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Michael Schuyler

Senior Economist
Institute for Research on the Economics of Taxation

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Summary

The Postal Service's financial problems are largely due to its costs, which are high and which it finds hard to control. Especially worthy of the Commission's attention are numerous federal mandates and pressures that significantly drive up postal expenditures. These include universal service mandates, postal wages and benefits that exceed those of comparable workers in the private sector, and restrictions on rationalizing the number and location of postal facilities. The Commission should be skeptical of arguments frequently made by the Postal Service over the years that, due to its weak bottom line, it must be allowed to set postal rates with less regulatory oversight and that it needs to expand. At a private-sector company, of course, poor financial results would be a strong signal not to expand. If the Commission concludes that the Postal Service is likely to need financial assistance in the future for core operations within the postal monopoly, it should recognize that explicit payments would lead to greater accountability and better decisionmaking than increased reliance on hidden subsidies.

My name is Michael Schuyler. I am a senior economist with the Institute for Research on the Economics of Taxation (IRET). The President's Commission on the United States Postal Service is engaged in an important task, and I thank it for accepting this statement.

The Commission was established because of concern about the Postal Service's finances. After reporting positive net income for the five fiscal years from 1995 to 1999, the Postal Service has lost more than $2.5 billion in the last three fiscal years. While the agency forecasts that it will have a small positive net income this year, many are concerned about the agency's longer term finances.

In carrying out its work, the Commission has a broad mandate to examine the Postal Service's costs, prices, the legal and regulatory structure under which it operates, and what level of mail service it should provide to fulfill its universal service obligation. ***Indeed, the concept and definition of universal service should be subjected to scrutiny and not taken for granted.***

The Postal Service is currently a government-owned enterprise with monopolies on both non-urgent letter delivery and mailbox use. As a monopoly, it is less subject to market discipline than other businesses. Consequently, ***when addressing the Postal Service's problems, the Commission should endeavor to make recommendations that protect both postal consumers and taxpayers, and which do not damage the economy.***

As the Commission has noted, it has the opportunity to rethink what role the Postal Service should play in the 21st century. In asking how to help the Postal Service financially, the Commission should not assume as a given that the agency's role in the future ought to be what it was in the past.

Money Problems

After several years of positive net income in the last half of the 1990s, the Postal Service slipped into the red in 2000. It spilled more red ink in 2001. In 2002, the agency held its loss to $676 million, which is less than it had earlier expected, only through a burst of determined cost cutting and a mid-2002 postal rate increase (its third since the start of 1999).

Some of the adversity is temporary, due to the one-two punch of the recession and the anthrax attacks. Fortunately, the recession's negative effect on mail volume will reverse, perhaps with a several-month lag, as the economy moves into recovery, and the damage inflicted on mail volume and costs by the anthrax assault will tend to dissipate, provided that there is no new attack.

A longer term worry is that electronic alternatives may eventually produce a sustained drop in mail volume. The Postal Service is especially concerned about electronic diversion of financial statements and payments, which have been among its cash cows.

However, looking only at recent events misses red flags that have been flying for decades. In the 31 years since the U.S. Postal Service was formed from the old Post Office Department, the organization has reported losses in 20 years and positive net income in only 11 years.[1] The tendency of the Postal Service to fall short of its break-even target is a chronic problem, not a new one.

Concentrating on the recent (hopefully temporary) drop in mail volume may create the misleading impression that the Postal Service's financial problems are primarily revenue and volume related. In fact, since the Postal Service was established, year-over-year revenues rose in 19 out of 20 money-losing years, and year-over year volume grew in 18 of those 20 years. For example, the 1980s was a period of rapid volume and revenue growth for the agency. From 1980 to 1989, mail volume surged by more than 50% and revenues more than doubled. Nevertheless, the Postal Service lost money in five of those ten years, and if not for $8.5 billion of Congressional appropriations during that decade[2], it would have lost money in all but one year.

