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Post Office Socialism

By
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I N T R O D U C T I O N

The U.S. Postal Service (USPS) is a government run enterprise, with its Board of Governors (analogous to a Board of Directors) appointed by the President. This corporation has a legally enforced monopoly on the delivery of certain classes of mail. Anyone other than the USPS who delivers such mail has committed a federal crime and is subject to fines and even imprisonment.

Because the USPS is a government run legal monopoly, it enjoys a number of additional powerful privileges. For example, it is exempt from all income taxes, sales taxes, property taxes, and other government mandated fees and assessments. It is also exempt from many costly federal regulations and most state and local regulations.

Unfortunately, the USPS is now using these privileges to enter into other businesses outside of its mail monopoly, where private companies are already serving the market quite well. These include long distance telephone cards, cellular telephone towers, electronic money transfers, bill payment processing, package delivery, and overnight mail.

This is bad policy, for several reasons. It is essentially a form of outdated socialist economic policy, with the government owning and operating business enterprises in the private marketplace. Moreover, with all of the abovementioned government granted advantages, the USPS would quite likely drive many of the private competitors out of business in these markets. This would simply extend the improper monopoly and socialist policies of the USPS. This would impose additional costs and inefficiencies on the economy, and ultimately harm - not help - consumers.

Federal legislation proposed by House Postal Subcommittee Chairman John McHugh (R-NY) seeks to reform the Postal Service. His bill, H.R. 22, the Postal Modernization Act of 1999, provides price setting authority and other commercial freedoms for the USPS. As a safeguard, the bill tries to impose a separation on the activities of the USPS that will prevent it

from using its government granted monopoly and other government privileges to advance its business activities outside its mail monopolies. However, this separation will be ineffective and will not solve the problems of post office socialism. At the same time, the bill provides firmer, broader, and more express authority for the USPS to engage in such activities than ever before.

Consequently, Congress should reject H.R 22. The USPS cannot be allowed to enter business markets outside of its mail monopolies until it gives up those monopolies and other government privileges. The USPS argues that entering those other markets is now essential to its overall efficiency and viability. But such expansion will only be beneficial for the public if the USPS gives up its monopoly and other government ties. If such expansion is necessary, that only shows how outdated the USPS postal monopoly has become.

P O S T O F F I C E S O C I A L I S M

The U.S. Postal Service is organized as an enterprise owned and run by the federal government. The President appoints its Board of Governors, which acts as a corporate Board of Directors. The President also appoints a weak oversight body called the Postal Rate Commission. The Postal Service has no outstanding stock, and is run with little check by the Board the President appoints.

This government postal entity is one of the largest economic enterprises in the country and, indeed, the entire world. It has annual sales of over \$60 billion and about 800,000 employees, with 38,000 post offices and over 200,000 vehicles.¹ It is larger than the 3 largest airlines combined, and bigger than DuPont, Texaco or Citicorp.² In fact, Sidak and Spulbar note that the Postal Service has 7 product lines that would each qualify as a Fortune 500 company.³ Among private firms, it would probably be the largest employer and be at or near the top in sales volume.

Current law grants USPS a legal monopoly over first class and Standard A mail. First class mail includes individually addressed letters and cards. Standard A mail includes mass mailings of advertisements or other solicitations to specific names and addresses. Anyone other than USPS who delivers such mail has committed a federal crime and is subject to fines and even imprisonment. Even Boy Scouts who volunteer to deliver Christmas cards in their neighborhood would be committing a federal crime.

Current law grants the USPS a monopoly as well over the use of all mailboxes in the U.S. You may think the mailbox outside your own home that you bought and installed is your own. But the government has decreed that you do not have the right to decide who may use it. Anyone other than the USPS that uses it has again committed a federal crime and is subject to fines and imprisonment. This monopoly allows only USPS to earn profits from the national mailbox network.

¹ Sidak and Spulbar

² id.

³ Id.

