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Competing with the U. S. Postal Service:

Effects on Consumers, Competitors, and Virginia State and Local Government

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March, 2004

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Foreword

What effect does the United States Postal Service's status as a monopoly provider have on the Virginia economy? The answer is: plenty.

Because of its array of special protections, monopoly advantages and tax-exempt status, the USPS is able to undercut taxpaying businesses in Virginia and drive out or block the entry of private firms that would stimulate further economic growth in the Commonwealth.

Furthermore, as state and local governments struggle for revenue to meet core obligations, the USPS represents a huge business exempt from state and local taxes.

This paper, by Cornell University Associate Professor Rick Geddes, inventories the government-granted competitive advantages enjoyed by the United States Postal Service, allowing the USPS to unfairly compete with private firms. He argues persuasively for a return to the core mission of the USPS – delivery of letter mail – and outlines the host of services into which the Postal Service has expanded to the detriment of private businesses.

Mr. Geddes' report demonstrates the desperate need for accountability in a bureaucracy held accountable to no one, and concludes that the Postal Service's regulator – the Postal Rate Commission – has inadequate authority to control the USPS' wandering eye toward activities having nothing to do with the service's core mission.

This paper is illustrated with the impact of the USPS tax exemption on state and local government – from corporate income to real property taxes, and from vehicle property taxes to business, professional and occupational license (BPOL) taxes. It is this last point that has such a significant impact on local governments that are so heavily reliant upon asset-based tax models from which the USPS is exempt.

Finally, Mr. Geddes offers a number of conclusions and possible reforms for the USPS – from a long-term proposal to offer Postal Service employees ownership of the service to short term requirements that the USPS restrict itself to its core mission of letter delivery and provide greater transparency in its operations.

These reforms would go a long way towards developing robust private businesses that would both serve the public and provide badly-needed revenue for state and local government here in Virginia.

This report is developed as a public service of the Thomas Jefferson Institute in order to contribute to the debate about the future of the US Postal Service and the local government tax debate in Virginia by placing new and reinvigorated ideas on the table. The conclusions of this paper do not necessarily suggest support or opposition to any specific legislative proposal by this foundation or its Board of Directors.

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March 2004

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Introduction

The United States Postal Service (USPS) enjoys monopolies over both the delivery of letters and the use of customers' mailboxes. It is entirely owned by the U.S. government. It receives a range of special government-granted privileges and immunities, including exemption from all taxes, exemption from antitrust scrutiny, exemption from SEC reporting requirements, the ability to borrow from the Treasury at below-market rates, exception from paying investors a rate of return, and the power of eminent domain, among many others.

As Virginia struggles to close its budget gap, these Postal Service advantages not only inhibit the formation and expansion of private businesses but further deny states and localities badly-needed tax dollars. In Virginia alone, the monopoly and tax-exempt status cost the state and localities millions of dollars.

One might suspect that the Postal Service's regulator, the Postal Rate Commission (PRC), would have substantial authority to control the USPS' formidable powers. Unfortunately, the authority of the PRC is inadequate for its task. It does not have authority to actually set postal rates, to determine the quality of delivery, or to obtain desired information from the USPS.

The Postal Service is, however, unlikely to remain financially viability in its current form for long. Demand for first-class mail delivery, the USPS' core revenue source, is declining rapidly. In 2002, first-class volumes suffered the largest drop in thirty years. Single-piece first-class letter, flat and parcel volume (customers mailing single items) is falling at an accelerating rate. First-class volume continued to fall throughout 2003. The decline is not due to short-term fluctuations or depressed economic conditions. At the same time, the Postal Service's network is expanding steadily. In 2003 the number of delivery points expanded 7.8 percent.

The USPS is consequently searching for new revenue sources, expanding into activities outside of its core function of delivering mail. It has ventured into selling mugs, tee shirts, phone cards, Direct Mail services, passport photos, and a variety of e-commerce services such as eBill Pay, NetPost Cardstore, and NetPost Certified Mail. The USPS has lost money on many of those services, and in the process has weakened or driven private firms out of the market. Moreover, it asserts that its decision to provide such services, and the prices it charges for them, are outside the jurisdiction of the Postal Rate Commission. The USPS is able to pass its losses from such services along to customers who are captive to its delivery monopoly, without regulatory oversight.

I address those issues in this report. I first review the various government-granted benefits that allow the USPS to inefficiently compete with private firms, and provide a definition of inefficient competition. In Section II, I discuss the core mission of the U.S Postal Service, which is the delivery of letter mail. In Section III, I discuss how the USPS has ventured beyond that core mission to offer a host of services that compete directly with private firms. It is apparently able to undertake any activity it pleases without any regulatory oversight. In Section IV, I discuss how the Postal Service's expansion into non-core activities is harmful to private business, to postal customers, and to state and local governments. In Section V, I point out that the USPS is unlikely to remain viable for long in its current organizational form. That is one reason why it has been so aggressive in seeking revenues outside its core mission. Section VI addresses a crucial issue with regard to USPS organization: accountability. The USPS is currently not accountable to any clearly defined group, either in government or in business. In Section VII, I suggest that the Postal Service's regulator, the Postal Rate Commission, does not have adequate authority to control the USPS. Section VIII concludes and offers policy recommendations.

I. The Postal Service Receives Government-Granted Benefits that allow it to Inefficiently Compete with Private Rivals

The Postal Service possesses a wide variety of special privileges and immunities. They can be grouped into two broad categories: (i) monopoly and suspension (or the ability to "suspend" its monopoly at its own discretion) powers; and (ii) a set of special privileges and immunities stemming from government ownership and government sponsorship. Those powers give the USPS an artificial competitive advantage over private rivals. By artificial, I mean that the firm's competitive advantage is not based on economic factors such as superior management skills, more efficient technology, more vigorous innovation, better labor relations, improved corporate governance, or enhanced incentives; it is an artifact of its government-granted benefits.

