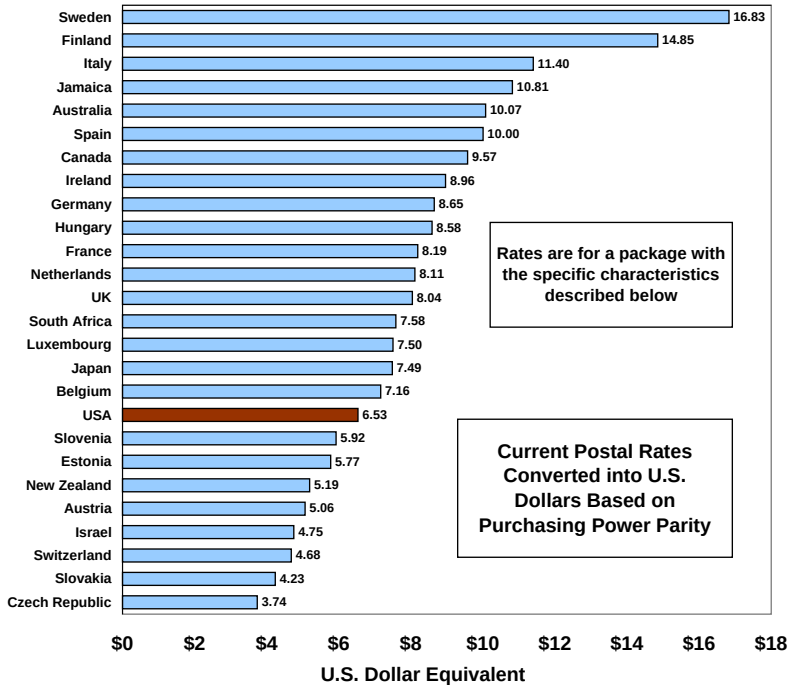


Chart 4, which compares USPS to a sample of 25 foreign posts, offers a preliminary answer.

USPS's package rates depend on a host of variables, such as package weight, size, distance shipped, speed of delivery, and sometimes package contents. To keep the comparisons manageable, it is assumed that an individual in this country sends a three pound package measuring just under one foot on a side from New Haven, CT to Washington, DC (about 300 miles) via USPS Parcel Post. It is further assumed that individuals in the 25 foreign countries have packages with similar characteristics that they send domestically via their posts' ordinary package service. As the chart shows, USPS charges less for this package than about two-thirds of the other postal services.[14] The average rate for the 25 foreign postal services in the sample is 24% higher than USPS's rate.

**Chart 4 Postage For A Domestic Package In The USA And Selected Other Nations**




The charge for sending a package depends on its weight, dimensions, speed of delivery, submission and arrival points, and other factors. It is assumed an individual in the United States sends a 3 pound package measuring just under 12" on a side from New Haven, CT to Washington, DC (about 300 miles) via USPS Parcel Post. For other countries, it is assumed individuals have packages with similar characteristics that they send domestically via ordinary package service.

Sources: Websites of the postal services listed. Prices as of June 2012. Purchasing power parity data from the OECD and the World Bank.

Several limitations of this study's comparisons should be mentioned. First, the rankings are based only on domestic first-class mail and on domestic parcel post for a package with specific characteristics. Second, the rankings do not adjust for differences among posts in service quality. Third, each foreign post is counted equally; they are not weighted by variables such as mail volume or a nation's gross domestic product. Fourth, the specific numbers depend on the countries in the sample. It would be worthwhile to extend the study by considering more types of mail products, attempting to adjust for service quality differences, perhaps weighting the foreign results by foreign posts' relative sizes, and adding more foreign postal services to the samples.

**Would higher postal rates narrow or widen the U.S. Postal Service's deficit?**

The foreign experience also provides real-world evidence that addresses a disagreement about whether USPS's finances would improve or worsen if it raised its rates. The dispute arises because a price increase has two opposing effects on receipts. It increases the amount received per sale, which lifts revenue. However, it also leads to fewer sales because customers demand less of a product when its price rises, and that depresses revenue.