Moreover, even if — contrary to fact — the Postal Service's volume and revenues were highly erratic, that is the sort of volatility with which private-sector businesses must cope if they are to survive and prosper. For instance, the Postal Service often compares itself to Fortune 500 companies. For the years from 1997 and 2001, the percent of companies in the Fortune 500 that reported year-to-year drops in sales ranged from 15% to 42% and averaged 23%.[3] Many of the drops were large, sudden, and unexpected. In comparison, sheltered by its government monopolies on non-urgent letter deliver and mailbox use, the Postal Service's declines in revenues and volume have been few, far between, and mild. Although electronic alternatives to mail may be slowly weakening its monopoly, the monopoly remains a powerful force and the Postal Service can count on a revenue base that is much more secure than that of most private-sector businesses.

The Postal Service's frequent deficits, despite revenues and volume that have grown over time and have only rarely failed to increase from one year to the next, indicate that the agency's financial woes should not be blamed on its revenues.

The real problem is on the cost side. The Postal Service's costs are too high and the agency has trouble keeping them under control. For example, why does it cost the Postal Service 24 cents to sell $1 of stamps at a post office counter (according to the agency's numbers), but just 10 cents when a contract postal unit sells the stamps?[4] Moreover, on those occasions when the organization is in the black because revenues (temporarily) exceed costs, costs usually rise quickly to close the gap. For instance, the agency went from positive net income in 1995 to a loss by 2000 because,

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[1] U.S. Postal Service, *Annual Reports*, various issues. The period covered is fiscal years 1972 (when the Post Office Department officially became the Postal Service) to 2002.

[2] U.S. Postal Service, *Annual Report*, various issues.

[3] *Fortune Magazine*, April 27, 1998, April 26, 1999, April 17, 2000, April 16, 2001, and April 15, 2002 issues. These percentages understate the sales declines because they do not include firms whose sales fell so much from the previous year that they dropped off the Fortune 500.

[4] United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. 15, accessed on the Internet at http://www.usps.com/strategicdirection/transform.htm.

although revenues increased every year during that period (at a respectable average pace of 3.5% annually), costs climbed every year at a faster rate.[5]

Federal Mandates Have Contributed To The Postal Service's High Costs

Government enterprises usually have trouble managing their costs. Government ownership and operation create incentives that often subordinate cost issues to political and bureaucratic goals. For this reason, the Postal Service may not have been as consistently vigilant in managing its costs as it should have been. Accordingly, the Commission should closely examine business practices that are within the Postal Service's control.

But the Commission may be able to make an even larger contribution if it also looks carefully at the numerous burdens that the federal government places on the Postal Service. The federal government's various demands on the Postal Service have a price tag that totals billions of dollars every year. The Postal Service regularly complains that Congressional mandates in areas like service standards, the location of facilities, and employee compensation and work rules seriously limit its ability to manage costs.

There are two reasons for the Commission to evaluate such claims. First, the potential cost savings are large, even from relatively small changes in federal requirements. Second, an outside body like the Commission may be better able than the Postal Service itself to persuade Congress to modify the ground rules in some of these areas, if it thinks the changes are justified.

Consider some of the mandates the federal government imposes on the Postal Service:

Uniform rates. The Postal Service must provide mail delivery to all addresses at uniform rates. Deliveries are particularly costly in remote areas and high crime areas. To cover the cost of universal service in high-cost areas without having to enact an explicit on-budget federal subsidy, the government grants the Postal Service a monopoly, and gives it tax exempt status and other disguised assistance. The monopoly allows the Postal Service to overcharge low-cost consumers to cover the expenses of servicing high-cost consumers. This is a cross-subsidy from one group of postal customers within the monopoly to another. The subsidy is not explicit and apparent, but it is still there.

Frequency of delivery. The Postal Service provides mail delivery six days a week. That sixth delivery day is expensive. According to a rough estimate from the Postal Service, moving to five-day-a-week delivery would produce cost savings of $800 million to $1.1 billion yearly.[6] Moving to delivery every other day would presumably save still more. Yet, on those occasions when the Postal Service has mused about eliminating the sixth delivery day, the political firestorms have been intense. This is clearly not an area where the Postal Service can take action on its own.

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[5] U.S. Postal Service, *Annual Report*, 2001, pp. 48-49.

[6] Postal Service, *Transformation Plan*, *op. cit.*, p. 69.