Those powers allow the USPS to inefficiently compete with private firms in a variety of businesses. Inefficient competition occurs when a higher cost (less efficient) firm is able to drive a lower cost (more efficient) firm from the market, deter it from entering, or reduce its market share, because of its artificial competitive advantage. Because of its array of special protections, privileges and immunities, the USPS is able to drive out, or deter the entry of, private firms that may actually be more efficient.

a. The Postal Service Retains Two Government-Protected Monopolies

The USPS retains several powers relating to its monopoly. They are a monopoly over letter delivery, over the customer's mailbox, and the "suspension" power.[1] The USPS retains a statutory monopoly over the delivery of anything considered a "letter". The majority of USPS revenue is obtained from monopolized delivery. In 2003, over 56 percent of the Postal Service's revenues from mail were derived from monopolized first-class mail, while over 26 percent were derived from partially monopolized Standard Mail. The delivery monopoly raises many concerns, but a crucial one is the fear of cross-subsidy. The USPS provides both monopolized services (e.g. letter delivery) and competitive services (e.g. package, express mail, and many others), and may try to use revenues from monopolized activities to lower price where it faces competition, thus cross-subsidizing competitive activities.

The letter delivery monopoly in the United States differs critically from other utility monopolies, however, in that its scope is effectively defined by the Postal Service itself. The

[1] Because it is merely a postal regulation, commentators dispute the legality of the suspension power. See, e.g. James I. Campbell Jr. *An Introduction to the History of the Postal Monopoly Law in the United States*, mimeo, revised June 27, 1995; available at http://www.jcampbell.com, p. 29.

Private Express Statutes prohibit the private carriage of "letters or packets," and the Postal Service defines a letter as "a message directed to a specific person or address and recorded in or on a tangible object."[2] That definition of "letter," adopted by the Postal Service in 1974, differs greatly from earlier definitions and is much more expansive.[3] Such an expansive definition leads naturally to monopolization of materials not intuitively considered letters, such as bills and advertising matter, which constitute a substantial and increasing proportion of the mail stream.[4] Experts in regulation have noted this unusual arrangement.[5] According to the Postal Service's definition, an addressed grocery store advertisement is a letter. The courts have accepted the Postal Service's broad test for a letter as, "the presence or absence of an address."[6] The USPS can strictly enforce its monopoly by conducting searches and seizures if it suspects citizens of contravening its monopoly.

The second monopoly is over the use of private mailboxes. The Criminal Code stipulates a fine if matter on which postage has not been paid is deposited in a mailbox. The mailbox monopoly exists only in the United States.[7] No sound arguments from either efficiency or equity have been offered for the continuation of the mailbox monopoly.

Strangely, the USPS in 1973 assumed the power to suspend its own delivery monopoly at will for certain types of messages. As Yale Law School professor George Priest states:

> In the 1973 Report the Governors announce for the first time that they possess and that they will exercise the authority to suspend the private express statutes at their discretion. No Postmaster General has ever claimed the power to repeal or to "suspend" the private express statutes by administrative order. But the Governors have discovered an obscure postal regulation which will allow them, with sympathetic interpretation, to surrender bits and pieces of their exclusive grant in ways to preserve the substance of the monopoly.[8]

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[2] 39 C.F.R. § 310.1(a).

[3] See James I. Campbell, Jr., "The Postal Monopoly Law: A Historical Perspective," in *The Last Monopoly: Privatizing the Postal Service for the Information Age* (Edward L. Hudgins ed. Cato Institute 1996), p. 18. Campbell documents in detail how the Post Office and then the Postal Service has expanded the scope of its monopoly over a 200-year period.

[4] Campbell, Id. at 18-9 states:

> In 1974, the Postal Service adopted comprehensive monopoly regulations that substantially revised the previous administrative definition of *letter* to read "a message in or on a physical object sent to a specific address." This definition manifestly included within the postal monopoly all physical communications, whether recorded by means of writing, printing, photography, or electromagnetic process.

[5] For example, Gregory Sidak and Daniel Spulber state that: "The result is unlike that in any other regulated industry: Because the Postal Service claims for itself the term 'letter,' which defines the extent of its monopoly, the monopolist has the power largely to define the scope of its own monopoly." J. Gregory Sidak and Daniel F. Spulber, *Protecting Competition from the Postal Monopoly* (AEI Press 1996) p. 12.

[6] See *Associated Third Class Mail Users v. United States Postal Service*, 600 F.2d 824, (830 D.C. Cir. 1979) (Wright, J.).

[7] Robert H. Cohen, William W. Ferguson, John D. Waller, and Spyros S. Xenakis, "An Analysis of the Potential for Cream Skimming in the U.S. Residential Delivery Market," in Michael A. Crew and Paul R. Kleindorfer, eds. *Emerging Competition in Postal and Delivery Services* (Boston: Kluwer Academic Publishers) 1999, p. 143.

[8] George L. Priest, "The History of the Postal Monopoly in the United States," 18 *Journal of Law & Economics* 33 (1975) p. 79.

