PROGRESSIVE POLICY INSTITUTE

Opening the Mail

A Postal System for the New Economy

Progressive Policy Institute
Technology & New Economy Project

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"One person with a belief is a social power equal to ninety-nine who have only interests."
—John Stuart Mill

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Introduction

The United States Postal Service (USPS) is experiencing rough times in the aftermath of the recent terrorist attacks. Anthrax spores sent through the mail have killed several people, including two postal workers in Washington, D.C. Postal revenues in the weeks following the September 11 hijackings were far below projections. Postmaster General Jack Potter went before Congress in early November to ask for a massive bailout: up to $4 billion to pay for sanitizing the mail, and up to $2 billion to pay for revenue losses that USPS contends are a direct result of terrorist attacks.

Our sympathies are rightly with the postal employees in the wake of these tragic deaths. Congress should take steps to increase confidence in the safety of the mail. But the financial losses experienced by USPS after the attacks have only compounded a severe crisis that has been a long time in the making. What USPS needs is not a bailout, but substantial reform.

As the anthrax attacks have reminded us, USPS is a massive organization and a major part of the U.S. economy. With nearly 900,000 full- and part-time workers, it employs more people than Ford and General Motors combined. USPS delivers billions of pieces of mail to over 100 million addresses every year. With annual revenue approaching $70 billion, it has more sales than Microsoft, McDonald's, and Coca-Cola combined. If USPS were an ordinary enterprise, it would rank near the top of the Fortune 500.

But USPS is no ordinary business enterprise. It is sui generis: a government entity with no shareholders providing a commercial service, operating under a break-even mandate, paying no federal, state, or local taxes, and holding the power not only to set its own prices on monopoly services but also to regulate its competition. With so much power, and so little incentive to change, the primary management trends in American business—to innovate, become more dynamic, more flexible, less bureaucratic, and more productive—have bypassed this monopolistic giant. Despite the investment of billions of dollars in equipment to improve efficiency, its productivity gains over the last 30 years are one-fifth that of American business as a whole. The retail counters at postal stations have become infamous for their long lines, short hours, and poor service. In every line of business in which USPS has competed directly against the private sector—from express mail to parcel delivery—it has been thrashed by the competition. The bottom line: USPS fell $1.7 billion further into debt this fiscal year and has requested a postage rate increase that outpaces inflation. Moreover, with the current anthrax scare likely to lead to reduced mail volumes (at least in the short run) and increased postal costs, additional rate increases will be necessary to stem the revenue losses.

Even before the anthrax threat, the Postal Service's core business faced a serious threat: the Internet. Digital services such as email and electronic bill payment are expected to cause significant declines in the Postal Service's most profitable categories of mail; in response, USPS is moving into e-commerce itself, on the grounds that its mission is to deliver messages—physical mail in the old economy, electronic messages in the New Economy. There is little reason to believe that USPS could make this transition successfully, and many reasons to believe that it should not even try.

Substantial and fundamental reform is needed to bring USPS into the Information Age. The objectives of any postal reform effort are relatively straightforward: cut costs by bringing the benefits of competition to the postal system to the greatest extent possible, all while maintaining service and preserving universal delivery. The primary goal of any serious reform effort should not necessarily be to preserve USPS as an organization or to straighten out its finances, but to create the lowest cost, highest quality public and private postal system nationwide. Subsidizing the physical mail business by entering other areas of the economy is neither appropriate nor likely to succeed. Radical privatization or liquidation schemes, on the other hand, are not workable, particularly if the United States is to remain committed to universal postal service.

The terrorist actions must not be used as an excuse to delay or forego postal reform. If anything, the anthrax attacks make reform even more urgent. Between an economic downturn and public fears about the safety of mail, we are likely to see further declines in the growth rate of mail volumes, which in turn will lead to higher costs. Rather than throw good money after bad, we need to modernize the entire postal system.

This report offers a plan that represents a Third Way between propping up the status quo and privatization. It would preserve USPS monopoly on "last mile" delivery while opening up the acceptance, transport, sorting, and processing of the mail to much greater competition. In our vision, customers will be able to send mail from local stores instead of the local post office, private companies will sort and transport the mail faster and more cheaply, and customers who put more effort into preparing their mail will get discounts on postage. All the while, USPS mail carriers will deliver to American homes and businesses.

This kind of reform will require changes in how we all think about USPS and the postal system. It may well mean that USPS will cut its workforce substantially, but there is no fixed law that says USPS must employ nearly one million people. It will also bring uncertainty and risk to the postal system, and some new players in the postal delivery system will surely fail. Though we do not put our faith in USPS or any particular competitor, we do have faith that competition will lead to a better, more efficient system, and that competition will force USPS to innovate and become more efficient.

To that end, PPI suggests that the rules governing the postal system be changed to give greater incentives to private entities to more efficiently compete in larger portions of the postal value chain. To ensure that this new competitive mandate is carried out fairly and quickly, a new regulatory framework should be established to oversee the postal industry. Specifically, we recommend:

- encouraging greater competition and efficiency by letting mailers keep the savings created when they use private entities to accept, process, and transport mail while retaining the USPS monopoly on mail delivery as well as its universal service obligation;

- creating a Postal Regulatory Commission to foster and protect the competitive environment; the new commission should combine the rate setting functions of the Postal Rate Commission, greater oversight responsibility, and the rulemaking authority that now resides with USPS;

- allowing for reasonable cost-reducing cuts in service, such as closing local post offices, that are currently barred by statute and by congressional intervention;

- developing performance incentives for postal workers and managers that reward boosts in efficiency and outstanding financial performance;

- requiring USPS to stick to delivering physical mail and refrain from engaging in competitive lines of business unrelated to the postal function; and

- ensuring that new measures to improve the security of the mail from further terrorist attacks are appropriate to the risks and costs involved.

Background of the Postal Service

The United States Postal Service has played a significant role in the development of the United States dating back to colonial times. The Second Continental Congress established the forerunner to the modern Postal Service, appointing Benjamin Franklin to be the first postmaster general in 1775. In the more than two centuries since, the Postal Service (known previously as the Post Office and the Post Office Department) served as the primary means of communication between citizens and businesses in the far-flung colonies, states, and territories.

For most of that history, the Postal Service has operated under the Private Express Statutes, which give it a monopoly on the delivery of letters over postal routes.[1] In 1934, Congress also granted a monopoly on access to mailboxes, making it illegal to deliver any item to a mailbox or mail slot without paying postage.[2]

Though the Post Office played a vital role in the economy, it was hampered by decades of political patronage, mismanagement, labor unrest, and graft. The Post Office reached a crisis point in the mid-1960s, typified by a delivery strike in Chicago in 1966. In 1969, Congress began looking at ways to fix the Post Office, and the Postal Reorganization Act took shape. Under that proposal, the Post Office would no longer be a Cabinet-level agency, but an independent executive agency with a mission to maintain universal service and to operate on a break-even basis.[3] In August 1970, President Nixon signed the Postal Reorganization Act, and the Post Office Department became the U.S. Postal Service, not a government corporation but an "independent establishment in the executive branch."

Over the past three decades the Postal Service has had some good years and some bad years, but taken as a whole, the reorganization has been a major disappointment. Billions of dollars have been invested to modernize mail handling operations with new technology, but postal productivity has increased only 11 percent in the last 30 years,[4] compared to nearly 55 percent growth in nonfarm business productivity for the same period.[5] As USPS opened some postal products to competition—express mail and parcel delivery—it consistently has found itself with less market share than its competitors (Federal Express and United Parcel Service). Moreover, USPS has shown surprisingly little innovation in business practices or services, lagging far behind on basic services such as online parcel tracking.

In recent years, new technologies for messaging, from fax machines to email, have begun to eat into demand for mail. As mail volume growth slows (or even declines), either USPS must become more efficient or postage rates must be increased to compensate for lost mail volume. As first class postage rates increase, the incentive to move away from the postal system and toward electronic communications increases. This creates a self-reinforcing downward spiral that represents a key challenge for USPS going forward.

The spiral will continue until a new point of equilibrium is reached, but it is impossible to foresee where that point will be. As postage rates increase, so will the cost of advertising through the mail. At the same time, online marketing costs will decrease as Internet penetration, broadband deployment, and e-commerce use increase. Eventually those costs will cross, and once online marketing is cheaper than direct mail, this downward spiral will accelerate. Even if direct marketers continue to find USPS to be the most cost-effective method for marketing over the near term, the spiral effect of the decline in first class mail could continue.