Whether a price hike will generate more or less revenue depends on which of these two effects dominates. If the percentage increase in price exceeds the percentage decrease in volume, the price hike will boost revenue and profit. (This is known as inelastic demand with respect to price. For instance, if a 1% price increase causes a 0.2% quantity decrease, the price effect is bigger and revenue will rise about 0.8%.) On the other hand, if the

percentage increase in price is smaller than the percentage decrease in volume, revenue will fall and so could net income. (This is known as elastic demand. For instance, if a 1% price hike causes a 1.2% quantity decrease, the elasticity of demand is -1.2 and revenue will fall about 0.2%. More information is needed to know what will happen to net income in this case, because decreased volume lowers input requirements, which reduces costs.[15])

Many mail users and some members of Congress implicitly assume the volume effect dominates (mail demand is elastic). They fear higher postal rates would drive away so many customers that USPS's revenue would decline instead of increase. The most vehement critics warn of a death spiral in which a succession of price increases aimed at boosting revenue would instead crush mail volume and cause a precipitous fall in revenue, destroy much mail-related commerce, and make USPS's financial problems far worse than they are now. For example, when USPS filed an exigent rate request in 2010, unsuccessfully seeking regulatory approval for an above-inflation rate increase, averaging 5.6%, on market-dominant products, one commentator blasted the proposal for "defying all logical business sense" and declared that the increase, if enacted, would "send customers running and [push] the Postal Service further into its own death spiral."[16]

In contrast, the Postal Service generally views moderate rate increases as financially helpful. It has raised rates on many occasions over the years, always in the expectation that higher prices would bolster its revenue. In 2010, the Postal Service similarly believed that higher prices would "improve its financial situation" when it asked for an exigent rate hike.[17]

In a study for the Postal Service's Office of Inspector General, Robert Cohen and Charles McBride recognized that the practices of most foreign postal services in developed countries offer guidance regarding whether high rates help or hurt the bottom line and decisively test the proposition that prices slightly above USPS's current rates would produce a death spiral.[18] Cohen and McBride write, "Many posts in developed countries in Europe and Japan have higher prices than in the United States... The mailing operations of these posts are almost all profitable."[19] In other words, the lofty prices common at foreign posts furnish practical evidence that postal rates much higher than those at USPS are financially viable, with no appearance of a death spiral.

It might be added that if high-price foreign posts thought they could become more profitable by cutting prices, they would quickly do so; neither customers nor politicians would object. Instead, the overwhelming majority of foreign posts indicate through their actions that they see financial benefit in keeping rates high. Hence, judging by experiences in other nations, USPS's financial distress could be eased through rate increases, if Congress wished to take that route.

Additional evidence that higher postal prices generally produce more revenue comes from many careful studies done over the years, in this country and elsewhere, that have empirically estimated the price elasticities of demand for various postal products.[20] Those studies have found that most postal products have inelastic demands, which refutes the view that rate hikes are financially self-defeating. To be sure, not all postal products are equally price inelastic; rate increases beyond some point would be counterproductive; and sudden, large price hikes could be unnecessarily disruptive and cause "rate shock". Another caveat is that the growth of electronic substitutes may have made the demands for some postal products more price sensitive than they once were.[21]

People who seek domestic evidence but are reluctant to rely on econometric elasticity estimates can alternatively ask whether the Postal Service's revenue seemed to rise or fall following the many past occasions on which it increased its prices. The answer is that revenue dependably rose after rate increases. Indeed, from the early 1970s until the rate setting process was changed by the Postal Accountability and Enhancement Act of 2006 (PAEA, P.L. 109-435), the Service's standard

response to losses was to boost rates, which pushed up receipts and normally restored profitability until rising costs eroded the gains and set the stage for the next rate increase.

How a well-run, self-supporting enterprise responds to market adversity depends on the specific conditions it faces. The U.S. newspaper industry provides a dramatic, real-world example from another industry that higher prices sometimes make sense for businesses in trouble. Since 2006, newspapers have lost over half their advertising revenue,[22] which is their main income source, and circulation volume is declining. In percentage terms, their revenue loss is far worse than what the Postal Service has suffered. Many newspapers have responded by significantly increasing their newsstand and subscription prices, as well as sharply cutting their staffs, believing those changes, while distasteful, offer the best chance for survival.

This discussion suggests an additional reason why the U.S. Postal Service is so financially weak compared to most other posts. It is conceivable that at least a few foreign posts have healthier bottom lines than USPS not because they have smarter managers or less expensive workers or better designed networks or are subject to less government interference, but simply because they charge more.

**Current law restricts U.S. Postal Service rate increases**

Years ago, Congress directly set the rates that the old Post Office Department charged. However, because rate increases caused political pain, they were infrequent, which is one of the reasons why the Post Office Department chronically ran massive deficits. Over the period 1950-1970, the agency's losses averaged 16.4% of costs.[23] (USPS's deficit in 2011, which is appropriately ringing alarm bells throughout the nation, was "only" 7.2% of costs.[24])

To place the government enterprise on a more businesslike footing, Congress enacted the Postal Reorganization Act of 1970 (P.L. 91-375). Among its reforms, that act removed Congress from direct involvement in setting postal rates. It created a regulator concerned with both efficiency and equity and implemented cost-of-service rate regulation, whereby "rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs."[25]