Exceptions include the obvious, such as "letters accompanying cargo" and "letters of the carrier" (which, for example, encompass interoffice correspondence), but also include "letters by special messenger," as well as "extremely urgent letters." The latter two allow for bicycle messengers and overnight delivery services, such as Federal Express. Importantly, the suspension power allows the USPS itself to decide who falls under its monopoly.[9]

However, it remains unclear whether Congress ever gave the Postal Service authority to suspend the postal monopoly. The suspension authority thus remains under a legal cloud.[10] The suspension power creates further confusion about the scope of the Postal Service's monopoly, which injects additional uncertainty into a private firm's decision to enter a market in which it may compete with the USPS.

b. Subsidies Through Debt, Equity, Taxation, and Other Special Privileges

In addition to monopoly powers, the USPS retains a number of valuable government-granted privileges and immunities. Although often overlooked, it can use these valuable subsidies to unfairly compete against private firms that are not so favored. There are at least nine implicit subsidies that the USPS receives by virtue of government ownership:

- The USPS is exempt from all taxation, including local property and business taxes. Such an exemption is significant, and likely costs local taxpayers billions of dollars each year. For example, in Fairfax County, Virginia alone, two United Parcel Service facilities pay more than $221,000 a year in real property taxes. The smaller of these units, comparable to the size of a large U.S. Postal Service facility, pays $18,269 in real property taxes. Given the large number of post offices, distribution centers, and post office trucks (on which personal property taxes do not need to be paid), as well as its exemption from local business taxes the postal service's competitive, local taxpayer-subsidized advantage may well run into a million dollars or more in that one Northern Virginia county alone.

- The USPS can borrow from the U.S. Treasury at taxpayer-guaranteed preferential rates, which artificially reduces its capital costs. The federal government guarantees this debt.[11] Such preferential borrowing has saved the USPS billions of dollars in interest costs since its inception.[12]

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9 James C. Miller III. 1983. "End the Postal Monopoly," 5 *Cato Journal,* p. 150.

10 James I. Campbell Jr. *An Introduction to the History of the Postal Monopoly Law in the United States*, mimeo, June 27, 1995, p. 29.

11 39 U.S.C. §§ 2006 (a), (c).

12 Paul W. MacAvoy, and George S. McIssac, *The Current File on the Case for Privatization of the Federal Government Enterprises* in *Deregulation and Privatization in the United States* (3 Hume Papers on Public Policy, Paul W. MacAvoy, ed., Edinburgh University Press 1995) state:

> The public enterprises have had special access to capital through the Federal Financial Bank (FFB) which guarantees public bonds at interest charges less than market rates for private companies of comparable risk. Both TVA and USPS financed their placements of debt with the FFB at a 12.5 basis-point premium above Treasury bond rates. This rate was lower than on bonds of companies with comparable financial performance . . . If these organizations had not had access to FFB financing, the additional interest charges which they would have incurred would have exceeded $5 billion over the first half of the 1980s.

- The taxpayers who funded the USPS' original capital stock are, by definition, prohibited from withdrawing their funds (i.e. selling their interest in the venture) in the event of poor firm performance.[13] The USPS, like all government-owned firms, is absolved from paying dividends or indeed any expected return to shareholders, which lowers significantly its cost of capital relative to a privately owned, publicly traded corporation. Conversely, the USPS is free to dissipate owner's equity through consistent losses over time without fear of owner's withdrawing their capital.

- There is a perception that the USPS does not face a bankruptcy constraint because it will be "bailed out" by the government in a financial crisis. Such implicit government support further lowers capital costs.

- The USPS is immune from antitrust scrutiny[14]

- The USPS is not required to abide by SEC disclosure requirements

- The USPS maintains its own police force of armed postal inspectors

- The USPS has the power of eminent domain

- The USPS is not required to pay parking tickets

Each of these government-granted benefits is enormously valuable. That economic value (in addition to value generated by the delivery and mailbox monopolies) can be used to artificially lower prices in areas where the USPS has ventured outside of its core mission and thus faces competition from a private rival. I discuss the Postal Service's core mission in the next section.

II. The Core Mission of the U.S. Postal Service is Mail Delivery

The ostensible reason for the Postal Service's government-enforced monopolies over the delivery of letter mail and the customer's mailbox is to ensure that it provides universal mail service. That has historically been the core mission of the USPS, and its infrastructure is designed to provide universal mail service. The government has presumably granted it special privileges and immunities to assist it in that mission. The USPS should focus on its core mission. Movement into activities outside of that core mission diverts resources and expertise away from the core.

Authorities have noted the importance of that core mission, as well as the Postal Service's recent deviations from it. The 2003 Report of the President's Commission, for example, highlighted in its executive summary the need for the USPS to focus on its core activity of delivery mail, stating:

[13] Indeed, this can be considered a definition of government versus private ownership. Under government ownership, the government retains a monopoly over the holding of shares in the firm, while they are transferable under private ownership.

[14] The current understanding is that the USPS is immune from antitrust enforcement, but the question is now being argued in the courts. The relevant case is *U. S. Postal Service v. Flamingo Industries*. See, e.g. http://www.oyez.org/oyez/resource/case/1668/ for details.

> Delivering high-quality service in an era of stagnant mail volumes will require the Postal Service to recognize that as demand for its services contracts, so, too, should the institution. To do so without sacrificing essential services, however, will require the Postal Service to focus on its core value: the reliable, affordable delivery of the mail to every American home and business.
>
> While the Postal Service in recent years has explored an array of new revenue streams far afield of what most American's consider "postal services," the Commission recommends that the Postal Service be restricted to products and services related to the delivery of letters, newspapers, magazines, advertising mail, and parcels. More broadly, the Commission recommends that the mission of the Postal Service be "to provide high-quality, essential postal services to all persons and communities by the most cost-effective and efficient means possible at affordable and, where appropriate, uniform rates."[15]

Unfortunately, the Postal Service's expansion into activities unrelated to its core mission of universal mail delivery has been extensive, as I document in the next section.