How Did This Happen?

On its face, the problem with the Postal Service is that the organization is bleeding money while providing service that is not keeping pace with technological change in the economy. As experienced by customers—individuals, businesses, and mass mailers—the problems manifest themselves as ever-increasing postal rates without noticeable increases in service. The underlying causes stem from the Postal Service's confused status as a former government agency trying to operate as a private corporation providing a commercial service while still carrying many of the burdens (and advantages) of a government entity.

Resistance to Cutting Costs

With monopolistic power over pricing and with powerful unions and congressional mandates standing in the way, USPS has generally found it easier to raise prices than take on the painful job of cutting costs. Postal unions have historically resisted changes that could decrease costs. For example, union opposition has discouraged USPS from installing automated machines in the lobbies of postal stations that could weigh parcels, determine the postage due, and print the postage stickers so customers can affix them and drop them off in the outgoing mail bins. Because the unions are so powerful, and because USPS operates as a monopoly, postal employees are able to extract a wage premium of nearly one-third over their private sector counterparts.[6] The ratio of labor costs to total costs—about 77 percent—is the same as it was 30 years ago when the Post Office Department became USPS, despite the rise of and investment in new technologies to improve efficiency.[7] USPS also has very serious labor relations problems, characterized by massive numbers of grievances and a convoluted arbitration process, that eat into postal productivity.

But the internal problems should not be attributed only to the postal unions. Overall, management has often shown little inclination to do the hard work of restructuring and reorganizing to cut costs. Rather than do battle with unions to change work rules or rock the boat internally to close unneeded facilities, it has proven easier to go to the Postal Rate Commission for rate increases. Like many middle managers in the private and public sectors, USPS managers sometimes put the preservation of their bureaucratic fiefdoms above aggressive cost-cutting efforts. This results in the continued operation of underutilized mail processing facilities and other unnecessary postal infrastructure.

Another serious problem is interference by Congress. Congress has stretched the universal service obligation from simply requiring that USPS serve every mailing address to mandating levels of service. For example, USPS is prohibited by statute[8] from closing any of the 37,000 postal stations for poor financial performance.[9] Congress also places a rider on the annual postal appropriations bill that prohibits USPS from reducing service; this forecloses several options that could contribute to massive cost savings, such as cutting delivery on expensive routes to five days per week or requiring some customers to move their mailboxes from the front door to the curb.[10] Though the intent of Congress is to prevent USPS from cutting service to disadvantaged and rural areas, the effect is to saddle the postal system with high costs that must be made up by overcharging customers in profitable areas. Members of Congress have also been known to intervene to prevent the closure or relocation of postal data-processing and mail-processing centers, making it more difficult for USPS to cut costs while maintaining service levels for end customers.

Declining Growth in Demand

The growth of the Internet economy has begun to take business from USPS. One of the biggest problems facing USPS today is the slow growth in first class mail. First class mail is one of the largest contributors to the overhead costs of USPS, but growth in first class mail volumes is slowing. First class mail volume grew 18.7 percent in the 1990s, compared to 48.1 percent in the 1980s. This slowing demand for mail is due in large measure to advances in other communications technology, such as fax machines, the Internet, and deregulated long distance service. E-mail and phone calls are replacing letters between family members and friends. One particularly vulnerable market segment is the presentment and payment of bills and financial statements, which represent more than one-fourth of USPS revenues. USPS estimates that as much as half of that revenue could be lost to electronic funds transfer and the sending of statements over the Internet. As discussed below, the anthrax threat is likely to contribute to slowing the demand for mail.

This slowing of demand is leading to a contraction spiral problem—as mail volumes decrease, rates will increase, which will cause volumes to decrease, and so on in a spiral. If broadband Internet access deployment rates[11] and electronic bill payment adoption rates[12] are any indication, the spiral will continue for some time. What's more, as postage rates increase, mass mailers may also turn to the Internet for marketing. According to the Direct Marketing Association, online marketing efforts cost 12.8 cents for every dollar of revenue generated, compared to 9.1 cents per dollar of revenue for catalogs and direct mail. But the trend shows bad news: Postal rates must increase dramatically to cover costs and capital needs, which will increase the cost per dollar of revenue for mail advertising. Costs of Internet advertising, on the other hand, will decrease as more people get online, and as broadband makes Internet advertising more effective. (Imagine the targeting capability of Internet ads combined with the production values of television ads.) In short, technology is likely to lead to a per-capita decline in paper mail, especially the first class mail that contributes most to the overhead costs of USPS.[13]

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Anthrax Attacks

In addition to being a terrible tragedy for the affected postal employees and their families, the recent anthrax attacks have also contributed greatly to the financial problems of USPS and put the organization in a Catch-22. On the one hand, the measures proposed to reduce the risk of bioterrorist attacks to both postal workers and the public will be very expensive. USPS has already moved to acquire scanning machines that will irradiate mail to kill anthrax spores. Its contract with Titan Corporation calls for eight machines to be installed at high-risk facilities (such as in Washington, D.C.) at a cost of $40 million, with an option to acquire twelve more machines.[14] At $5 million each, installing these machines at even a small percentage of postal facilities will be an enormous strain on an already tight capital budget. Moreover, the equipment will incur more than just one-time capital costs (operating the machines on a daily basis may cost as much as $1 billion per year) and may increase the costs of processing the mail (by adding a bottleneck to the system). Such cost increases could hasten the downward spiral in mail volume and revenues.

On the other hand, if USPS does not take high-profile steps to make the mail safe from bioterrorists, the public may lose confidence in the mail. Mass mailings such as catalogs may be thrown straight into the garbage without being looked at, dramatically increasing costs for direct marketers. Magazine subscriptions may decline. Consumers may turn more rapidly to email and electronic bill payment in order to decrease the amount of mail they receive.[15] Senders may choose alternative means as well (such as email) in order to ensure that their messages get through and get read. All of this would accelerate the contraction spiral—USPS claims that revenue for September and October 2001 was about $650 million less than anticipated—and could ultimately cause serious damage to the financial health of USPS.

Flawed Incentive Structure

Because USPS is required by law to operate on a break-even basis, the traditional incentives of the market system do not easily apply. There are no shareholders or other "residual claimants" to demand accountability from postal management and profit from increased efficiency. Since USPS can borrow money directly from the U.S. Treasury, there is no enforced discipline by the capital markets. This lack of profit motive creates a flawed incentive structure that not only stifles innovation, but also contributes to a culture of taking the path of least resistance: It is simply easier to raise rates than to do the hard work of cutting costs, including standing firm against unreasonable union demands. Moreover, under the current break-even system, there is no reward for doing this hard work.

The effects of this are unmistakable to individual customers and mass mailers. The Postal Service has long had the reputation of offering stable lifetime employment at good wages, and for good reason: There is no competition, and the federal government virtually guarantees that USPS will never go out of business. This means that neither employees nor managers work under many of the pressures of a competitive environment, where layoffs could come at any time, where a takeover by the competition is always a threat, where bankruptcy and dissolution of the organization is a real possibility. Though the people who make the postal system work traditionally have been animated by their mission to bind the nation together (as most employees of nonprofit organizations are driven by a sense of mission), USPS is characterized now by low morale and sky-high grievance rates rather than an innovative competitive spirit.

> USPS also has considerable latitude in trying out new lines of business with little oversight and little accountability for failure; if a nonpostal venture fails, USPS simply raises rates on its monopoly mail products to cover its losses.

Too Much Power Vested in USPS

When the Postal Service was reorganized, it ceased to be a full-fledged government agency, becoming a quasi-governmental entity instead. But USPS retained many governmental powers. One of the most important powers is the ability to set rates. Under the current system, USPS applies for rate increases to the Postal Rate Commission, and submits with its "rate case" reams of supporting documentation about revenue projections, capital requirements, and the like. The Postal Rate Commission then makes a decision on the size of the increase. Generally USPS follows the decision of the Rate Commission, but they are not bound to do so. A unanimous vote of USPS governors[16] can overrule the Postal Rate Commission and set the rates that USPS wants. Such an occurrence is rare (it has happened only twice in the last 30 years), but it does happen, most recently in May of this year. More importantly, it can happen because USPS has the power to do so. USPS also has considerable latitude in trying out new lines of business, such as electronic bill payment or selling clothing, with little oversight and little accountability for failure; if a nonpostal venture fails, USPS simply raises rates on its monopoly mail products to cover its losses.[17]

More egregiously, USPS has the power to set the regulations that govern postal service. This is the equivalent of telephone companies being able to set regulations on long distance service. Being able to set regulations not only gives USPS the power to decide the rules under which it operates, it allows them to set the rules under which its competitors operate. Predictably, USPS has used this power in anticompetitive ways.