In 2006, because of complaints that rate cases took too long, were too adversarial, and gave the Service too little flexibility to adjust rates quickly in response to changing market conditions, Congress moved to a more modern regulatory system, rate-cap regulation, as the centerpiece of PAEA. An additional criticism of cost-of-service regulation, in comparison to rate-cap regulation, was that it did not provide strong incentives to control costs, in that a regulated business can generally recover higher costs simply by raising its prices. (It is much to USPS's credit that, despite the weak incentives of cost-of-service regulation, it was sufficiently efficient to maintain low rates by international standards while subject to that type of regulation.) Under the new regulatory system, the Service has considerable flexibility to change rates, subject to the constraint that the prices of market-dominant products do not rise faster than the inflation rate.[26] The cap does not apply to competitive products. Instead, competitive products are subject to the requirements that each product covers its attributable costs and that competitive products collectively make what the regulator deems to be a reasonable contribution to overhead costs.[27] (Both sets of rules attempt to protect consumers. The rate cap on market-dominant products seeks to prevent the Service from exploiting mail users over whom it has great market power. The rate floor on competitive products aims to prevent the Service from selling competitive products below cost and forcing market-dominant-product customers to subsidize competitive products.)

PAEA allows a narrow exception to its rate cap, permitting above-inflation price increases on market-dominant products for financial distress that is "due to either extraordinary or exceptional circumstances."[28] In 2010, as mentioned earlier, the Service requested a higher-than-inflation price

increase on the basis of the exigent provision. However, the Postal Regulatory Commission (PRC), with the strong backing of Senator Susan Collins (R-ME), one of PAEA's principal authors, denied the Service's request, ruling that its problems are not due to the special circumstances cited by the Service and, hence, do not meet the conditions needed to invoke PAEA's limited escape clause.[29]

If the Postal Service wishes to secure an above-inflation rate increase on market-dominant products, it will have to persuade Congress to authorize the increase.

**Assessing postal rate hikes from the perspective of what is least bad**

Higher real postal rates would burden mail users and render mail less of a bargain. However, rather than automatically opposing rate increases because they are painful, a better approach is to recognize that sometimes we must make unpleasant choices. The fundamental question Congress should ask is whether a special, above-inflation rate increase would be better or worse than the alternatives. The Postal Service's financial distress is undermining its financial sustainability and forcing it to consider major, adverse changes in service quality and a diminished universal service obligation (USO). Higher postal rates would allow some of the painful service changes to be avoided. Senator Thomas Carper (D-DE) aptly expressed this idea when he wrote, "[I]f something is worth having, it is worth paying for."[30] Congress should also keep in mind a third approach that can help keep prices low and service quality high: the more flexibility it gives the Postal Service to trim costs not closely related to the agency's core mission, the fewer difficult tradeoffs will need to be made between the price and quality of mail service.

In some cases, a rate increase would not be worth the money. For instance, the Postal Service in recent years has pointed to numerous public opinion surveys indicating that most individuals would rather lose Saturday mail delivery than accept higher postal rates.[31] The Service has further noted that many, although not all, commercial mailers share that sentiment.[32] Those views suggest that an above-inflation rate hike in order to finance Saturday delivery might not be a good value. (If Saturday delivery were to be dropped, an option to consider is offering it for a surcharge to those who badly want it.) As another example, a real rate increase would meet vehement and justified opposition if its only purpose were to delay needed operational reforms by a year or two. Mail users would feel they were unfairly being singled out to bear the pain, and the higher prices would, in effect, be subsidizing inefficiency, which is undesirable from the perspective of the overall economy.

In some other cases, though, a real rate increase may be the lesser evil. For example, suppose mounting deficits prompt the Service to contemplate operational changes that would seriously degrade reliability. Because mail's value would plummet if senders and recipients became uncertain when, or if, their letters and small packages would arrive, it might be reasonable to maintain reliability by raising postal rates. Or suppose that USPS's deficits were to lead to calls for a taxpayer bailout. It is difficult to justify a taxpayer bailout when the federal government is already running unsustainably large budget deficits and especially hard to defend a bailout as more of the mail stream becomes advertising, which now comprises about 60% of the mail that households receive.[33] Higher rates would be a better option than a taxpayer bailout, although both choices are unappealing.