III. The Postal Service Has Expanded into Activities Outside It's Core Mission

USPS expansion outside of its core area, and into areas where it faces competition, is not new. United Parcel Service has been concerned about the Postal Service's pricing and behavior in parcel post markets for decades. Federal Express and other express delivery firms have been concerned about the Postal Service's provision of overnight delivery services since the inception of that service in 1977. A major fear regarding the provision of services outside of its core business is that the USPS will use revenues from monopolized activities to price below cost in activities where it faces competition. That is, it will cross-subsidize competitive activities.

Cross subsidization can drive more efficient private competitors from the market, or deter them from entering altogether. Indeed, when it passed the 1970 Act, Congress recognized the dangers of cross-subsidization. It mandated that the Postal Rate Commission take the cost of providing specific classes of mail explicitly into account through the requirement that "each class of mail or type of mail service bear direct and indirect costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to each class or type."[16] One can argue about how effective the Postal Rate Commission, given its limited powers, has been in preventing cross-subsidy. Perhaps as importantly, there have been numerous recent expansions by the USPS into new business activities where it faces competition. Those activities appear to be outside of the Postal Rate Commission's jurisdiction. The Postal Service is thus unconstrained in the services it chooses to offer and the prices it charges for those services.

Two entities, the Office of the Consumer Advocate within the Postal Rate Commission and a consumer advocacy group called Consumer Action, warned of the deleterious effects of the Postal Service's entry into a variety of new activities.[17] Consumer Action, in its' petition to the

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[15] *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, Report of the President's Commission on the United States Postal Service, 2003, p. xi.

[16] 39 U.S.C. §3622 (b) (3).

[17] See *Petition of Consumer Action Requesting that the Commission Institute Proceedings to (1) Review the Jurisdictional Status of Fourteen Specified Services and (2) Establish Rules to Require a Full Accounting of the*

Postal Rate Commission, lists numerous services that the USPS has entered without the Commission's approval, and about which there is either very poor or non-existent cost data. Those services include:

1. Sure Money
2. Online Payment Services: eBillPay
3. ePayments
4. NetPost CardStore
5. NetPost Certified Mail
6. Electronic Postmark
7. Unisite Antenna Program
8. Returns @ ease
9. First Class Phone Cards
10. Retail Merchandise

Many of those services have an electronic aspect, therefore competing directly with numerous small Virginia electronic and retail businesses.

It is remarkable that the USPS would not first seek the consent of the Postal Rate Commission, and guidance on prices to be charged for them, before offering such services. In a statement before the President's Commission on the Postal Service, Shelley Dreifuss, Director of the Office of the Consumer Advocate, stated:

> In recent years, the Postal Service has stepped up its efforts to sell a variety of e-commerce services to the public. These include "eBillPay," "NetPost CardStore," and "NetPost Certified Mail." The Postal Service started up these services without first coming to the Postal Rate Commission with a request to offer a new class of mail service and the price it wished to charge for the service. For mail services that the Postal Service views as more traditional in nature, like a new type of package service (perhaps at a lower price than currently available, but for a slower service), the Postal Service does not start up the new service unless it has a recommended decision from the PRC following a proceeding conducted under the Postal Reorganization Act, which incorporates due process procedures from the Administrative Procedure Act.[18]

The retail merchandise mentioned above includes goods such as T-shirts, coffee mugs and passport photos.[19] Moreover, General Accounting Office reports indicate that these services generate huge losses for the USPS, but that USPS cost accounting for the services is so poor that it is impossible to measure the size of those losses with precision.[20] If the USPS does not recover

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Costs and Revenues of Non-Jurisdictional Domestic Services, Petition for Review of Unclassified Services, Before the Postal Rate Commission (October 15, 2002).

[18] See the comments of the Office of the Consumer Advocate of the Postal Rate Commission to the President's Commission on the United States Postal Service, presented by Shelly Dreifuss (untitled document), available at: http://www.ustreas.gov/offices/domestic-finance/usps/comments/organizations/comments_ConsumerAdvocate-PRC.doc, page 1.

[19] Ibid.

[20] See, e.g. Government Accounting Office Report GAO-02-79, *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections* (December 2001), available at: http://www.gao.gov/new.items/d0279.pdf.

its costs through the prices charged on those services, it is likely that they will be passed on to captive first-class customers.

Importantly, the USPS does not believe that it needs to obtain authority to offer those new services, nor does it believe that it needs to offer them at a cost-recovering price. As the Office of the Consumer Advocate states:

> Without a clear statutory requirement that the Postal Service establish such services at a cost-recovering price, following a public proceeding under the Administrative Procedure Act, the Postal Service's position is that it *will continue to sell any service or product it wishes, whether or not the service or product has any connection to traditional postal services, at any price that it likes*. *Furthermore, the Postal Service does not believe that it has to account to any outside organization for these costs or activities.* To the extent that losses are generated, the Postal Service believes that it is the obligation of the Postal Rate Commission to *pass the losses along to ratepayers* such as First Class, Periodicals, and Package Services without giving those ratepayers any say at all on the imprudence of entering into such activities in the first place (emphasis added).

This type of diversion by the USPS into new activities has several harmful effects. First, there is a straightforward misallocation of resources into those activities because prices are not aligned with true economic cost. Because they are not as concerned with profits as their private counterparts, government-owned firms are more willing to set price below cost and keep it there without regard to long-term losses.[21] Second, more efficient but unsubsidized private firms will shrink, not invest, or may not start up if they observe or anticipate competition from a government rival. Third, if there is uncertainty over the government firm's intention or ability to expand into an activity, that uncertainty will contribute to private dis-investment. Fourth, taxpayers or other captive groups will have to fund more (or all) of the overhead costs of the competitive activity, even though customers using the good or service are willing to pay for it. Finally, ventures outside of the government firm's core activity divert resources from that core activity, which is presumably why the firm was granted special privileges and immunities in the first place. I explore the effects of the USPS' monopoly powers and expansions outside of its core activities more fully in the following section.