The best example is the rules USPS sets for private mail boxes. Commercial mail receiving agencies (CMRAs) such as MailBoxes Etc. provide a competitive alternative to renting mailboxes from the local post office. Among the advantages provided by CMRAs, customers with private mailboxes can use regular street addresses rather than P.O. Box addresses. This allows customers to receive deliveries from the Postal Service's competitors, such as Federal Express and UPS. (Due to the monopoly on mailboxes, private delivery services can't deliver to a P.O. Box.) Customers with private mailboxes can also use their box to create the illusion of having an office—a technique used by many small business owners who work out of their homes—by referring to their private mailbox number as a suite number.

USPS in 1999 issued a bulletin imposing several new requirements on CMRAs, including a rule that all mail received in a private mailbox have the letters "PMB" before the box number.[18] The stated reason for this new rule was to reduce mail fraud by individuals who trick senders into believing that the mail is being sent to a real address.[19] The rule required CMRA customers to sign a form acknowledging the PMB requirement, and ordered CMRAs to terminate any customer that received mail without the PMB label.[20] Despite overwhelming opposition during the comment period, USPS went forward with the new regulation. As opposition grew, and Congress weighed in with legislation intended to overturn the rule, USPS backed down: The new rule now allows CMRA customers to receive mail with either the PMB label or a number sign (#) before the box number.

Though USPS was (eventually) responsive to public pressure in this case, this is no way for a monopoly business to operate. Just as USPS should not have unilateral authority to set rates on its monopoly products, it should not have the authority to write regulations governing its competitors.

Labor Force Demographic Bubble

USPS has a rapidly aging workforce. By 2010, according to Postal Service estimates, 85 percent of executives, 63 percent of managers and supervisors, and 48 percent of career employees will be eligible for retirement.[21] As a result, the pension and health care liabilities that this demographic bubble represents could put a serious strain on Postal Service finances. USPS estimates that total annual payments for pension and health benefits will be $6 billion more in 2010 than today.[22] Given the large current operating deficits, the fact that USPS is about to hit its statutory debt ceiling of $15 billion, the lack of capital to fund new facilities and equipment, and the slowing growth of first class mail volumes, these payments to retirees loom large in USPS financial picture. While the coming spate of retirements will help USPS streamline its labor force with a minimum of conflict with the postal unions (by not filling vacancies left by retirees), rate increases will likely be necessary to pay for it.

Privatization: A Step Too Far

It has been 30 years since the laws governing the Postal Service have undergone a serious modernization, and in that time postal reform has become something of a cottage industry, spurred on by reform efforts in other countries. The most developed reform proposal currently under debate has been offered by Rep. John McHugh (R-N.Y.), the former chairman of the now-defunct House Subcommittee on Postal Service. Rep. McHugh has been refining his postal reform legislation for several years, and the latest version of his legislation is currently in discussion draft.[23] McHugh's proposal makes significant strides toward rectifying the current situation, and embodies several of the postal reform principles that PPI supports: more competition, greater efficiency, better incentives for postal workers and managers, stronger regulation of USPS, and a mandate to stick to the physical mail.

Many proponents of postal reform, however, do not believe this goes far enough. They insist that the only way to save the Postal Service is to privatize it. Former Postmaster General William Henderson is one of the best known proponents of this view.[24] The reasoning is simple: Because USPS operates under a break-even mandate, no one within USPS stands to benefit directly if the organization becomes more efficient, gains market share, or offers new and innovative products and services.[25] Privatization seeks to change that by creating "residual claimants," who can keep USPS profits for themselves. If USPS has owners or investors who stand to gain financially from improved efficiency and higher quality service, then improved efficiency and higher quality service are bound to follow, at least in theory.

Privatization of postal services is gaining popularity around the world. Holland, New Zealand, Germany, and the United Kingdom, to name just a few, have all commenced privatizing their postal systems. The mechanics of privatization vary in each case. In Germany, for instance, Deutsche Post held an initial public offering last fall, in which a 29 percent stake in the company was sold to the public. (The government retained a 71 percent stake.) The German government has also scaled back Deutsche Post's monopoly on letter mail and plans to revoke the monopoly and divest itself entirely of the company by 2007 (originally 2003). Deutsche Post is now free to engage in competitive businesses, including acquiring other firms. Privatization in New Zealand has brought the end of the postal monopoly; other companies are free to accept and deliver mail, or to handle part of the process and contract with N.Z. Post to deliver the mail the rest of the way. (This is the more likely scenario for any USPS privatization scheme.)

These privatization efforts have not been without controversy. Deutsche Post, for example, has been fined by the European Commission for predatory pricing in its parcel service by cross-subsidizing from its monopoly mail revenues. Inherent in any privatization is the risk that the postal service will either move aggressively and unfairly during a transition period (when statutory and regulatory constraints on their behavior have been lifted but the monopoly and/or indirect government subsidies are still in effect), or that the postal service's market position will be so strong (both because of customer habit and the natural monopoly of last mile service) that the competition will never be strong enough to push the postal service into serious advances in efficiency or service. Moreover, the postal services in other countries that have experimented with privatization are much smaller than USPS; it is unclear how easy it will be to scale up such an effort for USPS.

If privatization is to work in the United States, many issues need to be resolved. Will the government retain a stake in the private corporation, and if so, will it be a minority or majority stake? Will the newly private corporation still benefit from the belief that the U.S. government will bail it out of any financial trouble?[26] Would foreign companies, including foreign postal services, be allowed to invest in a privatized USPS? Should USPS become employee-owned, thereby strengthening the performance incentive feedback loop and possibly ameliorating the serious labor relations problems within the organization? How will USPS assets, which belong to the government, be valued so that the capital raised by privatization properly compensates taxpayers for the assets that they lose while maintaining a pool of capital to fund USPS needs going forward? Questions such as these constitute considerable, though not insurmountable, barriers to a workable privatization proposal.

Even if USPS is privatized, however, it cannot be set free from strong government control. While acceptance, processing, and transport of physical mail can sustain multiple firms competing for business, the "last mile" delivery of mail into mailboxes is very possibly a natural monopoly. The postal system has significant economies of scale that constitute high barriers to entry for other firms, including high fixed costs of last mile delivery, which currently accounts for more than one-third of total USPS costs. Analyses done by the staff at the Postal Rate Commission demonstrate how daunting the barriers can be: Even if a competing firm could deliver the mail for 50 percent less per piece (due to lower labor costs and higher efficiency), and even if the firm delivered five days each week instead of six, the competitor would have to capture over 30 percent of the delivery market share just to break even.[27] Another analysis indicates that only 15 percent of total mail volume delivered to residences would be contestable by competing firms.[28] (The upside of this is that universal service could be maintained under privatization, with or without a legal mandate.) Privatizing the last mile may lower delivery costs on some routes, but cream-skimming would eventually lead to higher costs on other routes, and raise the overall cost of the postal system, which is contrary to the goals of postal reform.

Privatization sounds better in theory than it would likely turn out in practice, even if the controversies over the mechanics of privatization could be magically resolved.

Assuming that a privatized USPS would still be a natural monopoly, serious tensions would arise between the need to allow the private corporation to operate freely as a business and the need to strictly regulate its rates and business practices to ensure that no anticompetitive behavior arises. It is easy to imagine scenarios under which USPS might engage in anticompetitive behavior. A likely candidate would be expansion into "prepostal" lines of business, such as printing catalogs or advertising flyers, and offering customers "turnkey" discounts, thus leveraging that early stage of the postal value chain with the end stage of delivery to recapture those parts of the value chain that have been lost to work-sharing.[29] Absolute fire-walls would need to be established to ensure that monopoly profits do not subsidize competitive products and lead to predatory pricing. Of course, investors in a privatized USPS would likely chafe under the (inherently political) constraints on their business. On the other hand, investors could simply take a pass on investing in a privatized USPS that will be forced to operate under a constant dark cloud of antitrust accusations, investigations, and lawsuits.