Employee compensation. Approximately 80% of the Postal Service's costs are labor related. Federal law directs that postal workers are to receive wages and benefits comparable to those of similar workers in the private-sector[7]. Empirical evidence indicates, however, that postal workers actually receive substantially higher wages and benefits.[8] Although the above-market compensation, which is known as the postal pay premium, is contrary to the federal policy of pay comparability stated in law, it is actually a consequence, albeit unintended, of the federally mandated pay-determination process. If the Postal Service and one of its unions cannot reach a collective bargaining agreement, there is binding arbitration: a third-party arbitrator, who has no direct responsibility for the Postal Service's finances and the postal rates needed to cover labor and other costs, determines wages, some benefits, and various work rules. Generous arbitration awards can sharply raise labor costs, and the mere threat of arbitration may induce the Postal Service to accede to demands in labor negotiations that it would otherwise reject. Further weakening the Postal Service's position, some valuable benefits are specified in law, which means they have already been granted before negotiations begin. Because labor compensation is such a large share of Postal Service expenses, the postal pay premium is a very big-ticket item, probably adding $5 billion to $10 billion each year to the Postal Service's costs.[9]

High productivity could offset, in whole or part, high pay. But, in fact, postal productivity has, on average, lagged that in the private sector. Restrictive work rules diminish the productivity of postal employees in many cases.

It should be understood that just as the postal monopoly creates a need for regulating postal rates, so it creates a need to regulate postal wages and benefits. A Postal Service with a statutory monopoly in combination with strong postal unions with which the agency must deal produces what is known as a bilateral monopoly.[10] If there were no regulation of prices and pay, the Postal Service would likely charge monopoly prices to consumers in its protected market in order to capture monopoly profits that it could use for its own purposes. Postal unions, meanwhile, would try to seize the monopoly profits for their members by demanding increases in wages and benefits until no monopoly profits remained with the Postal Service. In a bilateral monopoly, it is indeterminate who will ultimately secure the monopoly profits. It could be the Postal Service or the postal unions or some splitting of the spoils. In any

[7] 39 USC, Sec. 101(c) and 39 USC, Sec. 1003(a).

[8] For a fuller discussion of this issue, notably a survey of empirical economic studies in the area, see Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No.131, July 24, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-131.PDF. Saying that postal workers, on average, receive much higher compensation than similar private-sector workers does not, of course, mean that every postal worker or every category of postal workers obtains a premium compared to what he or she would receive in the private sector.

[9] A rough estimate is that substantially reducing the postal pay premium would have saved the Postal Service $8.1 billion in 2001 alone. See Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *op. cit.*, for details about the estimate.

[10] For a fuller discussion of this issue, see Stephen J. Entin, "The Postal Service: A Monopoly That Loses Money," *IRET Congressional Advisory*, No. 130, June 3, 2002.

event, customers within the monopoly would be overcharged, forced to pay monopoly prices instead of the as-low-as-possible prices that are the government's declared policy.

The Postal Rate Commission attempts as well as it can to prevent the Postal Service from capturing monopoly profits for itself. But that leaves the postal unions. Unless wages and benefits are effectively controlled, they may rise so high that the Postal Service needs to charge monopoly-level postal rates to consumers within the statutory monopoly just so it can pay its workforce. In the legislation that established the Postal Service, binding arbitration was the method chosen to keep labor compensation in check. Given the monopoly, binding arbitration may be better than nothing, and it may prevent postal unions from capturing as much of the potential monopoly profits as they could otherwise. Nevertheless, arbitrators appear to have regularly issued awards whose benefits exceed the pay comparability standard called for under the law. That is, the presence of a substantial postal wage premium is evidence that binding arbitration, as it operates under current rules, has been a partial failure and has allowed postal unions to capture some of the monopoly profits for their members. Better control of postal wages and benefits is needed for the protection of consumers within the postal monopoly.[11] ***Postal arbitrators should be told to bear more firmly in mind the burden they place on postal customers when they ratify pay hikes.***

Small money-losing post offices. Federal law instructs the Postal Service never to close a small post office solely because it is losing money.[12] But many small post offices do lose money, and keeping them open is expensive

