



AMERICANS FOR TAX REFORM

P O L I C Y B R I E F

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A Different Kind of Postal Fraud

Why US Postal Service rate increases are effectively tax increases, how those taxes are being misspent, and what should be done to stop it once and for all.

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Introduction: It Works Like a Tax and Costs Like a Tax, So Let's Call it a Tax

The US Postal Service's Board of Governors, when defending its recent decision to pursue rate increases far exceeding the recommendations put forth by the Postal Rate Commission, made the incredible assertion that the USPS "has not received any tax money for operating expenses since 1982. The customers who use its services pay for the entire cost of operating the system."² This statement is terribly misleading for three all-important reasons:

1-The USPS has been granted by the federal government a monopoly over the delivery of First Class and Standard A mail, as well as the use of all mailboxes. The rates it charges are essentially the product of a unilateral *diktat* imposed in a closed market, and not the result of competitive pricing yielded by an open market.

2-Consequently, where the USPS has a monopoly, the USPS has no customers. No one chooses to have the USPS deliver their mail simply because no one has any other option. Therefore, the rates we pay are ineluctable; we are without recourse to another carrier. And any compulsory charge that is endorsed by a government, whether directly or indirectly, is a tax.

¹ The coauthors would like to thank the Adam Smith Institute of London for its assistance with this project.

² USPS Board of Governors Press Release 01-016, March 6, 2001.

3-Moreover, the USPS is exempt from all federal taxation (as well as state and local taxation, with the sole—and basically meaningless—exception being estate, inheritance, and gift taxes). This is tantamount to a massive tax expenditure on the part of governments at all levels deliberately in the USPS' favor. The USPS even has the right to borrow from the repository of the taxpayer's money, the US Treasury.

Every postal rate increase is thus, for all intents and purposes, a tax increase. And to make matters worse, the USPS has a power that other government agencies lack: it has the *de jure* authority to impose their *de facto* taxes independent of Congress.

It would be bad enough if the USPS just determined and collected its own taxes. Yet not only is the USPS legally unencumbered by the mountain of regulation that buries businesses in the private sector, it can impose regulations on its already over-regulated (and heavily taxed) potential competitors.

This raises an obvious question: “How could an all-powerful monopoly sanctioned by government have potential competitors?” Which leads us to the next problem...

Looking for New Markets to Plunder

The USPS is notoriously inefficient and bloated. Its workforce persistently expands (over 900,000 employees and rising) as the volume of First Class mail it processes stagnates. Indeed, by 2004, most observers estimate that the volume will start dropping by three and a half percent a year, which would indicate an urgent need to downsize either by eliminating redundant jobs or by attrition through a hard and fast hiring freeze. Common sense would lead one to conclude that something's got to give. After all, why take on more workers when there in all likelihood won't be more work to do? But common sense unfortunately does not obtain here. Instead of downsizing, the USPS is upsizing.

Neal Denton, executive director of the Alliance of Nonprofit Mailers, couldn't have been more correct when he observed “A real, live, honest-to-goodness business that didn't have a government monopoly would recognize that it didn't have market share and would begin to scale back to something smaller, sleeker.”³

The USPS' own Office of Inspector General has identified over \$1.4 billion worth of misused funds going out the window every year. (One of the more egregious examples of USPS profligacy has to be the full page advertisement it bought in *The Washington Post* to celebrate the Tour de France victory of its sponsored cyclist

³ Nakashima, Ellen. “Coalition Seeks Special Delivery: Postal Reform” *Washington Post*. March 2, 2001. p. A23.

Lance Armstrong. The cost of a full page ad in the *Post* is \$24,204.60. And nothing against Lance Armstrong, he's a very nice fellow, but why does the USPS need to sponsor a cyclist in the first place?)