Privatization could also lead to further weakening of USPS's financial position because it would mean the end of indirect government subsidies. Though the Postal Service has revenues approaching $70 billion, it does not pay a host of taxes and fees faced by most corporations: property taxes on facilities, registration fees for its delivery vehicles, or even parking tickets (which can cost other delivery firms millions of dollars each year). Other noncash subsidies include the ability to borrow from the U.S. Treasury and the power of eminent domain.[30] Given that USPS is already facing massive deficits, taking away these subsidies would only make things worse in the short term, even if a privatized USPS could experience rapid efficiency gains to counteract the additional costs (a very big if). Again, investors may well be reluctant to buy into a corporation that is faced with dealing with this whole new set of financial and management issues.[31]

In the end privatization sounds better in theory than it would likely turn out in practice, even if the controversies over the mechanics of privatization could be magically resolved. Postal reform efforts should therefore focus on how to bring greater competition and efficiency to the postal system overall while maintaining the governmental status of USPS.

What Should Be Done?

The Progressive Policy Institute offers the following proposals to reform the postal system. Not all of these proposals require legislative changes; many of them could be instituted by the Postal Service itself, if the postal executives so chose. Taken separately, any of these recommendations would be a step in the right direction, but we believe that the greatest efficiencies can be gained if the recommendations are taken as a whole.

Create a Postal Regulatory Commission to Promote Competition in the Postal Industry

The Postal Service has a tremendous amount of power: It can create postal regulations governing its competitors and it can effectively set its own monopoly rates. PPI proposes that these regulatory and ratemaking powers be given to a new Postal Regulatory Commission, whose role would be analogous to the function the FCC plays in regulating a competitive telecommunications marketplace. The regulatory commission would also have several powers currently reserved for USPS itself.

The most significant change would be granting the regulatory commission unilateral authority to set rates. **Because competition in the postal value chain depends on the extent of the worksharing discounts offered on postal rates, the rate setting authority would be the key lever for encouraging greater competition.** Unlike the current system, in which a unanimous vote by USPS governors can overturn a decision of the rate commission, the Postal Regulatory Commission would have complete power to set the rates, much as public utility commissions in the states have the power to set rates for public utilities such as electric power or cable television. The regulatory commission should be charged with using the ratemaking authority to serve the needs of postal customers by bringing greater efficiency to the postal system, rather than basing its decisions on the financial needs of USPS. For example, a key goal of the Postal Regulatory Commission should be to improve the rate structure in such a way as to encourage postal customers to use the most efficient practices, including providing incentives for the private sector to process and transport mail farther along the postal chain using competitors to USPS.

The Postal Regulatory Commission would also have complete authority to create postal regulations. Currently USPS writes regulations for itself and its competitors, as noted above in the private mailbox example. New or amended postal regulations would be subject to the same rulemaking procedure as other federal agencies, with appropriate periods for public comment. This would not only be more fair to USPS competitors and customers, but would also perform the valuable function of separating policymaking from postal operations, freeing USPS executives to focus on the latter. Other authorities that should be granted to a Postal Regulatory Commission include control over the Postal Inspection Service (USPS law enforcement agency), unilateral authority to approve new products, and complete authority to examine the financial books of USPS.[32] USPS Office of the Inspector General (OIG), which was created in 1996 and reports to the Board of Governors, should be maintained but should report directly to the Postal Regulatory Commission instead.[33]

In establishing the Postal Regulatory Commission, it should be clear that the commission does not exist merely to oversee USPS, but to regulate and promote competition for the entire postal industry. Concerns that the commission might be "captured" by USPS, therefore, should be addressed up front with strong sense of the Congress language that the mission of the Postal Regulatory Commission is to foster a competitive postal system.

A Postal Regulatory Commission would not, in the long run, be the ultimate solution to the productivity and efficiency problems plaguing USPS; in the end, it is still up to postal executives and managers to make the decisions under which the Postal Service operates on a day-to-day basis. But a shift in authority in the postal system could go a long way toward bringing more accountability and competition to USPS and the postal system.

Use the Rate System to Encourage Greater Efficiency and Competition

One of the most powerful controllers of economic activity is pricing, but pricing for the postal system is far too insulated from market forces. Part of this comes from the problems inherent in lengthy rate cases, but a more serious problem is that the rate system is not subtle enough to price $70 billion worth of services each year.[34] This "rate averaging" places pieces of mail with different costs into the same category, discouraging attempts to increase productivity on the higher cost mail by effectively cross-subsidizing it with lower cost mail. **Eliminating rate averaging reveals the true cost of sending mail, and encourages both large and small mailers in the most cost-effective way possible.** Of course, if rate averaging is eliminated and some rates go down, then some rates may go up, possibly even on hand-addressed, single-piece "Aunt Minnie" mail. But this would lead to higher overall efficiency, as mailers either change their mailing behavior or find more cost-effective ways to send messages, such as email. Some rate changes that could bring further efficiency to the postal system include:

Eliminating rate averaging reveals the true cost of sending mail, and encourages both large and small mailers in the most cost-effective way possible.

- ***Expand "worksharing" for processing and transport of mail.*** Under the current worksharing system, USPS offers discounts to mailers who accept some of the functions that would otherwise be performed by postal employees. For example, the further a piece of mail is delivered into the postal system, the greater the discount. USPS has even created special bulk mail facilities that allow mass mailers to take advantage of lower rates. Discounts are also given for mass mailings that are presorted into carrier routes and placed in "walk sequence," so that no further sorting is necessary.

These discounts are entirely appropriate and contribute to the overall efficiency of the postal system.[35] But such worksharing—and therefore efficiency—does not apply to individual first class ("Aunt Minnie") mail.[35] If an individual customer wishes to mail a letter to someone, and drops off the letter at the local post office that serves the recipient, he pays the same amount as if USPS had to ship it 3,000 miles. In the former case, the customer benefits from faster delivery time, but receives no cost savings. Instead, USPS keeps all of the savings for itself to cover other expenses.

Cost savings on Aunt Minnie mail are not derived from deep insertion into the mail stream alone. Reading first class envelopes is also a significant expense. USPS has invested millions of dollars in optical character readers (OCRs) that scan hand-addressed envelopes, determine the destination, and print a bar code on the bottom so the mail can be read by the same bar code scanning equipment that is used for bulk first class mail. When the address is marginally legible, postal employees must handle the mail by hand at even greater expense. But if the Aunt Minnie mail comes with a typed address, or even better, the bar code already on it, the savings are not passed on to the sender.[36]

The most egregious examples of this lack of "cost sharing" is in PC postage technology—postage that is paid over the Internet and printed by the mailer. When a sender uses Internet postage, regulations require that the postage be printed either directly onto the envelope or onto the same sticker as the address.[37] When printing this postage, therefore, the sender must type the address into a computer, and the computer then connects to the Internet to verify the address against a national address database.[38] This mail is then turned over to USPS with a clearly readable, pre-verified address with a bar code already printed on it. What's more, the cost of placing the postage on the mail has been shifted to a third party; the Internet postage company has assumed the expense of delivering it to the customer and the customer has assumed the expense of printing the postage (saving USPS the cost of producing and selling a stamp). Despite all this, no discount is given on the postage; in fact, the sender must pay a service charge to the Internet postage company. (This applies to postage meters as well.) In the end, the sender pays more for the privilege of making life easier for USPS. The same principle is played out every day at private mail box franchises, grocery stores, and even ATM machines where stamps are sold at full price and the cost to the intermediary is either passed on to the consumer or absorbed by the intermediary.

Offering worksharing discounts on single-piece first class mail that has been heavily preprocessed to save USPS money is not simply a matter of fairness. Providing such discounts would create incentives for individuals to shift their mailing behavior to more efficient, lower cost methods. Just as worksharing discounts change the way mass mailers use the Postal Service, pricing Aunt Minnie mail based on the true costs to the Postal Service will change individual mailing patterns. As more mail arrives at USPS ready for the machines, labor costs will inevitably go down.

USPS is required by law to maintain a single rate for Aunt Minnie mail.[39] There are a number of reasons for this. The most often cited excuse for the single first class rate is that customers prefer the simplicity of knowing that one price can send any letter to any address in the United States. This relieves the customer of having to compute postage based on how the mail was prepared or the location from which it was sent.