Other closings and consolidations. The law does not bar all post office closings, but it specifies that no post office can be closed unless a complicated, time-consuming process is followed. In addition, political pressures are often applied when the closing of a post office is being considered, which further hinders efforts to rationalize the network of post offices. Similarly, political objections have complicated efforts to rationalize the network of mail processing plants and to reduce mail transportation costs. Since the anthrax attacks, a sense of urgency has lowered some of the political barriers that previously existed. This has allowed the Postal Service to undertake more consolidation than would have been politically feasible previously, and the cost savings are significant. Further progress, however, may depend on the Commission giving its imprimatur to the effort.

Transparent Federal Funding Would Lead to Better Decisionmaking

The most transparent way to finance the extra costs that special federal requirements place on the Postal Service would be through explicit payments as part of the federal budget. Transparent federal funding would improve accountability in Washington by forcing elected officials to acknowledge that the special obligations they place on the Postal Service do have costs. Transparency would remind elected officials and voters that the costs exist and should be weighed against benefits when deciding which requirements are worthwhile and which should be modified.

[11] For a discussion of numerous ideas for reducing the disparity between postal pay and private-sector pay, see Michael Schuyler, "How To Bring Postal Compensation Into Line With The Private Sector," *IRET Congressional Advisory*, No.132, August 28, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-132.PDF.

[12] 39 USC, Sec. 101(b).

Indirect Financing Through Special Powers and Privileges Hides the Costs and Distorts Market Signals

Universal service, continued operation of inefficient post offices and processing facilities, pay-determination procedures that result in high wages and benefits, and other federal requirements constitute a long and expensive list of federal mandates. To keep the costs of these mandates off the federal books, the federal government provides its Postal Service with an array of hidden, off-budget government subsidies and the granting of a monopoly. Although the subsidies and monopoly are worth billions of dollars annually, they never appear explicitly in the federal budget. These subsidies help the Postal Service survive, despite high costs that are due in part to federal requirements. Even a partial list of its special powers and privileges is long[13]:

- The Postal Service's crown jewel is its government-granted mail monopoly. Because of that monopoly, households and businesses are forced to go through the U.S. Postal Service if they want to send or receive non-urgent letters or make use of mailboxes. The monopoly is often defended as being the funding device for uniform rates, which says, in effect, that there is massive cross-subsidization within the monopoly: some customers are charged much more than they cost the Postal Service in order to provide below-cost service to other customers. Another way to express this is that a considerable portion of the universal service obligation is an unfunded federal mandate. The monopoly allows the Postal Service to shift much of the cost to a subset of ratepayers.

- The Postal Service enjoys an array of tax breaks that includes: exemption from federal, state, and local income taxes; exemption from property taxes on all the real estate it owns; exemption from inventory and gross receipts taxes in localities that impose such taxes; and exemption from having to charge state and local sales taxes. Although being exempt from income taxes is not particularly valuable for an organization that usually loses money, the other exemptions are valuable.

- The Postal Service has a special low-interest-rate credit line directly into the U.S. Treasury for up to $15 billion.

- The Postal Service's owner, the federal government, never demands a market rate of return (or any positive monetary repayment) on the billions of dollars of equity it has invested in the organization.

- The Postal Service enjoys a de facto federal guarantee against bankruptcy.

- The Postal Service does not pay state motor-vehicle licensing fees and is immune from parking tickets and related expenses.

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[13] For rough estimates of the dollar magnitude of several of the Postal Service's hidden subsidies, see Michael Schuyler, *The Anti-Competitive Edge: Government Subsidies To Government Businesses: Case Studies Of The Postal Service, TVA, And Amtrak* (Washington, DC: Institute For Research On The Economics Of Taxation, 1999). The study does not estimate the value of the postal monopoly. The paper also provides estimates for many of the subsidies at TVA and Amtrak.

- The Postal Service is not bound by local zoning laws and related restrictions and expenses (although it does have a policy of cooperating with local zoning authorities).