Several foreign governments have permitted above-inflation price increases to preserve service quality. For instance, Canada Post is in the middle of five years of above-inflation price increases that will take a first-class domestic stamp from 53 cents (Canadian) in 2009 to 65 cents in 2014. Canada Post said it needed the increases to fund "critical infrastructure investment," "ensure that Canada Post can continue to meet its service obligations to Canadians," and "address Canada Post's financial pressures in order to ensure it does not become a burden on taxpayers."[34] As a second example, the U.K.'s Royal Mail boosted many of its rates in April

2011, with the price of a first-class stamp climbing from 41 to 46 pence (over 50% higher than USPS's price when one converts pounds into dollars), after its regulator agreed that higher rates were "required to help alleviate the company's short term cash flow problems, and to keep on track the modernisation programme necessary to secure the ongoing sustainability of the universal service."[35] (This spring, Royal Mail again raised its prices, with the price of a first-class stamp jumping a whopping 30%, from 46 to 60 pence.[36] Although Royal Mail claims the latest increase is to support the USO, some observers believe the real goal is to earn an attractive rate of return.)

In their study for the Postal OIG, Cohen and McBride argue that higher postal rates here will be difficult to avoid because of the profound and continuing decline in mail volume coupled with USPS's high fixed costs.[37] The problem is that as volume falls, there are fewer units over which to spread the Service's overhead, which means each remaining piece of mail must cover more fixed costs. In consequence, their argument continues, postal rates that once would have allowed USPS to break even or earn a profit will now produce losses, with the red ink growing over time as volume continues declining. Intensifying the financial distress, the mail mix is shifting away from high-margin first-class mail toward lower-margin advertising mail. USPS often notes that it takes three pieces of advertising mail to equal the contribution to overhead made by a piece of first-class mail.[38] Cohen and McBride conclude that real rate increases are necessary if the U.S. Postal Service is to remain financially viable.

The case for an above-inflation postal rate increase would be most persuasive if Congress made it one component of a balanced package that maintains acceptable service standards while rationalizing the Service's nationwide facility network and significantly reducing its labor costs. Labor-related expenses are the elephant in the room at approximately 80% of USPS's total costs. As mail demand shrinks and the Service's unit costs rise, Congress should recognize that its mandates, which also drive up the Service's costs, increasingly conflict with USPS's core mission of providing reliable, affordable, self-financing mail service to everyone in the nation.[39] Were Congress to enact an above-inflation rate increase without cost-management reforms, a significant danger is that financial discipline would slacken and the extra revenue would be eaten up by higher costs.

If Congress imposed fewer mandates, USPS would have greater operational flexibility and be better able to shed expenses in response to falling volume.[40] A portion of the cost savings would occur because some of the Service's "fixed" costs are fixed only due to statutes and political pressure, not by production technology. With fewer inflexible mandates, there would be less tendency for unit costs to rise as mail volume declines. The cost savings would moderate the price increase needed to return the Postal Service to solvency.

**If Congress grants a special rate increase, how should it be apportioned among various mail products?**

In the five-year business plan it floated in February, the Postal Service suggested that the price of a first-class stamp jump 11.1%, from 45 cents to 50 cents.[41] The Service estimates the five-cent increase, which would apply exclusively to single-piece first-class mail customers, most of whom are households and small businesses, would improve its bottom line by about $1 billion annually.[42] USPS's trial balloon spotlights the question of which customers should pay more, if Congress decides to allow higher rates.

There are several possible explanations for why the Service is aiming its proposal at single-piece first-class mail users, but all of them are troubling. One possibility is that USPS, after identifying some service reductions that would save money but be especially harmful to single-piece first-class mail users, is offering to forgo the service cuts if the same customers pay higher rates. If this is the Service's thinking, it amounts to saying that the households and small businesses sending most single-piece first-class mail will be forced to shoulder an especially

heavy burden one way or another. An objection to such an approach is that it does not tell us why so much of the burden should be placed on single-piece first-class mail users in the first place.

A concentration on single-piece first-class mail might be justified if current single-piece first-class rates were low relative to those of other USPS products and services, but the opposite is the case. In 2011, rates on single-piece first-class mail averaged 161.2% of attributable costs.[43] (Attributable cost is a technical term for the costs associated with each product or class of products, including variable costs and some product-specific, nonvariable costs.) While that is less than the average attributable-cost coverage on all first-class mail, which was 199.4%, it substantially exceeds the average attributable-cost coverage on Postal Service products and services other than first-class mail, which was 133.6%.[44]

Another possibility is that the Service thinks it would be sensible to target single-piece first-class mail because demand for it is relatively inelastic. The low elasticity means that most of a price increase would feed into higher revenue and only a little would be lost to an induced drop in mail volume. USPS has historically treated first-class-mail customers as cash cows due to their low responsiveness to price changes and heaped a disproportionate share of the agency's total costs on them. The further argument is sometimes made that it is allocatively efficient to place the highest markups on the least elastic products (Ramsey pricing).