This same simplicity argument, however, was made when the monopoly in long distance telephony was broken up. Contrary to dire predictions, long distance customers have not only accepted but embraced the explosion of different long distance rates and calling plans. The same will probably be true of discounted first class postage; those who value the discount more than the convenience of a full price stamp will embrace the discounts. Moreover, the relative decline in first class mail volume is not exactly evidence that customers are satisfied with the current system.

The more compelling argument is that discounting is difficult for a product that is already priced so low. Since discounts on single pieces of mail have to be given in whole cents, there is very little flexibility in the discount rate. Under the current rate, for example, cutting postage from 34 cents to 33 cents is a savings of 2.9 percent. Cutting the postage to 32 cents is a savings of 5.8 percent. If printing a legible, verified, bar-coded address on an envelope cut delivery costs by 5.5 percent, a two-cent reduction would actually cost USPS money. They would have no choice, therefore, but to under-discount the postage and keep nearly half of the savings for themselves. While a 2.9 percent discount might be significant for a mass mailer who is sending out millions of pieces, the one-cent savings is unlikely to serve as much of a motivation for Aunt Minnie (though it might for small businesses).[40]

While it may be true right now that cost sharing for Aunt Minnie senders would be too insignificant to change behavior, the incentive will become greater as USPS falls deeper in its contraction spiral. As more people and businesses move away from mail and onto the Internet for correspondence and bill payment, first class postage rates are likely to increase significantly, especially given the fact that mass mailers will fight ever harder against rate increases on their classes of mail. As the price of a first class stamp goes up, whole-cent discounts will become an increasingly subtle way to share costs with Aunt Minnie mailers. Moreover, small discounts could still be effective incentives to aggregators of Aunt Minnie mail, as we shall see.

The bottom line goal of expanding worksharing is to increase efficiency to the greatest extent possible, so the incentives must apply to the greatest amount of mail possible. **By**

breaking mail into more categories (i.e., reducing rate averaging), the rate setting body could not only reduce the cross-subsidization of more expensive mail by less expensive mail in the same rate category, it could encourage mailers to prepare their mail in a less expensive way, thereby increasing efficiency in the overall postal system.

- ***Give discounts to encourage private acceptance of mail.*** Currently, USPS can license businesses to accept mail on behalf of the Postal Service, though doing so is not without peril. Postal unions fight bitterly against contracting out any USPS functions. More importantly, because USPS gives no discounts on postage rates, mailing a parcel from MailBoxes Etc. (or a similar business) adds costs to the sender even though it saves money for USPS. Nevertheless, an important element of postal reform must be the further opening of the retail mail acceptance function.[41]

The relative decline in first class mail volume is not exactly evidence that customers are satisfied with the current system.

Imagine being able to mail a package from the checkout line at the grocery store, where a highly accurate scale is already available and a transaction is about to take place anyway. Mail could also be accepted at services like Mail Boxes Etc. or even at drug stores, convenience stores, shopping malls, office supply stores, or any other place where Aunt Minnie senders might be going anyway. The address and postage could be printed onto stickers for parcels or standard-size envelopes that would overwrap cards and letters. The acceptor could sort (local and distant) and aggregate the mail and deliver it directly to the nearest appropriate USPS facility, with greater discounts applied if the acceptor contracts with private transport to deliver the mail directly to a sectional processing facility for local delivery. The discounts could be absorbed by the private acceptors, the benefit to the senders being the ability to avoid a trip to the post office, or passed along to some extent to the consumer: If private companies can accept mail for less and are allowed to keep the savings, competition may well lead them to share the savings with customers, allowing individuals to send a letter from their local grocery store for less than sending it from their local post office.

If done properly, this kind of system could very well eliminate the need for customer service counters at postal stations, and in fact bring about a drastic reduction in the number of post offices.[42] This would bring significant savings in labor costs while simultaneously improving customer service (imagine being able to send mail 24 hours a day at your local drug store) and possibly even lowering prices for senders. This improvement in relations with the customers that provide the highest margins to USPS could in turn lead to better growth in first class mail, thus decelerating the downward spiral in profitable mail and alleviating some of the financial problems facing USPS. It will also allow USPS to do what they do best—deliver mail along the last mile—while leaving retail customer service functions to those businesses who count customer service among their core competencies.[43] Many retail businesses would clamor to provide these services, as it is a way to attract customers to stores without very little initial investment for the provision of the service. Shifting the acceptance role to private companies could cut costs through more aggressive use of technology and by providing better service, more convenient locations, longer hours, and shorter lines.

As an additional incentive to decrease usage of high-cost retail postal facilities, USPS should charge surcharges to customers who wish to use the services of a clerk at a USPS station. In most cases, customers see a clerk because a parcel needs to be weighed for postage or because the mail needs special handling, such as a return receipt. These functions could easily be handled by self-service computer kiosks, at significant labor savings to USPS.[44] Offering discounts to customers who use only automated functions has worked well in the banking industry, where many banks offer free checking accounts to customers with unlimited access to ATMs and Internet banking functions, but charge extra for those customers to visit a teller face to face.

▸ ***Give discounts to even out the flow of mail through the system.*** One of the biggest problems with the postal rate system is that the mail flow is subject to peaks and troughs, while the proportion of fixed costs in the delivery network is relatively high: The letter carriers must visit every address every day whether or not they're carrying a little mail or a lot of mail. USPS network is built for performance during peak periods, such as holidays, when the volume of mail spikes considerably. That network, however, is overbuilt for the slow periods, which for USPS is the summer months.

Other businesses with high fixed costs and low marginal costs, such as movie theaters and hotels, use peak pricing to spread out their customers across their infrastructure. Matinee prices at movies, for instance, serve two purposes. One is to bring in customers who might otherwise not see a movie because the price is too high. The other is to give an incentive for some customers who might see a movie during the crowded evening hours to watch it during the less crowded afternoon hours. By giving this incentive, theater operators are able to capture additional revenue for the low marginal cost of running the film during the day rather than the much higher overhead cost of building a bigger theater to accommodate all of the customers during the evening.

USPS should take advantage of peak pricing for the same two reasons: to capture customers who otherwise would not mail at all due to the price, and to create incentives for customers to put mail into the system during less busy times. For example, USPS typically collects mail throughout the day, but the last pickup of the day generally contains the most volume. By giving mailers discounts for sending mail in the morning rather than the afternoon, some customers might hold their mail until the next morning, thereby evening out the flow of mail and making the network operate more efficiently.[45] Discounts could also be given during the summer months to encourage more mail, or during the pre-holiday period to shift volume away from the busiest time of the year.

▸ ***Give discounts that encourage more efficient operations.*** **The purpose of worksharing discounts is not merely to give savings back to mailers, but to encourage mailers to use the most efficient methods of sending mail.** Given the problems facing USPS, it is entirely appropriate to focus worksharing rates on the goal of creating more overall efficiency, even if it means abandoning other longstanding public policy goals that have been built into the rate system. This sort of rational pricing will lead to a more efficient postal system overall.

A good example of a lost opportunity for worksharing discounts is an abandoned pilot program for drop shipping magazines, started by Time Inc. in 1998. Time hired a private trucking company to deliver their magazines directly to the destination unit post offices in several zip codes near their Torrance, Calif., printing facility. Because dropping the magazines at their final destination saves USPS a considerable amount of money, the Postal Service sought to give a discount to magazine publishers who did so (and have done so again in its September 2001 rate case). This would have allowed Time to pay their private delivery firm and still save money over the cost of handing the magazines directly to USPS. Unfortunately, the Postal Rate Commission denied the discount, citing a century-old policy that editorial material must be delivered throughout the nation for the same price.[46] This pricing policy made sense in the pre-electronic media era, ensuring that news would be transmitted, but the current effect was to discourage the publisher from using the most efficient (in price and service quality) carrier for its mail. Time discontinued the pilot program shortly thereafter.

USPS tends to oppose efficiency-boosting incentives most strongly when mailers already have an incentive to increase efficiency on their own. For example, bundling bulk mail on pallets can generate significant efficiencies and savings for both mailers and USPS. But because many bulk mailers began using pallets for other reasons, USPS resisted giving back the savings in the form of a worksharing discount, arguing that such a discount would not be an incentive since mailers were beginning to use pallets anyway. It may be true that the discount would be pure profit for mailers already using pallets, but the full pass-through of savings as a principle will not only encourage other mailers to start using pallets, but also encourage mailers to invest in other efficiency-boosting operations more quickly and more aggressively.