IV. The Postal Service's Expansion into Competitive Activities Harms Consumers, Businesses and Local Governments

The harmful effects of anticompetitive behavior by the USPS on local governments and businesses are often ignored because they are difficult to observe: firms that do not exist or do not enter the market because they fear competition, firms that contract because of below-cost pricing by the USPS, or taxes not collected because the tax-exempt Postal Service crowds out private taxpaying businesses. Yet, because of the special privileges and immunities enjoyed by the USPS, those effects are important for state and local consumers, businesses and government. I here review the numerous ways in which the Postal Service's behavior impacts on state and local government and business, with particular emphasis on the State of Virginia.

[21] For detailed discussion of this point, see David E.M. Sappington and J. Gregory Sidak, "Anticompetitive Behavior and State-Owned Enterprises: Incentives and Capabilities," in R. Richard Geddes, ed. *Competing with the Government: Anticompetitive Behavior and Public Enterprises* (Stanford, CA: Hoover Institution Press) 2004.

a. The Postal Service Unfairly Hurts Private Businesses With Which It May Compete

I first examine several ways in which the Postal Service's behavior affects businesses in their capacity as competitors to the USPS. Importantly, the enormous legal uncertainty surrounding the Postal Service has a significant chilling effect on small businesses. There are several ways in which legal uncertainty surrounding the Postal Service will negatively impact small business:

- Uncertainty surrounding regulatory control over the Postal Service's offering of new products will deter small business. It is currently not clear which new products, if any, fall under Postal Rate Commission jurisdiction. The Postal Service's entry into a variety of electronic businesses, as discussed above, is of particular concern for a region with a large technology sector, such as Northern Virginia. Because the Postal Service retains numerous government-granted benefits, and because regulatory jurisdiction over its forays into non-mail activities is so uncertain, technology businesses fearing competition from the USPS are less likely to enter.

- Uncertainty surrounding the scope of the Postal Service's delivery monopoly, and how it will choose to enforce that monopoly, will hurt small business. This includes uncertainty regarding the extent of the monopoly, as well as which activities the USPS will decide are exempt from the monopoly. Examples of USPS abuse of its monopoly include the well-known confrontation with Mailboxes Etc.[22] and the 1993 raid on Equifax Inc., in which armed postal inspectors entered the headquarters of that company demanding to know if mail sent via Federal Express was indeed "extremely urgent" as postal regulations required.[23] Such harassment using the USPS' own police force is likely to discourage competitors (as well as customers) from entering markets in which they fear competition from the USPS. This is particularly important for small businesses that cannot afford to confront the USPS in costly litigation.

- Uncertainty surrounding regulation of USPS non-core activities, and the extent of its monopoly, will also slow innovation and investment by private firms because returns on those investments are more uncertain.

The second way in which the USPS hurts business is through cross-subsidy from money losing ventures. This effect is independent of legal uncertainty. As noted above, the majority of non-core activities the USPS enters lose money. The USPS is not recovering its costs on those activities. Private business cannot afford to run losses over time. Moreover, private firms do not enjoy the array of government-granted privileges and immunities enjoyed by the USPS. The USPS can thus artificially under-price services where it faces competition, driving more efficient private firms out of the market, or discouraging them from starting up.

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[22] See e.g. http://www.postalwatch.org/oped19991007.html. The USPS required all holders of private mailboxes to "re-register" with the Postal Service by filing a new postal form, and required all mail directed to a private mailbox to contain the designation "PMB." It later altered the required designation to a "#". The USPS claimed that this designation would somehow reduce mail fraud. It is more likely that the USPS wished to impose costs on private rivals providing mailbox services.

[23] See J. Gregory Sidak and Daniel F. Spulber, *Protecting Competition from the Postal Monopoly* (AEI Press 1996), p. 31-2.

b. The Postal Service Hurts Consumers

USPS organization also harms businesses and individuals in their capacity as postal customers. Evidence that postal prices are excessive can be obtained from many theoretical and empirical sources, but the substantial wage premium obtained by postal workers is perhaps the most obvious. About 80 percent of total postal expenses are labor-related. Numerous empirical studies confirm that postal workers are paid more than their private sector counterparts. In two studies, Sharon Smith found that postal workers are paid more than their comparable private sector wage.[24] Douglas Adie found that postal salaries were 21 percent higher than competitive rates.[25] Similarly, Jeffrey Perloff and Michael Wachter found that, in 1978, postal salaries were 21.2 percent higher than for similar workers in the private sector.[26] Wachter and Perloff again found a postal wage premium of 21.3 percent using 1988 data,[27] while Barry Hirsch, Michael Wachter, and James Gillula found a wage premium of 28 percent.[28] Both businesses and individuals are clearly paying excessive postal rates to cover those premiums. Marginal businesses, particularly those that use the mails intensively, will go bankrupt as a result.

Additionally, the costs of money-losing ventures outside of the USPS core will be passed on to customers who are captive to the Postal Service's delivery monopoly. Those losses will further raise postal rates for customers.

A third way in which the Postal Service organization hurts customers is through the limitation of choice. Customers will, of course, face very limited choice in monopolized activities. However, they will also face limited choice because the USPS forces out private competitors in its non-core activities. Firms that would have provided an option to customers will either shrink or not start up because of postal competition in non-core areas.

c. The Postal Service Hurts State and Local Governments

Current postal organization has a profound effect on state and local government. The fact that the tax-exempt Postal Service provides services instead of private firms deprives state and local government of much-needed revenue. First, consider local government. There are numerous important sources of local government revenue that the USPS does not pay. As noted, the USPS does not pay property tax, corporate income tax, sales tax, local BPOL (Business, Professional, Occupational License) tax, parking tickets or any taxes associated with motor vehicles.