Such silly spending is endemic in, even characteristic of, the USPS. Its systemic shortcomings are manifested in the sorry fact that 30 years of investments in automation and information technology has increased productivity by an absolutely unacceptable 11 percent. **But instead of reducing its operating costs, or at the very least restraining the growth thereof, and focusing on its core tasks, the USPS wants to abuse its monopoly, its regulatory authority, and its fistful of money chiseled out of the taxpayers to muscle its way into fields already adequately served by companies in the private sector.**

To supplement its income through means apart from and in addition to rate increases, the USPS is looking to expand its overnight mail and parcel delivery (both of which have been handled, for the most part and exceedingly well, by private sector firms), and also to gain a foothold in the very sector that the USPS fears will drain one of its major revenue streams: electronic commerce. For example, the USPS has introduced Post-ECS, an Internet-based document delivery system; eBillPay, an electronic bill presentment and payment service; the Electronic Postmark (EPM), an anti-tampering security device for electronic document deliveries; and NetPost Mailing Online, a desktop printing and mailing service.

The USPS claims that such ventures are consistent with its *raison d'être*, but those in the know are quick to disagree. Postal Rate Commission Chairman Edward Gleiman (now retired) observed, "On the merits of embarking on e-commerce initiatives, some of the rationales the USPS offers appear to rest on questionable legal or practical assumption. There is no apparent legal mandate or compelling need for broadening the mission of this government enterprise to include telecommunications services generally."⁴

Expansion by the USPS into ventures outside of general mail delivery is unneeded because products and services of this sort are already provided by the private sector. As a trio of eminent economists (including Joseph Stiglitz, the former chairman of President Clinton's Council of Economic Advisors) recently concluded, "The presence of significant private-sector activity generally raises a *prima facie* case against the existence of a public good. Therefore, the presence of such firms suggests that one of the primary motivations for direct government provision of a good or service—that it is a public good—is likely to be absent."⁵

⁴ Testimony before the International Security, Proliferation and Federal Services Subcommittee of the Senate Governmental Affairs Committee, September 7, 2000.

⁵ Stiglitz, Joseph, Peter R. Orszag, and Jonathan M. Orszag. "The Role of Government In A Digital Age" October 2000. p.71 < <http://www.cciinet.org/digitalgovstudy/main.html> >

The entry of the USPS into electronic commerce is wholly unnecessary, and could prove to impede the formation and capitalization of e-commerce start-ups, which of course would be hugely detrimental to the development of this still nascent but very promising segment of the economy. Similarly, parcel delivery has benefited from competition, and having a government-subsidized business going head to head with private firms for scarce dollars would, to put it mildly, cause severe economic distortions. **But more unsettling, though, is the fact that taxpayers are footing the bill for the USPS' misadventures while even the most seasoned experts have had considerable difficulty tracking the use of its revenues.** It would appear that the stamp you buy pays for more than just postage...

The USPS' unreliable bookkeeping makes thoroughly evaluating its financing of products and services unrelated to basic mail delivery quite daunting indeed. Bernard Ungar of the General Accounting Office (Congress' primary investigative unit) has tried to slog his way through the USPS' budgetary thicket, with nowhere near as much to show for his efforts as he had hoped. He noted, "a couple of issues arise. One is, is there cross-subsidization inappropriately taking place? And, secondly, are these initiatives successful or not? No one could ever tell, and right now we would have to say we can't tell sort of where they are because of the problems with the accounting that's in existence."⁶

And when government activity of any sort is unaccountable, it is invariably followed by expensive and degenerative mischief. An extensive reform of our approach to the delivery of mail is sorely needed, especially when one considers how long it's been delayed.

The Call for Postal Reform: As Old As America Itself and Still Unanswered

In the early 19th Century, postal services were set up by the private sector to compensate for the inadequacies of the USPS' ancestor, the United States Post Office Department (USPOD). Such companies would legally distribute mail in the areas thought by the USPOD too thinly populated to serve, or to the more heavily populated areas already served by the USPOD but with the speed and security the USPOD could not provide. The postal market was certainly not free and open, but it was somewhat less closed than is the case today.