- The Postal Service is at least partially shielded from normal antitrust laws (although a recent Federal Appeals Court decision ruled against the agency's position that it has broad protection from antitrust liability based on sovereign immunity.[14])

The heavy reliance on disguised state aid as a funding mechanism is troubling for several reasons. It conceals the true costs of various obligations placed on the Postal Service, which makes it harder to reach good decisions in the political process about whether various requirements are worth their costs. The subsidies also distort market price signals, which causes a misallocation of resources and lessened productivity. For example, when some consumers within the postal monopoly are forced to subsidize other customers within the monopoly, those providing the subsidies are encouraged by the prices they face to use too little mail service and look too hard for non-postal alternatives. Further, the monopoly invites misuse in a manner that is contrary to policy, but tempting nevertheless. Because there are strong size-related rewards in government organizations, it is attractive to expand if at all possible.[15] One way to do that is to charge customers within the monopoly a little more (they have difficulty going elsewhere) in order to subsidize the sale of more goods and services outside the monopoly. The Postal Service denies that cross-subsidization from the monopoly into competitive markets ever happens, but it is suggestive that revenues from first-class mail users cover a disproportionate share of the organization's costs.[16] That is, although the Postal Service claims that expansion into non-core operations would help cover the cost of universal service within its core market, support and cross-subsidies appear to go in the opposite direction.

Furthermore, some of the other subsidies may lead to cases where those in the Postal Service genuinely think the organization can do well in competitive markets outside of its monopoly, even though it would actually be significantly less efficient than the private-sector businesses it would displace. Unlike private-sector businesses, the Postal Service is excused from paying many taxes and government fees, and is not expected to earn a market rate of return but can call itself successful merely for breaking even. Because of its implicit subsidies, the Postal Service can be satisfied with an expected pre-tax return 10%-20% lower than that of a private-sector business. That is a problem for the economy. When the Postal Service displaces private-sector businesses that had higher pre-tax returns, the economy's productivity declines.

In addition, the subsidies hurt the Treasuries of federal, state, and local governments due to reduced tax collections. After all, the Postal Service uses its multiple tax exemptions to escape

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[14] Flamingo Industries v. U.S. Postal Service, available on the Internet at http://www.ca9.uscourts.gov/ca9/newopinions.nsf/D971661C3CE8DF6488256C1E00030FEF/$file/0115963.pdf?openelement.

[15] Size can bring rewards in the private sector, too, but the profit motive provides a brake that is missing in the government sector. Expansion tends to be punished in the private sector when it hurts profits.

[16] This issue is discussed more fully in Michael Schuyler, "Does First-Class Mail Carry Too Much Overhead?" *IRET Congressional Advisory*, No. 141, November 13, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-141.PDF.

paying many of the taxes that private businesses carrying out the same operations would have to pay. The more the Postal Service expands, the greater the revenue loss to governments, and to maintain a given level of government spending, the more governments must borrow or collect through higher taxes on other taxpayers.

What the Commission Should Do: Help the Postal Service Lower Its Costs

Redefine universal service.

Many of the federal requirements that drive up the Postal Service's costs cannot be tackled unless Congress is persuaded that changes are needed. The Commission can play a crucial role by examining these requirements to see if some of them are not worth the costs they add, and then building a consensus for reform.

For example, one of the Commission's assignments is to examine how "universal service" should be defined in the future. It should not regard the current interpretation of universal service as sacrosanct. The Commission might evaluate the pros and cons of proposals that have been floated previously, such as not requiring six-day-a-week mail delivery. That particular change would solve what postal officials claim is a serious problem. Recently (and perhaps temporarily) the number of addresses has grown more quickly than the volume of mail, which reduces the number of pieces of mail per delivery. The Postal Service complains that fewer pieces of mail per delivery raises its unit costs. Slightly reducing the frequency of mail delivery, say from six times weekly to five, would more than offset that, so that, on net, pieces of mail per delivery would rise.

If the Commission is willing to think (just slightly) outside the box, it might consider ideas like defining universal service as a basic level of delivery service that is relatively uniform at all addresses but breaking from the one-size-fits-all mold by permitting the Postal Service to offer enhanced delivery services to customers willing to pay more. For example, cable TV companies usually offer basic service for one price and provide premium services at higher prices. Local telephone companies normally offer a basic "lifeline" service at a reduced price. Similarly, many banks offer an economy-priced basic checking account and charge more for checking accounts with enhanced options.