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[24] Sharon P. Smith, "Are Postal Workers Over- or Underpaid?" 15 *Industrial Relations* 68 (1976), and Sharon P. Smith, *Equal Pay in the Public Sector: Fact or Fancy?* (Industrial Relations Section, Princeton University 1977).

[25] Adie, Douglas K., "How Have the Postal Workers Fared Since the 1970 Act?" in *Perspectives on Postal Service Issues* 74 (Roger Sherman ed., AEI Press 1980).

[26] Perloff, Jeffrey M. and Michael L. Watcher, "Wage Comparability in the U.S. Postal Service," 38 *Industrial & Lab. Relations Rev.* 26 (1984).

[27] Wachter, Michael L. and Jeffrey M. Perloff, "A Comparative Analysis of Wage Premiums and Industrial Relations in the British Post Office and the United States Postal Service," in *Competition and Innovation in Postal Services* (Michael A. Crew and Paul R. Kleindorfer, eds., Kluwer Academic Publishers 1991).

[28] Hirsch, B. T., M. L. Wachter, and J. W. Gillula, "Postal Service Compensation and the Comparability Standard," 18 *Research in Labor Econ.* 243 (1999).

Consider the effect on local government tax receipts. For local governments overall in 2000, about 28 percent of revenue came from property, corporate income tax, or sales and gross receipts taxes.[29]

In Virginia, the effect was even more profound. In Fiscal Year, 2002 local governments in Virginia received more than 62 percent of their revenues from real or personal property taxes or business taxes such as the BPOL tax.[30] While the majority of that percentage is derived from individuals, the lack of a local income tax results in a reliance on taxes based on hard assets like property, buildings, equipment, and vehicles – which the US Postal Service has in abundance.

Nationally, the USPS physical assets include 38,000 retail postal outlets, 446 mail processing facilities, and 215,000 vehicles – all part of a network that would be taxed in a private company but provide no revenue to localities when operated by the government.

Were the Postal Service treated as a private firm, or if private firms were able to compete on a level playing field with the USPS, the expansion in privately-held assets would increase revenues to Virginia localities.

V. The Long-Term Viability of the Postal Service is Threatened

The USPS will not remain viable in its current form for long. The growth of substitutes for letter mail, in the form of telephones, facsimiles, and particularly electronic mail, suggests that postal revenues cannot be maintained at current levels without further substantial rate hikes. Additional rate increases, however, will only invite more substitution into those alternatives. Large direct taxpayer subsidies are politically untenable. The General Accounting Office has recognized this, and issued a report to the Senate Government Affairs Committee stating that the "basic business framework of the Postal Service doesn't look like it will work in the future."

In the Postal Service's 2002 fiscal year, first-class mail volume suffered a decline of 1.7 percent, the largest drop in thirty years. First-class volume declined at an even greater rate in 2003, falling 3.2 percent.[31] Because those declines accelerated in the latter part of the fiscal year, they do not appear to be driven by economic conditions. To offset declining volume, the USPS has ventured into a wide variety of business activities outside its core responsibility of delivering mail. However, there is little evidence that these ventures are doing anything more than draining resources from the USPS core business.

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[29] See "Table 443. State and Local Governments -- Revenue and Expenditures by Function: 2000," in Statistical Abstract of the United States: 2002 (Washington, DC: US Census Bureau) p. 286.

[30] See "Local Revenue of Virginia's Counties and Cities: FY 2002", Commission on Local Government, Commonwealth of Virginia, November 2003, p.1, at www.clg.state.va.us/locrev02.pdf.

[31] For 2003, using the Postal Service fiscal year, overall first class volume fell by 2.7 percent in quarter 1, by 1.7 percent in quarter 2, by 2.9 percent in quarter 3, and by 3.2 percent in quarter 4. Single-piece first class mail volume fell by 3.8percent in quarter 1, by 1.4 percent in quarter 2, by 4.4 percent in quarter 3, and by a stunning 6.6 percent in quarter 4.

VI. It is Unclear to Whom the USPS is Accountable

The current structure of the USPS was established in the Postal Reorganization Act of 1970.[32] A major goal of the Act was to make the USPS less subject to political influence. To that end, it mandated a number of important organizational changes. The Postal Service became an independent establishment of the executive branch of the federal government. The Act created the Postal Rate Commission to oversee rate and classification changes, and to rationalize the postal rate structure. It created a corporate-like governance structure with an eleven-member Board of Governors and mandated an independent personnel system. It required the Postal Service to break-even, and authorized it to borrow money and issue public bonds. It did not, however, affect the Post Office's legislated monopoly over letter mail and over use of the customer's mailbox. The Act succeeded in reducing direct Congressional and executive control over the Postal Service, while retaining some minor powers of Congressional oversight.

Although direct political control over the USPS was successfully reduced by the Act, it came at a high cost: the USPS is accountable to no one. It is not legally accountable to taxpayers, employees, or mailers. It is certainly not accountable to shareholders, or indeed to any specific group.