One caution regarding arguments based on low elasticity is that with the continued development of electronic substitutes, the demand for first-class mail may have become more price elastic than was once the case. A deeper objection is that the low price sensitivity of first-class mail is not due to natural forces but to the statutory monopolies on letter delivery and mailbox access. Because of the government-created monopoly, first-class mail users cannot turn to other mail providers if USPS raises its prices, which means USPS loses fewer customers than otherwise when its raises the prices of its monopoly-protected products.[45] (Much advertising mail is also subject to the statutory monopoly. But advertising mail has been more price elastic than first-class mail because advertisers have historically had a greater range of acceptable non-mail alternatives.) The mail monopoly supposedly exists to provide people throughout the country with affordable, convenient postal access and service, and one of the classes of mail for which that is deemed most important is first-class mail. Given that one of the monopoly's major goals is supposedly to promote and protect first-class mail use, it would be unjust, counterproductive, and hypocritical to employ a consequence of the monopoly as a rationalization for charging extra high prices to households and businesses that depend on single-piece first-class mail.

Accordingly, if Congress decides to grant USPS a special rate increase, it should include protections for first-class mail users, which would be the opposite of the Service's tentative suggestion.

If time were not of the essence, Congress might wish to instruct the PRC to open an old-style omnibus rate case, in order to hear from all concerned parties and arrive at a set of rate changes that carefully balance efficiency, equity, and self-sufficiency objectives. Unfortunately, an omnibus rate case can easily take a year and a half between when preparations begin and when the rate increase becomes effective. To avoid that long delay and in light of the Service's rapidly deteriorating finances, a better choice might be an across-the-board rate increase that would apply uniformly to almost all USPS products and services. A further advantage of a uniform increase is that Congress would avoid trying to pick winners and losers among postal products, a task for which it is ill-suited. The one exception is that Congress might want to authorize additional increases for products that are "under water", with attributable costs exceeding prices, meaning the Service losses money on every unit it sells. The PRC identified 10 market-dominant products and services that failed to cover their attributable costs in 2011.[46] Congress could

combine the approaches by ordering an immediate, uniform rate hike to give USPS prompt financial relief, while at the same time instructing the PRC to open an omnibus rate case, which could result, later, in modifications in how the increase is spread among USPS's various products and services.

**Conclusion**

In designing PAEA, Congress hoped an inflation-based price cap on market-dominant products would motivate the U.S. Postal Service to strive for greater efficiency. Spurred on in part by that incentive, the Service's senior managers have worked diligently both to remove excess costs from the system and to generate added revenue by developing new or improved postal products. Unfortunately, the combination of the precipitous drop in mail demand that began during the "great recession" and Congressional restrictions on cost management have overwhelmed USPS's efforts to bring costs into balance with revenue.

Postal officials and informed observers had long expected that electronic alternatives would displace an increasing portion of the mail stream. Based on historic trends, a reasonable expectation was that electronic diversion would occur gradually, and USPS would have many years during which to adjust.[47] Reality, of course, proved far different. From 2006 to 2011, total postal volume dropped 21.2%, with the volume of highly profitable first-class mail plummeting 25.0% and other products' volume falling 18.0%.[48]

The decline in demand does not justify a taxpayer bailout for the Postal Service any more than it does for other enterprises that have been buffeted in the past or present by changes in technology or a weak economy, ranging from blacksmiths to typewriter manufacturers to newspaper publishers to construction companies to home furnishing stores. However, it does mean that the Postal Service needs urgently to implement major operational adjustments. Despite some missteps, the Postal Service has made impressive progress in responding to the challenge. Postmaster General Donahoe told Congress that the Service has reduced its annual costs "by more than $19 billion" through operational adjustments it undertook during the period 2000-2011.[49] Because of the magnitude of the revenue decline and the expectation that mail demand will continue falling, however, the savings are not nearly enough.

If the U.S. Postal Service is to be financially viable, Congress needs to enact genuine postal reform. The central element should be less Congressional micromanagement of postal operations, which would allow USPS better to control its costs. Congress should also stretch out the time frame over which the Service must fund the retirement health benefits it promises its workers, and allow the Service to withdraw some money from pension funds that are currently overfunded by roughly $13 billion.[50]

A special rate increase by itself carries the danger that the money it brings in might become an excuse to delay or water down the operational changes that the Postal Service needs. However, an above-inflation, across-the-board rate increase could be a valuable addition if approved as part of an "all of the above" reform package. In deciding if a rate increase belongs in a reform package, the question to ask is whether the benefits in the forms of fewer cuts in mail service and improved financial viability are worth the higher rates.

Much higher prices than those seen here are part of the business plans of many successful foreign posts. Even with a rate increase, postal rates in this country would remain an international bargain.