- ***Give discounts to mailers that guarantee a certain amount of mail.*** Large mailers can often bring efficiencies to the postal system, and the rates should therefore encourage smaller mailers to consolidate and pre-process their mail. Giving discounts based on volume could do just that. If a financial benefit can be derived from a volume discount—either reduced costs or higher overall revenues—the regulatory commission should establish lower rates in exchange for a guarantee of a certain volume over a given period of time from a given mailer.

Because of the monopolistic nature of the Postal Service, safeguards would have to be implemented into volume discounted rates. The rates should be available to any organization that can provide the volume. The discounts should apply to single classifications of mail to discourage discounting of monopoly mail to enhance market share in competitive lines of business. (For instance, USPS should not be able to give volume discounts on first class mail to mailers who agree to use its electronic bill payment service.) Most importantly, penalties must be in place for customers who fail to live up to their volume commitment, to prevent abuse of the discount.

Allow More Changes in Service

One of the largest single factors that prevents USPS from controlling costs is Congress. Because of language in Title 39 of the U.S. Code, and a perennial rider to the Treasury and Postal Appropriations bill, USPS is prohibited by law from making changes that could save billions of dollars a year. If the postal system is going to be preserved, these changes will be necessary.

One easy change in service would be to give USPS the authority to close those postal stations where other alternatives are available, particularly those with operating costs far out of line with the number of customers served. Many unnecessary postal stations are in urban areas, where other postal stations are available within a few miles or even within a few blocks. There is no reason that these stations cannot be closed.[47] If the mail acceptance functions are opened more widely, as we suggest, the number of postal facilities that could be closed would be even larger, since private alternatives (e.g., Mail Boxes Etc. or the local grocery store) could take their place. There will always be some postal stations that must remain open, even though they are not economically justifiable, either because customers have no other easy alternatives (e.g., private companies have not stepped forward) or because the facilities are key to the logistics of universal delivery. However, USPS should have the power to make those decisions based on its needs and financial situation.

Savings could also come from reducing deliveries on high-cost rural routes from six days each week to five or four days. The potential for cost savings in labor are obvious, but fewer delivery days in rural areas could save in other ways as well, such as reducing maintenance and replacement costs on rural delivery vehicles. Though USPS recently abandoned this idea under pressure from Congress and the public, we believe it should be reconsidered specifically for high-cost routes.

Of course, the ability to make changes such as these must come with limits. A great deal of cross-subsidization already exists within the postal system, since citizens on low-cost routes pay the same amount to have their mail delivered as citizens on high-cost routes. If service reductions were concentrated primarily in low-cost routes, that subsidization would be even higher. It would be entirely appropriate, therefore, that costs be allocated fairly by placing the greatest reductions on high-cost routes.[48]

Similarly, any changes to the law that allow USPS to modify its delivery service should not interfere with the universal service obligation. Maintaining delivery to every address in the United States is an important public policy goal; unlike telephones, television, and the Internet, the mail is the only form of communication that has 100 percent household penetration. Moreover, the universal service obligation is the rationale for the delivery monopoly enjoyed by USPS. But it is important to remember that universal service means only that every address must be served by USPS. It does not mean that every address must have equal service; in fact, some rural addresses do not have home delivery at all, forcing customers to travel to the nearest post office box. That same principle can apply to delivery days while preserving universal service.[49]

Those citizens who choose to live and work in rural areas accept certain trade-offs. Living in a rural area means less crime, less noise, less pollution, lower housing costs, lower insurance costs, and so on. But rural areas by definition have fewer amenities: fewer stores, fewer movie theaters, fewer medical professionals, fewer higher education institutions. There is no reason that postal service should not be among the reduced amenities. Those residents choose to live where they do because they believe the benefits of rural life outweigh the deprivations. Slight reductions in mail service are a small price to pay, especially if those reductions are necessary to maintain the financial viability of USPS; without those reductions, prices would go up even more for everyone.

> One of the largest single factors that prevents USPS from controlling costs is Congress.

Link Performance Incentives to Productivity Improvement

Postal managers are eligible now for modest performance-based bonuses, but the bonuses are poorly linked to the actual performance of USPS.[50] A new incentive structure is needed. Rather than reconsidering rates whenever USPS gets around to submitting a new rate case, the Postal Regulatory Commission should establish rates on the various classes of mail that would stand for a period of years. The rates would take into account projected mail volumes, USPS operating expenses and capital requirements, and needs for debt service or other liabilities, such as pensions. The rates would be sufficient to meet the revenue needs of USPS for the established time period under the status quo for USPS operations.[51]

Once those rates are in place, the revenue would be guaranteed to USPS. If the Postal Service can reduce costs or increase volume more than was expected when the rates were set, USPS should run a surplus. The surplus should then be distributed to USPS employees and managers on a formula that could be set by USPS in conjunction with the unions and approved by the Postal Regulatory Commission.[52] On the other hand, if losses are incurred in a given rate period, those losses would be deducted before bonuses are awarded in the subsequent rate period.

In order to make such an incentive system work, the regulatory commission would have to ensure that the excess revenues come from true productivity increases rather than merely from reducing services without reducing prices. To do so, the regulatory commission would base the revenue assumptions on certain service levels, and any unanticipated service reductions that occur within the rate period would be subtracted from the bonus amount. For instance, the rates might be set on an assumption that 5,000 local post offices will be closed. If USPS actually closes 7,000 local post offices, the Regulatory Commission would determine the savings from the extra 2,000 closings and deduct that amount from the bonuses.[53]

If USPS is able to increase productivity enough to win bonuses from excess revenues, the new productivity levels will form the basis for the assumptions underlying the next rate case. For example, in a given rate period, USPS shuts down a processing center that is no longer needed, saving tens of millions of dollars, which are distributed to employees. When the next rate case is filed, USPS will not need revenues to support operation of that defunct processing center, so the revenue assumptions are lowered by that amount. Then, in the next rate period, USPS would have to make further productivity gains in order to earn bonuses. This process will provide an incentive for ever-increasing productivity while keeping rates as low as possible. In addition, it may well be necessary to raise the base salaries of top postal executives in order to attract experienced business leaders from the private sector into the relatively low-paying and low-prestige Postal Service.

Stick to the Mail

Over the years, USPS has tried to raise revenue through various avenues other than delivery of mail. These products have been related to the primary mission of USPS to varying degrees. The massive variety of first class stamps, for instance, is aimed at philatelists; each stamp that is purchased but not redeemed for delivery service is almost pure profit for USPS.[54] Some of the products were clearly not related to the primary mission, such as clothing and other products featuring images of stamps.[55] Some products are tangentially related to the primary mission, such as packaging services and supplies.

At first glance, allowing USPS to get into other lines of business seems appealing: The Postal Service is facing an annual deficit of billions of dollars, and a debt of billions more. In addition to the deficits, USPS also holds tens of billions of dollars in liabilities for employee pensions and health care, and will require billions more in capital to build new facilities as the nation's population continues its shift toward the southwest. As new technologies decrease the need for physical mail, it is becoming clear that the Postal Service will have to either cut costs or implement significant rate hikes. Allowing USPS to get into nonpostal businesses and earn profits will alleviate the pressure for rate hikes or taxpayer bailouts. Moreover, it sounds like a good way to increase efficiency, especially for those product lines that are related to its primary mission: The local post office is right there, they have extra room in the lobby, why not use it to sell boxes and bubble wrap? Or use the trucks to deliver pizza in the evenings?

The problem is that nonpostal products and services are commercial enterprises, and the Postal Service is a government entity. It is not appropriate for USPS to expand its charter past the basic function of delivering physical mail to competing with private enterprises in electronic bill payment, email, provision of Internet service, retail sales, the restaurant business, or any other private enterprise. It is proper for government to provide services only when there is a natural monopoly, where there is a significant public goods justification (as there is with National Public Radio, for instance), or when equity considerations are involved. Many of the businesses USPS has tried to start, especially the Internet businesses, do not meet this test.

> Postal executives seem to believe that their function is the movement of information. It is not. The function of the Postal Service is to move physical mail; atoms, not bits.