Commentators from across the political spectrum have recognized this crucial weakness of the Act. Gregory Sidak and Daniel Spulber, for example, state: "Unfortunately, the current forms of public control of the Postal Service are ineffectual. In essence, the Postal Service is an unregulated monopolist that is constrained only in the sense that it is expedient for the enterprise not to show a profit."[33] Consumer advocate Ralph Nader, writing in 1981, was still more strident:

> The new 20-cent first-class stamp represents not only runaway postal costs but also the unchecked power of the Postal Service. The new rate came about because the mail system's Board of Governors deliberately overrode the Postal Rate Commission (P.R.C.), which, on three separate occasions, had found the latest increase unnecessary. We can only conclude that the Postal Service is no longer accountable to anyone – not to the P.R.C., not to the President, not to Congress and certainly not to the American people.[34]

The reason for this lack of accountability stems from one major failure of the 1970 Act: it did not create any ownership rights to the USPS. In the language of economics, the USPS has no *residual claimants;* no group can assert a property right to the net cash flows of the organization. Selling shares in the USPS would create a clearly defined group to whom it would be directly and legally accountable: stockholders.

Nor is accountability established simply through the creation of a corporate-style board of directors. A corporate board is appointed by shareholders to monitor managers on its behalf. Because there are no shareholders in the USPS, it is unclear to whom the board should hold managers accountable, or what performance measures it should use. The only remaining option

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[32] For a discussion of the events leading up to the act and the changes it instituted, see Chapters 2 and 3 in Rick Geddes, *Saving the Mail: How to Solve the Problems of the U.S. Postal Service* (Washington, DC: AEI Press) 2003.
[33] J. Gregory Sidak and Daniel F. Spulber, *Protecting Competition from the Postal Monopoly* (Washington, DC: AEI Press) 1996, p. 100.
[34] *The Nation*, "Price Fixing by the Postal Service," Dec. 12, 1981, p. 631. See also Richard Meyer, "Care for a Spin in my Chateau, Postmaster?" *Washington Monthly*, Feb. 16, 1984, p. 54.

aside from returning the USPS to the undesirable pre-1970 arrangement where it was controlled directly by Congress is the creation of tradable ownership shares.

The implications of the USPS' lack of accountability are manifest. The USPS is not subject to SEC reporting requirements, and is not required to disclose detailed financial information. It does not have to disclose information on the costs of particular services. It is not subject to the antitrust laws. Even its regulator, the Postal Rate Commission, does not have authority to subpoena information from it.

There are several reasons why the public should be concerned about the Postal Service's lack of accountability and the need for greater transparency. First, the public is ultimately responsible for the liabilities incurred by the Postal Service, including its outstanding bonds and pension liabilities. Taxpayers thus should know the true financial condition of the USPS. Second, the Postal Service ostensibly receives its government-enforced monopoly power and numerous other privileges in order to ensure universal mail delivery service. To make informed voting decisions, the public should know the full, true costs of continuing the Postal Service's special powers so that they can be weighed against the benefits. Third, the public has an interest in the maintenance of sound corporate governance at the USPS to avoid inefficiency and waste. Effective corporate governance is simply impossible without unfettered access to detailed financial information. Unfortunately, even the Postal Service's regulator, the Postal Rate Commission, does not have access to comprehensive financial information on the firm. That is one reason why the PRC's powers should be enhanced.

V. The Postal Rate Commission Has Inadequate Authority to Control the USPS

Given the variety of privileges and immunities discussed above, one would expect that the Postal Service's regulator, the Postal Rate Commission, would be endowed with substantial administrative authority to control the USPS' monopolies and special privileges. Unfortunately, the regulator does not have sufficient authority to control the USPS, for a variety of reasons:

- The Commission does not have authority to actually *set postal rates*. Instead, it *recommends* rates to the Board of Governors of the USPS after a rate change request from the Postal Service.[35] A recommended change in a rate proposal is sent to the Board for reconsideration, and the Board can overrule the Commission if it is unanimous.[36] In an analogously regulated utility, the utility's board of directors would be able to overturn the rate decisions of the state public utility commission and impose their own desired rates. The Board of Governors uses that power. It overruled the Commission in 1981, raising first-class rates to 20 cents after being thrice rebuffed by the Commission.[37] More recently, the Board voted unanimously to overrule the Commission and implement rate increases effective July 1, 2001.[38]

[35] 39 U.S.C. § 3661 (b). These recommendations are made after the Postal Service proposes a rate or classification change.
[36] 39 U.S.C. § 3625 (a),(d).
[37] N. Y. Times, October 1, 1981, p. A1.
[38] "Postal Service to Raise Rates on Most Classes," *Wall Street Journal,* May 9, 2001, p. A2.

- The Commission is weak because of government ownership itself. It cannot reduce the wealth of stockholders by reducing rates, or by threatening to do so. A public utility commission can quickly reduce equity values by refusing to raise rates, raising them slowly, or by reducing them. This power places substantial pressure on managers in a private firm because private ownership facilitates strong links between shareholder wealth and the interests of managers, which are eliminated under government ownership.

- The structure of the ratemaking process prevents the Commission from imposing effectively a revenue constraint. The Commission must simply take the Postal Service's costs as given, and try to allocate those costs across the various mail classes. Under private ownership, denying rate increases can reduce equity, as noted above. However, the Postal Service can simply claim inability to meet its costs, such as payroll, forcing the Commission to either raise its rates or risk overdrafts.[39] The Commission consequently has little power to constrain the costs of the USPS. The "break-even constraint" is indeed considerably softer than the revenue constraint of a private competitive firm.