The USPS has many other special legal privileges as well. It is exempt from federal and state income taxes, state and local sales taxes, state and local business and property taxes, and unemployment compensation taxes. It is also exempt from all motor vehicle licensing and registration fees and parking tickets.

The USPS is exempt from many costly regulatory requirements as well. It does not have to comply with, for example, the Department of Transportation's Hazardous Materials enforcement program. As an enterprise run by the federal government, it is effectively exempt from the antitrust laws. It is also exempt from federal highway weight standards. The USPS is also exempt from most state and local regulations, such as zoning requirements.

Internationally, because of its federal government status, the USPS can arrange special preferential treatment by foreign customs officials for packages it delivers overseas. Through the Universal Postal Union, it can arrange preferential treatment for other types of mail and other services. Indeed, imported goods shipped into the U.S. in packages delivered by the USPS generally avoid applicable import duties and tariffs.

Finally, the USPS has the right to borrow from the U.S. Treasury, giving it access to a virtually unlimited supply of capital.

In recent years, the USPS has begun involvement in several new product lines outside of its mail monopoly. A recent General Accounting Office study reviewed *nineteen* new product lines offered by USPS. These include long distance telephone cards, cellular telephone towers and electronic money transfers. Another new service was bill payment processing at a mail remittance center on Staten Island, New York, which processes payments for American Express, a gas utility and a bank credit card.

The only profit generating business out of the 19 was merchandise with emblazoned stamp images, such as t-shirts. The USPS has sold such merchandise at some post offices. The USPS also opened professional packaging service operations and has offered an overnight package delivery service in selected cities called Fastnet.

Internationally, the USPS has initiated a new express delivery service called Global Priority Mail, along with a regular package delivery service called Global Package Link. It also offers an international expedited mail service - Express Mail International.

USPS has developed plans for many other new businesses. These include overnight delivery of merchandise ordered on the Internet, electronic transmission of business reply mail, Internet access in Post Offices, and various e-mail postmarks and certifications.

The GAO concluded that under current law the USPS in fact has broad authority to initiate new products, services and businesses. New postal products require approval of the Postal Rate Commission. But nonpostal products do not, and USPS can introduce them entirely at its own discretion.

All of the special legal privileges of the USPS discussed above grant it a huge, highly problematic advantage over competitors in any business it conducts in competitive markets

outside of its mail monopoly. The tax exemption alone provides a cost advantage over any private competitor of around 30% (the average tax rate).

The regulatory exemption adds substantially to this as well. For example, motor vehicle licensing, registration fees, and parking tickets add up to a major cost for any national delivery firm.

Moreover, these regulatory exemptions translate into more than cost advantages. The exemption from zoning, for example, allows the USPS to locate in residential areas where no other private competitor can. Special exclusive arrangements with foreign customs officials also allow the USPS to provide services that no one else can. The effective exemption from import duties and tariffs for packages shipped into the U.S. through USPS is another artificial and unfair cost advantage.

Still another important advantage is the ability of the USPS to borrow from the U.S. Treasury, and its government ties in general. Borrowing from the federal treasury provides the USPS a guaranteed source of capital, while private competitors must fight for their investment funds in the capital markets. Moreover, the USPS receives such credit at favorable, below market interest rates because of the low cost of federal borrowing. In addition, any loan to the USPS from the private market is backed by the full faith and credit of the U.S. government. Such a federal guarantee again means favorable, below market interest rates for the USPS on such loans.

The mailbox monopoly provides another advantage over private competitors. Fed-Ex, UPS and other private firms delivering overnight mail cannot use the mailbox like the USPS can for such mail. The private firms must leave their mail on the doorstep. In some areas, the mailbox monopoly stifles effective competition altogether. For example, although private competitors *can* deliver fourth-class mail, which consists of unaddressed mass advertisements, they cannot use the mailbox. They must leave the material on the doorstep or lawn. Consequently, most such mailers use the USPS.