However, many companies bravely, and admittedly foolhardily, sprang up delivering mail without the approval of the federal government and entered markets already cornered by the USPOD. Undaunted by the Sword of Damocles hanging

⁶ Testimony before the International Security, Proliferation and Federal Services Subcommittee of the Senate Governmental Affairs Committee, September 7, 2000. (emphasis added).

over its head, one company, the American Letter Mail Company (ALMC), went so far as to argue that the USPOD's monopoly was unconstitutional. In the January 25, 1844 edition of the *Boston Courier*, ALMC founder Lysander Spooner proclaimed "The Company design also, if sustained by the public, thoroughly to agitate the question, and test the constitutional right, of free competition in the business of carrying letters." The ALMC was eventually put out of business due primarily to legal costs, and America's all too brief flirtation with the possibilities of a diverse and competitive postal market came gasping to an end.

But Lysander Spooner wasn't the first to come to blows with the postal monopolies. Even back in 1776, the father of modern economics, Adam Smith, recognized that a state monopoly postal service was not in the interests of consumers (in the following passage, remember that the word "mercantile" has negative connotations, in that it was the 18th century's rough equivalent of our word "protectionist"):

"The post office is properly a mercantile project. The government advances the expense of establishing the different offices, and of buying or hiring the necessary horses or carriages, and is repaid with a large profit by the duties upon what is carried. It is perhaps the only mercantile project which has been successfully managed by, I believe, every sort of government. The capital to be advanced is not very considerable. There is no mystery in the business. The returns are not only certain, but immediate."⁷

Smith explained, with nearly psychic foresight, that such industries will be highly inefficient: "**The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another.**"⁸

So it has been known for centuries that all postal monopolies have inherent structural flaws. But others have wisely decided to address their respective postal services' problems before they could cause the entire system to implode.

Other Countries Have Seen the Light. When Will We?

Developments across the globe, particularly the Netherlands, Germany and the United Kingdom, may very well indicate which course of action is most advisable for the United States. (In all candor, almost any postal reform case study reveals that the status quo in America is untenable.) And the reform efforts in Europe have a hypothetical D-Day: by January 1, 2003, all European Union postal markets will

⁷ Smith, Adam. "The Wealth of Nations" Book Five, Chapter Two, Part One. 1776.

⁸ *ibid.*

be obliged to open themselves to competition, which will have the certain effect of cutting postal prices throughout the EU, which in turn will increase the competitiveness of all European companies as will the EU's several national economies.

The Dutch Postal Service was one of the first EU postal services to be privatized in 1989. It was listed on the stock exchange with the shares gradually sold off by the government. It was widely thought that this privatization would bring significant aggregate job losses, but such job losses would be a small price to pay in the larger scheme of things. In fact, a year later, the workforce was slightly larger and now the workforce is of a similar size. As anyone who passed Economics 101 would have predicted, lower prices and improved services led to an increase by 50% in the quantity of mail being delivered.⁹ Although unnecessary jobs disappeared, new and necessary ones were created by heightened demand. Given a choice between employing as many people as possible (or even more than necessary by any objective criteria) and providing customers the best product at the lowest price, the Netherlands chose the latter and in so doing promoted the best interests of its workers.

The ongoing and gradual process of postal reform in Germany has been nothing short of breathtaking: Deutsche Post has been placed under private management, its workforce slashed by attrition and early retirement, and its non-monopoly services made subject to the same taxes and regulations as its competitors. In November 2000, Deutsche Post leapt boldly into the realm of privatization by debuting on the stock market (an initial public offering valued at \$5.6 billion), and thus made answerable to the most demanding and discerning overseers imaginable: its investors. And by the end of 2007, the transformation will be vividly, magnificently complete: Deutsche Post will lose its domestic letter monopoly, with the promise of full transparency of its accounts.