As a government entity, USPS has considerable competitive advantages over private companies: no taxes, favorable borrowing terms, a stream of monopoly profits, and so on. To bring these advantages to bear against private companies, especially in the highly competitive e-commerce field where companies regularly operate on the brink of bankruptcy, would be unfair. The government-entity status of USPS also raises serious issues of privacy and civil liberties for some potential e-commerce functions, particularly those involving private financial information.

USPS has shown that its entry into competitive product lines is haphazard at best. Last year the GAO issued a report on the Postal Service's e-commerce initiatives.[56] The report showed that USPS ventures into electronic commerce were a mess: New product initiatives were launched without proper approval or oversight, and the financial records of the initiatives were so bad that it was impossible for GAO to determine whether USPS made or lost money on its efforts, let alone the amounts involved. If money was lost, it will have to be made up by the rate payers, meaning postal customers will have to pay for the USPS's failed e-commerce ventures. For example, USPS has invested to get into the electronic bill payment function. Yet, it's likely that within a few years most banks will provide this service for free to customers since it saves them money in not having to process paper checks.

While it is completely understandable that USPS executives would rather focus on fun and exciting Internet ventures than on the mundane task of moving sacks of paper, USPS as an organization is particularly ill-suited to the task. As these ventures fail and management attention is diverted from the core task of moving physical mail, there is a reasonable chance that these nonpostal efforts will result in a worse financial position for USPS over the long haul.

Because USPS sees its mission as binding the nation together, postal executives seem to believe that their function is the movement of information. It is not. The function of the Postal Service is to move physical mail; to paraphrase one scholar, the Postal Service should move atoms, not bits. Last mile delivery of mail may be a natural monopoly, but there is no natural monopoly in the movement of information, and certainly no monopoly in the provision of information-related services, such as electronic billing, tax preparation, or providing Internet access. This is not to say that USPS should have no Internet presence whatsoever. On the contrary, USPS should expand into Internet enhancements of its mail service, such as online package tracking.[57] But they should refrain from getting into unrelated lines of business.

Many people, including members of Congress, contend that limiting USPS to the movement of mail is to seal its eventual doom, that the company cannot survive if it cannot expand into the New Economy. We do not believe this is true, but even if it is, this possibility cannot justify cross-subsidizing the mail with profits from unrelated government-owned businesses. If after centuries of dedicated service to the nation, the Postal Service finds its mail delivery service going the way of the buggy whip manufacturers, so be it. USPS should stick to mail and stay out of commercial activity that is not directly related to the acceptance, processing, transportation, and delivery of physical mail, no matter what the financial position, and no matter which institutional barriers are implemented to attempt to keep competition fair.

Take Prudent Measures to Improve the Safety of the Mail

USPS must aggressively combat both the risk of bioterrorist attacks through the mail and the consequences of such attacks: decreased confidence in the safety of the mail. USPS has already moved to protect postal employees, by acquiring respirator masks and protective gloves for all workers who handle mail. USPS has also entered into a $40 million contract to buy scanners that will irradiate mail at high-risk facilities to kill any potential biological agents on the mail. But Postmaster General Jack Potter has indicated in testimony to Congress his belief that improved security measures will ultimately cost several billion dollars.[58] Moreover, the Postmaster General claims he is reluctant to make ratepayers carry the full burden of these increased security measures, hinting that he would prefer the money to come at taxpayer expense.

Congress will surely agree that taxpayer funding of Postal Service expenses caused by terrorism is in the best interest of the economy, just as they did when they bailed out the airlines. In fact, the airport security legislation would be an appropriate model for postal security: The cost of the security measures should be split between taxpayers and ratepayers. Just as airline passengers are paying for increased security with a surcharge on every ticket, stamp buyers should be willing to pay more in order to improve the safety of the mail.

Because both taxpayers and ratepayers will bear the expense, it is important that the security measures proposed by USPS justify the cost. USPS is currently studying several options for sanitizing mail and protecting postal workers, from buzzing letters with electron beams to fogging them with chlorine gas. Before Congress agrees to federal financing of USPS to pay for increased security measures, they should ensure that the security proposals meet three conditions: proposed solutions must be effective, no other alternatives that are equally effective but less expensive must exist, and the money must be used only for increased security and not to underwrite postal operations or other non-security expenses.

Conclusion

Fixing the postal system is no easy task. Doing so will require tremendous political will on the part of all the players. As new technologies become an ever greater part of American life, the reason for the existence of USPS will gradually become less urgent. But the need for immediate change is urgent.

These proposals will change the postal system to such an extent that it may no longer be recognizable. Competition may well force USPS out of every part of the postal system aside from the last mile monopoly. If that happens, so be it. The important goal is improving overall efficiency and quality in the postal system (public and private) and improving service for customers, not to preserve USPS as we know it. As long as Americans want to move pieces of paper around the country in planes and trucks, a postal system is necessary; having USPS carry that paper every step of the way is not. Partial privatization of mail service and stricter control on the activities of USPS are necessary to make the postal system better, and are therefore steps that should be taken.

Endnotes

1. USPS has created significant exceptions to the mail monopoly, including the delivery of parcels and extremely urgent letters. These exceptions allow private services such as United Parcel Service (UPS) and Federal Express, as well as private courier companies, to operate.

2. This is a monopoly that USPS could eliminate at any time simply by defining "postage" as a licensing fee that private delivery companies pay to put certain kinds of mail into the mailbox.

3. The proposal also included pay hikes for postal workers. Despite this, the postal unions staged a massive work stoppage, foreshadowing future labor problems under reorganization.

4. "Major Management Challenges and Program Risks: U.S. Postal Service," General Accounting Office, January 2001 (GAO-01-262).

5. Bureau of Labor Statistics, http://www.bls.gov.

6. Economist Michael Wachter, working as a consultant to USPS, has calculated the wage premium to be 29.5 percent, meaning that USPS employees make 29.5 percent more than comparable employees in the private sector.

7. Though USPS has experienced considerably slower productivity growth than the rest of the economy, postal productivity has still grown 11 percent in the past 30 years. Yet that productivity increase has not resulted in lower labor costs.

8. "No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities." [31 USC 101(b)]

9. Though it is difficult to measure how much money a given postal station "loses" in a given year, it is clear that some post offices are redundant due to other nearby retail postal facilities.

10. Title II of the Treasury and General Government Appropriations Act, 2000 (P.L. 106-58). In July 2001, under considerable pressure from Congress and the public, USPS announced that it was abandoning consideration of cutting the number of delivery days on certain routes.

11. In August 2001, the Federal Communications Commission reported that broadband deployment in the United States had increased 63 percent in only six months, with a 158 percent growth rate for the full year. See the release on the study at http://www.fcc.gov/Bureaus/Common_Carrier/News_Releases/2001/nrcc0133.html.

12. According to the General Accounting Office, USPS estimates that of all bills and payments currently sent by first class mail (accounting for about $17 billion in annual revenue), roughly half eventually will be replaced by electronic bill payment. Since processing of electronic payments is less than half as expensive as processing payments sent and received in the mail, there is a strong incentive to adopt electronic payment, and it is possible adoption rates will be higher than USPS predicts.

13. In FY 2000, first class mail represented 50 percent of volume and contributed some $16 billion to overhead costs. Standard (mostly advertising) mail represented 43 percent of volume but contributed less than $5 billion to overhead. Thus the most profitable mail is the mail most vulnerable to nonpostal alternatives.

14. These machines, as well as other measures to protect the health and safety of postal workers such as masks and gloves, are being financed with $175 million released by President Bush from the emergency appropriations passed in the wake of the terrorist attacks.

15. For example, ABC News now encourages its viewers to communicate with it through email, and if they have to send a paper message to do it with a postcard, since they are no longer accepting letters.

16. USPS Board of Governors serves as the equivalent of a board of directors in a private corporation. The nine governors, who are appointed by the president and confirmed by the U.S. Senate, select the postmaster general and deputy postmaster general, who also serve on the board. When overriding a rate decision by the released by President Bush from the emergency appropriations passed in the wake of the terrorist attacks.

17. These nonpostal business lines also represent a diversion of organizational focus and resources that could better be spent on improving the core business of mail delivery.

18. The bulletin (Postal Bulletin 21994) also required CMRAs to resend mail received for former customers by adding new postage for a period of six months after termination of the account, rather than simply refusing the mail and leaving it to be forwarded at USPS expense.