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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. U.S. Postal Service, *Annual Report, 2006*, p. 60, accessed at http://about.usps.com/who-we-are/financials/annual-reports/fy2006.pdf

2. U.S. Postal Service, *Annual Report to Congress and Comprehensive Statement on Postal Operations, 2011*, p. 21, accessed at http://about.usps.com/publications/annual-report-comprehensive-statement-2011/annual-report-comprehensive-statement-2011.pdf.

3. U.S. Postal Service, "Integrated Financial Plan, FY2012," p. 1, accessed at http://about.usps.com/who-we-are/financials/integrated-financial-plans/fy2012.pdf.

4. Patrick Donahoe, "Statement of Postmaster General/CEO Patrick R. Donahoe," Before the Subcommittee on Federal Workforce, U.S. Postal Service & Labor Policy, House Oversight and Government Reform Committee, March 27, 2012, accessed at http://oversight.house.gov/wp-content/uploads/2012/03/3-27-12-USPS-Donahoe.pdf. Postmaster General Donahoe declared in his testimony, "Absent any action at all, from Congress or the Postal Service, we could see deficits exceed $21 billion annually by 2016." That number is probably too pessimistic in that it assumes the Service would suddenly stop making the sorts of adjustments that it has implemented over the past decade in response to rising costs and falling volume. Nevertheless, even if USPS continues its ongoing efforts to bring down costs and enhance revenue, the projected loses would still be enormous and growing.

5. Michael Schuyler, "Most Foreign Postal Services Are Profitable; The U.S. Postal Service Lags," *IRET Congressional Advisory*, No. 281, January 13, 2012, available at http://iret.org/pub/ADVS-281.PDF.

6. See Universal Postal Union (UPU), Postal Statistics Database, data by country, high income countries, series 1.2 (population), series 8.1 (average number of letter-post items posted per inhabitant), series 8.2 (number of letter-post items, domestic service), and series 8.3 (number of letter-post items, international service - dispatch), all accessed via http://www.upu.int/en/resources/postal-statistics.html. UPU data indicate letter-post volume per inhabitant was also higher for the Vatican, but that is a special case. Because the UPU does not list USPS's international letter-post volume in 2010 (or 2009), that number was imputed by assuming the same ratio between domestic and international letter-post as existed in 2008. Per capita volume for the United States in 2010 was then computed as the sum of U.S. domestic and international letter-post volume divided by U.S. population.

7. Michael Schuyler, "Why The U.S. Postal Service Is In Greater Financial Trouble Than Most Foreign Postal Services — The Role Of Government Micromanagement," *IRET Congressional Advisory*, No. 282, March 30, 2012, available at http://iret.org/pub/ADVS-282.PDF.

8. Michael Schuyler, "Why The U.S. Postal Service Is In Greater Financial Trouble Than Most Foreign Posts — The Role of Postal Retiree Health Care Benefits," *IRET Congressional Advisory*, No. 283, April 11, 2012, available at http://iret.org/pub/ADVS-283.PDF.

9. Current domestic letter rates were obtained in most instances from Markus Seitz, "Postage Rates Worldwide," updated March 2012, accessed at http://www.atms.ch/rates/index.php. In two cases, rates were obtained from posts'

websites and in two they were obtained from Deutsche Post DHL, "Letter Prices In Europe," 11th Edition, April 2012, accessed via http://www.dp-dhl.com/en/media_relations/press_releases/2012/letter_prices_europe_2012.html. For OECD member nations, purchasing power parity estimates were obtained for 2011 (latest available data) from Organisation for Economic Co-operation and Development (OECD), "Purchasing Power Parities For GDP," accessed at http://stats.oecd.org/Index.aspx?datasetcode=SNA_TABLE4. Otherwise, the estimates were obtained for 2010 (latest available data) from World Bank, "PPP Conversion Factor, GDP (LCU Per International $)," accessed at http://data.worldbank.org/indicator/pa.nus.ppp.

10. For example, if the common market basket could be purchased for $1 in the United States but would cost 2 units of the local currency in a certain foreign country, the foreign currency's value relative to the dollar would be 0.5, based on purchasing power parity. The conversions could alternatively have been done using foreign exchange rates. The general results would be the same, but the specific numbers would be different. Both conversion methods have strengths and weaknesses. A major problem with foreign exchange rates is that they often exhibit large, sudden movements. For example, Switzerland did not change its domestic stamp price between June 2011 and January 2012. Nevertheless, if one reexpressed the Swiss stamp price in dollars based on exchange rates, it would misleadingly seem to have fallen 10% over the period because of exchange rate movements.