A similar move is now afoot in the United Kingdom. Postal service in the UK has long been provided by The Post Office (not to be confused with the USPOD!), with competition existing in parcel deliveries but with a legal monopoly on letters up to £1.00. Up until 1969 it was a government department, at which point it became a separate government corporation (comparable to the USPS' current status). As of March 26, 2001, however, The Post Office was transformed into a government-owned plc (UK legalese for a "public limited company" which is listed on the London Stock Exchange with the ability for the shareholdings freely purchased and sold, and required to comply with the Stock Exchange rules). This gives the Post Office greater latitude in decision-making authority and the ability to freely borrow

⁹ Nigel Ashford, Richard Miniter, Jeroen Oomen, "What works?" January 2000: <http://www.lexingtoninstitute.org/whatworks/whtwrks14.htm>

to facilitate takeovers and investment. Indeed, the company has been re-christened “Consignia” to give it a more global branding as the world opens up to postal competition. Currently, all of Consignia’s shares remain the property of the government, but the new structure has been put in place to allow for its eventual privatization.

Most crucially, Consignia’s legal monopoly over deliveries costing less than £1.00 has been lifted. In anticipation of competition, earlier this year the government created a regulator, the Postal Services Commission (PostComm). Below the £1.00 level, known as the ‘reserved area’, PostComm has the duty of issuing licenses to competing services, with the first licenses issued in June 2001.

The experience in the UK has shown that political opposition to postal service privatization can easily, albeit gradually, be overcome. Only five years ago, the Conservative Party, in government at the time, cowered away from privatizing the Post Office, believing it would be deeply unpopular, not least because of a successful scare campaign by the Communication Workers’ Union. Now postal service privatization in the United Kingdom is underway, and under, of all things, a Labour government. The general public is basically neutral to the idea rather than hostile, while businesses (where postal costs and service can significantly affect profit margins) are enthusiastic, realizing that their operating costs will be reduced. And since fostering a competitive business climate will always benefit the nation as a whole, arguments against postal privatization are politically weak from the start and become all the more so as privatization measures are put in place...

The First Great Myth of postal service privatization, that the postal services are a natural monopoly such that it is impossible to introduce competition, and that therefore the government alone is capable of providing a particular good or service, has consistently been shown to be untrue by European examples, one of which is particularly illuminating: in Britain, during a 1971 Post Office strike, the government-enforced monopoly was lifted as an emergency measure. Within days, 562 competing services had been launched. Not surprisingly, the strikers realized that their jobs could easily be carried out by others and the dispute was settled. (Diminishing the ability of organized labor to unilaterally cripple postal delivery is sufficient reason in itself to consider the privatization option.)

The Second Great Myth of postal service privatization, that a Universal Service Obligation (USO) supports a government monopoly, has also been blown to bits by experience. In theory, fixing a single price to deliver mail to any destination, however remote, ensures complete delivery coverage, and introducing competition would lead to the creaming off of the best parts of the country by new entrants into the postal industry and in turn cause less lucrative areas to go neglected. In reality, postal privatization does not have to lead to a dissipation of the USO.

Notably, Britain's PostComm has concluded that the USO issue fails to undermine the overall case for privatization: "Monopolies all too often lead to inefficiency and poor service. Some argue that the Post Office has not taken full commercial advantage of its network of post offices, and that its provision of a universal service is as much a benefit as a cost or obligation."¹⁰ In fact, having a nationwide reach puts Consignia at a commercial advantage as businesses can use Consignia's service alone to deliver all their mail everywhere in the country. Accordingly, Consignia's competitors (and any other new mail delivery company in any country for that matter) would be wise to establish a comparably broad delivery network.

When the Worst Case Scenario Becomes Real

The postal reform movement is making headway outside of Europe. In Japan, Prime Minister Junichiro Koizumi was swept into office on a tidal wave of popular support, having been given a mandate by his people to take all prudent measures necessary to reinvigorate the ailing Japanese economy. Koizumi has rightly set his sights on Japan's post office, which has been a major factor in exacerbating the difficulties imposed by Japan's inflexible and seemingly deathless neo-dirigiste system of state-industry collusion. This is arguably a more daunting task than taking on the USPS: over the course of decades, Japan has allowed their postal monopoly to spread ("metastasize" might be more appropriate) into the realms of finance and insurance.