19. For instance, an identity thief might open a private mailbox and list the box number as an apartment number, leading credit card issuers and others to believe that the address is a residence.

20. http://www.usps.com/feedback/cmra_faq.htm.

21. GAO reports that the numbers are 85 percent of executives, 74 percent of managers and supervisors, and half of career employees ("U.S. Postal Service: Financial Outlook and Transformation Challenges," GAO-01-733T).

22. These are optimistic estimates at best. A more detailed analysis of the Postal Service's financial situation, including a harsher assessment of their assets and liabilities, is forthcoming this fall from Alan Robinson and David Rawnley.

23. The draft legislation, a summary, and a section-by-section analysis are posted at Rep. McHugh's web site at http://www.house.gov/mchugh/hot_postalcrisis.html. The Postal Service Subcommittee web site is also still active at http://www.house.gov/reform/postal.

24. http://www.washingtonpost.com/wp-dyn/articles/A27504-2001Aug31.html.

25. USPS does offer performance-based bonuses to non-union employees, but these bonuses are relatively small compared to either private sector bonuses or the massive profits to be made through stock options.

26. An analogous example is that of Fannie Mae and Freddie Mac, the government-sponsored enterprises that securetize mortgages under charter from Congress. Many critics of Fannie Mae and Freddie Mac contend that their profits are skewed because, even though the companies get no subsidies from the government, investors face little real risk due to the widely held belief that Congress will not let the companies fail. This perception, it is held, lowers the cost of capital for the companies and gives them a virtual monopoly on the secondary mortgage market.

27. Robert H. Cohen, U.S. Postal Rate Commission, and Edward H. Chu, U.S. Environmental Protection Agency, "A Measure of Scale Economies for Postal Systems," in *Managing Change in the Postal Delivery Industries*, ed. Michael A. Crew and Paul R. Kleindorfer, Kluwer Academic Publishers, 1997.

28. Robert H. Cohen, William W. Ferguson, John D. Waller, and Spyros S. Xenakis, U.S. Postal Rate Commission, "Universal Service Without a Monopoly," in *Current Directions in Postal Reform*, ed. Michael A. Crew and Paul R. Kleindorfer, Kluwer Academic Publishers, 2000.

29. This is exactly the business model taken in the "Mailing Online" initiative, which allows customers to send letters electronically to USPS, where they are printed and posted. Though USPS refuses to disclose financial data on this program, by most accounts it is a massive failure. This may bode well for competitors of a privatized USPS.

30. Though it is likely impossible to get an accurate estimate on the value of the indirect government subsidies, it is probably in excess of $1 billion per year.

31. On the other hand, privatization could vastly improve the financial picture if USPS were able to extract monopoly rents once free of the ratemaking process, or if they were able to break their unions and slash the wage premium that postal employees enjoy.

32. Oddly for a government entity, USPS is allowed to keep private some financial information for competitive purposes. Bookkeeping is a serious problem within USPS, as the General Accounting Office has repeatedly complained.

33. For more information about the OIG, or to view the reports to Congress, see http://www.uspsoig.gov/.

34. There is no statutory reason that this should be so. USPS has the authority to ask for any kind of rate it wants, and in fact is currently considering some of the recommendations we make in this section for its upcoming product redesign. PPI suggests that the recommendations in this section be adopted by USPS and the Postal Rate Commission even if the legislative proposals do not go forward.

35. There is some argument over whether worksharing discounts are large enough to truly reflect the savings to USPS. Another objection to worksharing is that USPS fails to capture the savings due to featherbedding—failing to eliminate the plants, equipment, and jobs that are unneeded because of the work being done outside the postal system.

36. Most popular word processing programs for personal computers include a feature for addressing and printing envelopes; in addition to having fully legible addresses, these can print bar codes onto the envelope. Payment return envelopes also are frequently preprinted with bar codes, allowing payment to be received more quickly, at full postage cost to the sender.

37. Complex, bar code-like patterns are printed along with the indicated postage. These patterns encode the address of the recipient, so machines at USPS can verify that the Internet postage matches the address to which the package is being sent. This is presented as an antifraud measure.

38. Because undeliverable mail essentially doubles the cost to USPS (the cost of attempting to deliver to the undeliverable address and the cost of returning the mail to the sender), this so-called "address hygiene" is also a significant savings to USPS.

39. 39 U.S.C. 3623(d).

40. For customers who send significant volumes of mail and use PC postage or postage meters, discounts can be given in fractions of cents.

41. Private acceptance of bulk mail is currently possible through "remailers" who aggregate and pre-process mail from smaller senders to take advantage of worksharing discounts. So the discount was not because they can do so much to increase productivity, from agreeing to changes in work rules to cutting the number of grievances filed.

42. In some areas, especially rural communities, citizens have an emotional attachment to their local post office and view the facility as a center of community pride and bonding rather than as a symbol of a dreaded chore. In these areas, political pressure to preserve the local post office rather than transfer its functions to the local drug store may be strong. USPS should be sensitive to such market pressures, but should not let those pressures keep it from closing postal stations that are unnecessary. It is not the role of postal rate payers to subsidize community centers.

43. To maintain control over the flow of mail and the law enforcement obligations that come with it, private companies that accept mail would have to be licensed, a function that currently occurs with the small number of private postal stations. To prevent USPS from using licensing authority to prevent competition with its own local post offices, that authority would need to reside with the Postal Regulatory Commission.

44. Such kiosks would need to be deployed in postal stations around the country.

45. PC postage or postage meters could be used to post mail based on the time of day, but giving time of day discounts for stamped mail would be difficult.

46. Postage for bulk mail like magazines is computed on a complicated formula that charges per piece and per pound. The Rate Commission ruled that the discount could apply to the non-editorial (i.e., advertising) portion of the magazines, which could make it effective for fashion magazines and the like, which contain nearly all advertising. Weekly newsmagazines like *Time* and *Sports Illustrated*, however, contain roughly 60 percent editorial content, so the discount was not cost-effective.

47. A process is in place for closing postal facilities, but the process is complicated (to ensure that the facility is not closed for the forbidden reason of losing money) and subject to intense pressure from politicians, postal unions, and interest groups. As a practical matter, USPS needs to be given unilateral authority to make closing decisions.

48. Although high-cost routes have more room for cost reductions than low-cost routes, service reductions may actually be focused more on low-cost routes simply because of volume: USPS serves 83.3 million city addresses, but only 29.4 million rural addresses.

49. Similarly, telephone companies have a universal service obligation for telephone service, but offer considerably more services (such as high-speed data service) to customers in densely populated areas. The universal service obligation is met, though the telephone companies provide unequal service based on the cost of delivering those services to a given area.

50. This problem was highlighted in a public furor last spring when USPS changed the formula for bonuses to ignore income and reward productivity increases, giving bonuses to executives who might not otherwise have earned them due to the multi-billion-dollar deficit projected at that time.

51. The Postal Regulatory Commission could also establish an expedited procedure for emergency rate increases to account for unexpected scenarios, such as the recent tragedy that led the Federal Aviation Administration to ban temporarily all mail from commercial airlines, a significant part of the USPS transportation network. Emergency increases would prevent USPS from having to absorb losses and make them up in the next rate case.

52. Fairness dictates that union employees benefit because they can do so much to increase productivity, from agreeing to changes in work rules to cutting the number of grievances filed.

53. It is important to note that these service-level assumptions should not be standards that USPS is required to meet. USPS would be free to make changes in service that are more or less than the assumptions in their rate case, but would only capture bonuses based on the service changes anticipated at the time the rates were set.

54. Another good example of this phenomenon is the U.S. Mint, which recently launched a line of quarters commemorating the 50 states in the hopes that some coins would be retained rather than redeemed, and which sells uncut sheets of paper currency for more than the face value of the currency.

55. Though the sales of stamp-related items in postal offices and stations has been largely discontinued, USPS offers "Pro Cycling Gear" at its online store in conjunction with its sponsorship of a pro cycling team.

56. GAO/GGD00-188, September 2000.

57. Such expansions should have to be justified on economic grounds, however.

58. In testimony on November 8, 2001, Potter indicated that preliminary cost estimates were $3 billion to $4 billion, but are subject to revision as decisions are made about which technologies to use for mail sanitation.

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