Closing and consolidating post offices and other facilities.

The cost saving would also be large if some of the current political obstacles to consolidating and rationalizing the number of post offices and the national network of mail processing facilities were eased.

Bring postal wages and benefits closer to those in the private sector (i.e., narrow the postal pay premium).

Still bigger cost saving could be realized by changing how postal wages and benefits are set. Although the political opposition to any changes in the pay determination process would be strong, it should be remembered that a well crafted reform to bring postal pay into closer alignment with private-sector pay would be fully consistent with the pay comparability policy currently stated in law.

Business practices under the Postal Service's control.

The Commission should also examine the business practices that are under the Postal Service's control. There is room for improvement. As one example, the Postal Service might be urged by the Commission to contract out more of its work. The Postal Service has already done some of this, in effect, by vigorously pursuing worksharing arrangements that have been determined by the independent Postal Rate Commission to save it money and by contracting out some of its operations to private-sector companies, but many additional opportunities remain. Federal, state, and local governments have repeatedly found that labor costs fall and productivity increases when governments open their activities to competition between government and private-sector workers. The Bush Administration has announced an initiative to open to public-private competition many jobs now performed within the government. The Commission could reinforce this initiative at the Postal Service, which is the government agency with the most employees except for the Defense Department.

Privatization

The experience with many state-owned enterprises in this country and abroad has been that the greatest productivity gains and cost savings can be achieved by privatizing the enterprises. The Commission should examine this option. Privatization would be the best choice from an economic perspective. The Commission should be aware, however, that for privatization to work properly, the newly privatized business must be put on a level playing field with other businesses. That means ending the special privileges it possessed as a government enterprise. If those subsidies remain on the books, the enterprise can use them to take business away from other, more efficient companies, which reduces productivity, distorts consumers' choices, and may have other drawbacks like increased risks for taxpayers and lost tax revenues for federal, state, and local governments. Accordingly, if the Commission offers privatization as an option, it should carefully explain how to reach the goal of full privatization, which includes ending the newly privatized firm's government-based special privileges.

What Should the Commission Recommend If It Judges That the Postal Service Cannot Break Even In its Core Mission of Delivering Non-Urgent Letters Throughout the Nation at Reasonable Prices?

First, the Commission should examine the many federally imposed rigidities that increase the Postal Service's costs. Relaxing some of these demands would be more than sufficient to allow the Postal Service to break even in its core mission.

But what if the Commission fears that the political process will stymie cost-saving reforms? Then the best choice is to finance the deficits in the core market through explicit appropriations in the federal budget to bring the costs into the open and foster better decisionmaking. For additional transparency, the Postal Service's accounting should be strengthened and it should be required to publicly release more information about its operations.[17] Any federal payments should be confined

[17] For a fuller discussion of why greater financial transparency at the Postal Service is desirable, see Michael Schuyler, "Transparency: Using Financial Openness At The Postal Service To Protect Consumers And Taxpayers," *IRET Congressional Advisory*, No. 125, March 27, 2002, available on the Internet at

to the Postal Service's core role. There is no good policy reason to allow the Postal Service to operate outside its monopoly and provide goods and services that are already offered by private-sector businesses, and it would be even worse public policy to subsidize the Postal Service to do so. In no event should the Commission recommend additional indirect subsidies involving special government privileges. They are not transparent, distort market signals, and misallocate resources.

The Postal Service Should Not Expand

On many occasions over the years, the Postal Service has claimed that it could strengthen its bottom line by expanding. Its argument is usually couched in terms of economies of scale and scope. However, the organization is already so large that it has captured virtually all significant size-based economies.[18]

In reality, a hidden, but central element of its business plan in any expansion would be making greater use of its government subsidies (tax exemptions, no need to earn market rate of return, low cost credit, etc.) to try to take business away from more efficient private-sector producers. Using open-ended hidden subsidies to finance expansion would be bad for the economy and for federal, state, and local governments and their taxpayers.