Japan's postal savings system is now the biggest financial institution in the world, with ¥255 trillion (over \$2 trillion) of deposits, which comprises 35% of all household deposits, nearly as much as all deposits in commercial banks put together. Its postal insurance business has ¥117 trillion (almost \$1 trillion) in policies, and controls more than a third of the country's life-insurance market. The government has funneled much of this money into self-serving programs such as state-housing loans or pork barrel public works projects. Most of the remainder has been invested in government bonds. Consequently, capital flows have been diverted away from higher-yielding assets and far more productive investments.¹¹

Hyperbolic though it may sound, long-term economic growth will be unattainable in Japan if its postal service monopoly is left untouched. And though Japan's predicament is not entirely analogous to what we in America face vis-à-vis the USPS, Japan's cautionary example makes plainly evident that the diversification of government-imposed monopolies can be taken to dangerous extremes, and that disastrous results unfailingly ensue.

¹⁰ see <http://www.postcomm.gov.uk/businessplan.pdf>

¹¹ see *The Economist*. June 21, 2001.

Nevertheless, change is always possible, and people all over the world are realizing that postal reform is not only possible but also necessary. The US should not hesitate to examine the efforts of other nations and emulate, if not adopt outright, those policies it finds most suited to affecting comprehensive (which is to say not merely cosmetic) change stateside.

Conclusion: Cease and Divest! If Not, Then Privatize.

The USPS desperately needs an overhaul that would assist the taxpayers who keep it afloat and the private sector companies put at a competitive disadvantage by the USPS' government protection scheme. But the overhaul must not be one that would unwittingly serve the USPS' interests. The much-lauded HR 22 from the 106th Congress, for example, would quite probably have made matters worse had it been enacted, since it failed to separate the USPS' core function of basic mail delivery from its forays into competitive products and services and to effectively constrain the cross-subsidization thereof from monopoly service revenues.

Indeed, enacting the wrong legislation is undoubtedly far less desirable than enacting no legislation at all.

The right idea would be to rein in the USPS and ensure it concentrates on its duty to simply deliver the letter mail, all with an eye towards divestment of its competitive products and services in order to prevent immensely unfair cross-subsidization from its monopolized products and services. Reducing its workforce and therefore its overhead through a hiring freeze would also yield manifold benefits; a staggering 80% of its operating expenses are solely attributable to labor costs. Reconfiguring its monopoly so that certain letters can be delivered by private sector couriers deserves to be contemplated at the very least, as should expanding the "last mile" approach for all mail deliveries. (Under a "last mile" arrangement, any courier can carry any piece of mail towards—but not ultimately to—any given destination. The USPS remains responsible for the eventual distribution to the addressee).

And what is to some the dreaded "P" word (privatization) should have its ridiculous stigma dispelled once and for all. If the USPS wants to become the real business it pretends to be instead of the government agency it actually is, then it should gradually be made a real business through a deliberate course of privatization, thereby leveling the now uneven playing field that keeps its private sector counterparts perpetually two touchdowns behind at the two minute warning.

An institutional shake-up is in order as well. Though the USPS' Inspector General has been doing a yeoman's job in bringing some of the USPS' more noticeable transgressions to the public's attention, the Postal Rate Commission should be strengthened and endowed with full subpoena power in order to uncover the less apparent but numerous instances of questionable practices. (And giving the USPS' Inspector General more independence from the Postmaster General would further improve oversight.)

Moreover, once armed with subpoena power, the PRC should be given the final say on rates, whereas the Board of Governors can now override any PRC decision through unanimous vote. A fully informed PRC will be more able to ascertain what it really takes to get a letter from Point A to Point B, and how much it really costs to do so.

ATR is confident that it isn't 34 cents.

Whichever reform is chosen, the time to act is NOW. This undertaking will become all the more difficult as the months pass and circumstances worsen. The USPS is poised to become an insatiable leech on what is today, mercifully, a steadily recovering economy. Let us endeavor to slay this Leviathan in its infancy, lest it grow so large it can sustain any wound we attempt with justification to inflict. Those who would prefer to continue feeding this baby monster will soon find themselves chewed between its jaws if nothing is done.