- The Commission does not have authority to regulate the *quality* of postal services.[40] The Postal Service itself is able to determine critical variables such as the number of deliveries per day, per week, and the speed of deliveries. An anecdote illustrates this point. On July 25, 1990, the Postal Rate Commission formally advised the USPS of its opinion that it should not implement a plan to downgrade nationwide first class delivery standards.[41] On July 26, 1990, Postmaster General Anthony Frank responded in a letter stating that, "After consideration of the opinion, we have concluded that it does not warrant changing our scheduled Saturday implementation of overnight standard changes . . ." [42]

- The Commission is weak because it lacks adequate information on Postal Service operations. The Postal Service is likely to have the best information on its operations, and the Commission depends upon the Service to provide that information. As former Postal Rate Commission Chairman Clyde DuPont stated, however, the Commission lacks:

> Explicit statutory authority . . . to prescribe or require the Postal Service to collect particular types of data. Although our discovery powers are generally sufficient to permit us to test and clarify evidence presented in our proceedings, the service has treated the actual collection of data as its exclusive domain. It reserves the design of its statistical systems and the data to be released as a matter of unilateral discretion . . . . Thus the commission and the parties to our proceedings have been tied to the data the Postal Service is willing and able to make available.[43]

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[39] In his 1994 testimony, the Postal Service's main revenue witness, John H. Ward (Tr. 5/2236) stated, "Despite maximum allowable annual borrowing for operating and capital purposes ($1 billion for operating purposes and $2 billion for capital purposes - net), the end-of-year cash and investment balances would be less than the amount necessary to fund one bi-weekly payroll (currently about $1.1 billion)."

[40] *Letter of the Postmaster General to the Chairman of the Postal Rate Commission*, July 26, 1990 (copy on file with the author). See also Sidak and Spulber, p. 50.

[41] *Summary of Postal Rate Commission Advisory Opinion on First-Class Delivery Standards Realignment,* N89-1, July 25, 1990.

[42] A public utility commission, in contrast, has control over such variables as the reliability of electric power by linking allowed rates of return to outages. Additionally, performance standards for a privately owned regulated utility are expressly stated. In telecommunications, for example, such details as time until dial tone, length of repair waits, and speed of infrastructure expansion are expressly specified. See J. Gregory Sidak and Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract* (Cambridge University Press 1998).

[43] Clyde S. DuPont, "The Postal Rate Commission," in Roger Sherman, ed. *Perspectives on Postal Service Issues*

Importantly, this is in contrast to the information disclosure requirements faced by a privately owned regulated utility, for example, which includes subpoenas, audits, and SEC disclosure requirements. The control the USPS enjoys over its information is likely to significantly weaken the Commission's ability to regulate it.

Postal scholars have noted that the Commission is weak, and that this essentially allows the Postal Service to price in an unconstrained manner. For example political science professor John Tierney states, "It hardly seems appropriate that a government agency enjoying a monopoly over certain of its services has the ultimate power to put into effect whatever rates it chooses."[44]

VIII. Conclusions, Recommendations, and Possible Reforms

The Postal Service's organizational structure is unique in the U.S. economy. It possesses monopolies over delivery of letters and over the use of the customer's mailbox, but is itself able to define the contours of those monopolies. It is government-owned, so it need not pay investors a rate of return. Its government status provides it with a panoply of benefits, including exemption from taxation, exemption from antitrust laws, exemption from SEC reporting requirements, the ability to borrow from the Treasury at below-market rates, its own police force, and the power of eminent domain, among others. Its regulator does not have authority to actually set its rates, to mandate service quality, or to subpoena information from it.

Because the Postal Service's revenue base is eroding, it has expanded into activities outside of its core mission of letter delivery, but there is little evidence that this expansion is anything other than a drain on core activities. In addition to its traditionally competitive activities of package and express mail, it has expanded into a variety of electronic businesses, and has begun selling T-shirts, coffee mugs, and passport photos, among many other items.

The current organizational structure of the USPS is harmful to postal competitors, customers, to state and local governments, and to the overall economy. The postal monopoly results in a straightforward misallocation of resources due to excessive pricing in its monopolized activities. The resulting economic inefficiencies create an economic drag.

Below-cost pricing in activities where the Postal Service faces competition drives more-efficient private competitors out of business. It also causes them to contract or to not enter at all. Legal uncertainty surrounding the Postal Service's offering of new products as well as the scope of its monopoly also harms business. There is uncertainty over regulatory control of new products and over the scope of the postal monopoly, among other issues. Below-cost pricing and legal uncertainty will also slow innovation and investment by private rivals.

Customers are also harmed by the USPS' current structure. Not only are postal rates significantly higher than they would be in a competitive environment, but customer choice is limited. The postal monopoly means that the USPS does not have go be a customer-service oriented organization.

(AEI Press, 1980) p. 115.

[44] John T. Tierney, *The U.S. Postal Service: Status and Prospects of a Public Enterprise* (Auburn House 1988) p. 210.

USPS' structure also has a profound effect on state and local governments. The USPS is not subject to taxation. Nor does it pay vehicle licensing or registration fees. When the USPS expands into an activity that could be provided by a private firm, governments lose tax revenue on every dollar crowded out of the private sector.

Given the Postal Service's fiscal challenges, meaningful reform is both timely and necessary. At a minimum, reform should include a requirement that the USPS restrict itself to its core mission of letter delivery, that its financial disclosure, transparency, and record-keeping procedures be enhanced significantly, that it be subject to antitrust enforcement, and that its regulator be given full authority to control the formidable powers of the USPS. Such reforms would be a first step toward mitigating the substantial cost imposed on society by the Postal Service's current organizational structure.

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Rick Geddes is associate professor in the Department of Policy Analysis and Management at Cornell University. He holds MA and Ph.D. degrees in economics from the University of Chicago, and a BA from Towson State University in economics and finance. His work has appeared in the *American Economic Review*, the *Journal of Regulatory Economics*, the *Encyclopedia of Law and Economics*, the *Journal of Legal Studies*, the *Journal of Law, Economics, and Organization*, and the *Journal of Law and Economics.*

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"… a wise and frugal government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned. This is the sum of good government, and this is necessary to close the circle of our felicities."

Thomas Jefferson

1801

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