11. For the history of first-class stamp prices, see U.S. Postal Service, "Rates For Domestic Letters Since 1863," January 2012, accessed at http://about.usps.com/who-we-are/postal-history/domestic-letter-rates-since-1863.pdf. For historical data on the consumer price index (CPI), see U.S. Bureau of Labor Statistics, "Consumer Price Index, All Urban Consumers," accessed via http://www.bls.gov/cpi/#data. For converting nominal prices into real prices (in January 2012 dollars), the CPI at the time of each rate increase and the two surrounding months is compared to the CPI in January 2012 and the two surrounding months.

12. Deutsche Post DHL, "Letter Prices In Europe," 11th Edition, p. 13, *op. cit.*

13. For postal rates, see U.S. Postal Service, "Rates For Domestic Letters Since 1863," *op. cit.*; and for the CPI, see U.S. Bureau of Labor Statistics, "Consumer Price Index, All Urban Consumers," *op. cit.*

14. Package shipping rates are from the websites of USPS and the 25 foreign posts as of June 2012. All rates are converted into U.S. dollars based on purchasing power parity data from the OECD or, in one case where OECD data was unavailable, the World Bank.

15. It will be profitable for USPS to raise the price of a product with elastic demand if the cost saving from lower production outweighs the revenue loss. An entry on the Postal Regulatory Commission's website indicates this is the case with express mail. See Postal Regulatory Commission, "PRC Glossary of Postal Terms," entry for Price Elasticity of Demand, accessed at http://www.prc.gov/prc-pages/misc/help/M-P.pdf. (The Postal Service now insists information on the elasticities of its competitive products is proprietary and not to be divulged to the public. However, the PRC based its comment on data released before USPS's assertion of confidentiality.)

16. Linda A. Woolley, Vice President, Direct Marketing Association, "Postage Increases Will Hurt USPS In The Long Run," *Huffington Post*, August 3, 2010, accessed at http://www.huffingtonpost.com/linda-a-woolley/postage-increases-will-hu_b_668865.html.

17. U.S. Postal Service, "Exigent Request Of The United States Postal Service," before the Postal Regulatory Commission, Docket No. R2010-4, July 6, 2010, p. 2, accessed at http://prc.gov/Docs/68/68792/Request.Final.pdf.

18. Robert Cohen and Charles McBride, "Implications Of Declining Mail Volumes For The Financial Sustainability Of The Postal Service," Sponsored by U.S. Postal Service Office of Inspector General, Report No. RARC-WP-10-006, September 29, 2010, accessed at http://www.uspsoig.gov/foia_files/RARC-WP-10-006.pdf.

19. Cohen and McBride, *op. cit.*, p. 6.

20. For a survey of price elasticity estimation models and model results for the U.S. Postal Service and foreign posts, see Alan Robinson, "A Review Of Price Elasticity Models For Postal Products," for Pitney Bowes research project "The Future of Mail," Background Paper No. 2007-01, September 2006, accessed at http://www.postinsight.pb.com/files/Price_Elasticity_final.pdf.

21. Demand will become more elastic if electronic alternatives give remaining mail users more mail substitutes to which they can easily shift. However, if most customers inclined to shift have already done so and remaining mail users have strong attachments to mail, demand need not become more elastic.

22. See Newspaper Association of America, "Trends & Numbers," accessed at http://www.naa.org/Trends-and-Numbers.aspx.

23. U.S. Post Office Department, *Annual Reports*, various issues.

24. U.S. Postal Service, *Annual Report, 2011, op. cit*., p. 2. If Congress had not postponed a $5.6 billion contribution to the Retirement Health Benefits Fund (RHBF), USPS's 2011 deficit would have been 15.1% of costs, which is close to the Post Office Department's average loss in the 1950-1970 period.

25. Postal Reorganization Act of 1970 (P. L. 91-375), sec. 2, revising 39 U.S.C., sec. 3621.

26. PAEA, sec. 201(a). The cap is applied to each product class. The price of an individual product can rise faster than inflation if the average for the product class does not. In addition, each type of market-dominant product is expected to cover its attributable costs, which is proving to conflict with the rate cap for some products that are "under water".

27. PAEA, sec. 202.

28. PAEA, sec. 201(a).

29. See Postal Regulatory Commission, "Order Denying Request For Exigent Rate Adjustments," Docket No. R2010-4, September 30, 2010, accessed at http://www.prc.gov/Docs/70/70341/Order_547.pdf. (The case is not technically finished because the U.S. Court Of Appeals For The District Of Columbia remanded it back to the PRC to clarify the meaning of "due to", but it is in limbo for the time being.)