Moreover, the Postal Service is so inefficient that it would probably still lose money if it offers new products outside its monopoly core, despite the artificial cost advantages it enjoys because of its subsidies. An additional concern is that bureaucratic rewards for growing larger would tempt it to underprice its competitive-market products in order to increase sales there, which increases the odds that it will lose money if it expands. If that happens, consumers within the postal monopoly would be forced to more heavily cross-subsidize the Postal Service's competitive-market products, and taxpayers would be at risk of having eventually to pay for an expensive Postal Service bailout.

Should Postal Rates Be Subject to Less Regulatory Oversight?

The Postal Reorganization Act of 1970, which created the Postal Service, also created an independent federal agency, the Postal Rate Commission (PRC), to provide regulatory oversight. The Postal Service cannot change postal rates and postal classifications on its own but must first seek approval from the PRC.

From the start, the Postal Service has complained about this arrangement. The Postal Service is correct that the rate setting process is time consuming and expensive. That does not mean it is

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ftp://ftp.iret.org/pub/ADVS-125.PDF; and Michael Schuyler, "New GAO Study Indicates Need For More Financial Transparency At The Postal Service," *IRET Congressional Advisory*, No. 144, December 11, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-144.PDF.

[18] This issue is examined much more fully in Michael Schuyler, *Wrong Delivery: The Postal Service In Competitive Markets* (Washington, DC: Institute for Research on the Economics of Taxation, 1998). To be sure, there are scale economies when mail carriers deliver more items with the characteristics of first- and third-class mail on each trip to the mailbox. Unfortunately for advocates of expansion, few other products have their characteristics. The most reliable way to increase how much is delivered per trip to the mailbox is to reduce the number of delivery days.

unwarranted, however. The Postal Service is a monopolist. Unless held in check through strong regulatory oversight, the monopoly gives it enormous pricing power over consumers within the postal monopoly. Thus, while current regulatory procedures are costly (but less costly than many other federal requirements), there is a very good reason for having them. Even if the PRC has not been fully able to prevent cross-subsidization from consumers within the postal monopoly to postal products in competitive markets, the cross-subsidies would be larger if not for the PRC's efforts.

One may think of current regulatory oversight as the quid pro quo for the postal monopoly. If the day ever comes when the Postal Service does not have its monopoly and the associated monopoly power over consumers within the monopoly, it should then be able to set prices on its own, without regulatory supervision. Until then, however, the oversight should remain in place.

The current type of regulation is known as cost-of-service regulation. Some have suggested switching to what is known as a rate-cap regime. Rate-cap regulation makes sense for a private-sector monopolist, but for it to work properly it requires the presence of private owners subject to the profit motive. At a government monopoly, there is danger that rate-cap regulation would lead to greater cross-subsidization from consumers within the monopoly to other products, while failing to achieve the hoped for efficiency gains.

Another proposal is that the Postal Service be allowed to change prices on its own, subject to later challenge before the PRC. That suggested change in regulatory oversight also has problems. First, it would weaken regulatory oversight by shifting from having the Postal Service justify postal rate changes to making postal consumers challenge the changes. Even when challenges were ultimately successful, the Postal Service would have had the rates it wanted in the meantime (although presumably refunds could be ordered.) Second, because the Postal Service would enter the regulatory review process with the postal rates it desires, the PRC would lose much of its current leverage to pry cost information from the Postal Service. With less information, the PRC would be less able to spot cross-subsidization from the monopoly to other products.

Conclusion

The Postal Service has demonstrated in the last year that cost control efforts can quickly yield dramatic financial results. Many of the most promising cost management reforms, however, cannot be used without easing rigidities created by various federal mandates and pressures.

The Commission can make the greatest contribution to ensuring that the Postal Service is financially viable in the long run, that it delivers satisfactory service, and that it charges reasonable rates by concentrating on cost issues. It should prod the Postal Service to stay focused on cost management in the long run, and not regard cost cutting as only a short run or medium run financial fix. It should examine how federal mandates greatly increase the Postal Service's costs, compare the mandates' costs to the benefits they bring, and make the case to Congress for relaxing the mandates with the highest costs and lowest benefits.