30. Thomas Carper, "Sen. Carper Reacts to GAO Report on USPS Efforts to Consolidate Mail Processing Facilities," Apr 12, 2012, accessed at http://www.carper.senate.gov/public/index.cfm/pressreleases?ID=795b7262-db6d-4217-b351-258536b868c7.

31. See U.S. Postal Service, "Delivering The Future: A Balanced Approach; Five-Day Delivery Is Part Of The Solution," March 2010, esp. pp. 27-30, accessed at http://about.usps.com/news/electronic-press-kits/five-day-delivery/plan/5day-plan-delivery.pdf.

32. *Ibid*.

33. U.S. Postal Service, "The Household Diary Study; Mail Use & Attitudes in FY 2010," April 2011, p. 2, accessed at http://www.prc.gov/Docs/73/73501/USPS_HDS_FY10_FINAL_.pdf.

34. Canada Post, "Canada Post Proposes Five-Year Pricing Plan," News Release, June 26, 2009, accessed at http://www.canadapost.ca/cpo/mc/aboutus/news/pr/2009/2009_june_five_year_pricing_plan.jsf.

35. Postcomm, "Laying The Foundations For A Sustainable Postal Service," Decision Document, November 2010, p. ii, accessed at http://webarchive.nationalarchives.gov.uk/20101214234258/http://www.psc.gov.uk/documents/1162.pdf.

36. "Stamp Price Rises Come Into Force," *BBC News*, April 29, 2012, accessed at http://www.todayheads.com/2012/7financial/stamp-price-rises-come-into-force.

37. Cohen and McBride, "Implications Of Declining Mail Volumes For The Financial Sustainability Of The Postal Service," *op. cit*.

38. See, for instance, U.S. Postal Service, "Form 10-K, Fiscal Year 2011," November 15, 2011, p. 18, accessed at http://about.usps.com/who-we-are/financials/10k-reports/fy2011.pdf

39. For a fuller discussion, see Michael Schuyler, "Why The U.S. Postal Service Is In Greater Financial Trouble Than Most Foreign Postal Services — The Role Of Government Micromanagement," *op. cit*.

40. Cohen and McBride note this in their study.

41. See U.S. Postal Service, "Plan To Profitability; 5 Year Business Plan," February 16, 2012, accessed at http://about.usps.com/news/national-releases/2012/pr12_0217profitability.pdf.

42. To verify that USPS intends the proposed increase to apply only to single-piece first-class mail, the author calculated the income change based on single-piece first-class mail volume, a five-cent per piece price increase, and the decline in volume induced by the higher price. The result is close to USPS's $1 billion estimate.

43. The numbers are calculated based on U.S. Postal Service, "Public Cost And Revenue Analysis, Fiscal Year 2011," December 2011, accessed at http://prc.gov/Docs/79/79172/FY11PublicCRA.xls. The portion of the price above attributable costs can be used to help defray the Service's high fixed costs.

44. *Ibid*.

45. The statutory monopoly artificially converts the demand curve for first-class mail from a relatively elastic firm demand curve into a relatively inelastic industry demand curve.

46. Postal Regulatory Commission, "Annual Compliance Determination, Fiscal Year 2011," http://prc.gov/prc-docs/home/whatsnew/FY%202011%20ACD%202011%20final%20revisions%20WEB_2587.pdf, p. 33. With some of those products, PAEA creates a dilemma for the Service and the PRC in that rates are supposed to cover attributable costs but rate increases above the legally permissible inflation cap would be required to accomplish that.

47. For example, first-class mail volume peaked in 2001, but its rate of decline was sufficiently modest prior to the recession that first-class mail revenue reached its high in 2007. Meanwhile, because of standard mail's vigorous growth, total postal volume set an all-time record in 2006 and total revenue grew until 2008. (U.S. Postal Service, *Annual Reports*, various issues.)

48. U.S. Postal Service, *Annual Report, 2011*, *op. cit*. pp. 22-23; and U.S. Postal Service, *Annual Report, 2008*, pp. 62-63, accessed at http://about.usps.com/who-we-are/financials/annual-reports/fy2008.pdf.

49. Patrick Donahoe, "Statement Of Postmaster General/CEO Patrick R. Donahoe Before The Committee On Homeland Security And Governmental Affairs, United States Senate," September 6, 2011, accessed at http://about.usps.com/news/speeches/2011/pr11_pmg0906.pdf.

50. The U.S. Office of Personnel Management (OPM) projected that USPS would have a $1.7 billion surplus with the Civil Service Retirement System (CSRS) and a $11.4 billion surplus with the Federal Employees Retirement System (FERS) as of the end of fiscal year 2011. (See U.S. Postal Service, "Form 10-K, Fiscal Year 2011," *op. cit*., p. 26.)