The USPS can also cross-subsidize any business it conducts in competitive markets outside of its mail monopolies with the profits and other advantages it gains from these monopolies and its other legal privileges. The Postal Service is able to pay for the enormous fixed and common costs of running a network (retail, sorting, transportation, and delivery) mostly with its captive, monopoly products. Its competitive products bear only a limited fraction of this cost, with ratepayers and taxpayers paying for the balance. The private sector competitors do not have the privilege of paying for their fixed costs with captive, monopoly products; instead, they must rely on the products that are in direct competition with the Postal Service to cover these costs.

At a minimum, these privileged profits provide another huge source of capital for investment in new businesses in private competitive markets. But this cross-subsidization is particularly virulent because the USPS is a quasi-government nonprofit operating with no shareholders demanding a profit on their investment. In a private business, shareholders would demand that any subsidies from profitable operations to new businesses earn an investment return over the long run at least as great as what they could earn on those funds elsewhere in the market. But the USPS is not subject to this market constraint. It can cross-

subsidize to maximize market share or scale of operations, or to protect its monopolies from encroachment, even where doing so results in great financial loss.

This lack of market constraint allows USPS to also engage in predatory pricing, or pricing below cost, in competitive markets outside its mail monopolies. For private firms which must earn profits, such predatory pricing is rarely workable. As the market share of a firm using predatory pricing rises, it loses more and more money on its higher volume sold at below-cost prices. Meanwhile, its shrinking rivals lose less on smaller volume, or none at all if they maintain their prices. The private firm then generally cannot recoup these losses through higher prices later, as they will probably be undercut by rivals who suffered smaller losses but were not wiped out, as well as by possible new entrants into the market.

But the situation for the USPS is entirely different. Without investing shareholders to satisfy, it is perfectly free to sink large profits from its mail monopolies into large losses on new businesses in competitive private markets due to below cost pricing in those markets. It can, therefore, expand total volume, employment, market share and its overall empire with no consideration for the losses. This maximizes net gain for the non-profit, quasi-government, USPS organization, which is not measured financially, but operationally.

The USPS, in fact, has an established pattern of charging below cost (particularly considering overhead costs), cross-subsidized prices in areas where it faces competition. For example, in 1997, the USPS monopoly on first class mail covered 100% of its direct costs and contributed another 77% of such costs to overhead. But package delivery services (parcel post), where USPS faces market competition, covered only 92% of its direct costs and contributed nothing to overhead. Similarly, in the international market the Global Priority Mail package delivery service and other initiatives facing market competition covered only 87% of direct costs in 1998 and contributed nothing to overhead.⁴

Indeed, USPS today will charge \$30 to deliver a 10-pound package from Alexandria, Virginia to Washington, DC right next door. But it will charge only \$27 to send that same package all the way to London, a service that costs about \$100 to provide based on private sector comparisons. Consequently, for the international package market where USPS has a priority to establish greater market share, it is willing to engage in predatory pricing charging well below cost.

For international services overall, where USPS increasingly faces competition from foreign postal operations, revenues only cover 112% of direct costs. That means these services are only contributing 12% of their costs to overhead, compared to 77% for the domestic first class mail monopoly, over 6 times as much. Clearly, USPS international services are not carrying their share of overhead.

The GAO found the same pattern in the 19 new products it studied. It reported that USPS lost close to \$100 million on these new products combined. That strongly indicates below-cost pricing.

⁴ Postal Rate Commission, 199 International Mail, Volumes, Costs, and Revenues, June 30, 1999, p. 9.

The same pattern emerges while examining long-term trends. From 1970 to 1995, rates for first class mail increased by over 400%, as did USPS labor costs. Yet, the CPI over this period grew by just under 300%. Comparatively, the rates for parcel post package delivery *did not even* keep up with that. They grew by less than 250% from when the service first began in 1973. Similarly, rates for Express Mail grew by just over 50% from when the service was started in 1978.

Cross-subsidies from the postal monopolies can take many other, more subtle forms. The USPS has built, at the public's expense, a huge intricate network to provide its monopoly mail services. This network can be used to provide many services outside the monopoly with relatively little additional cost, certainly far less than what a new competitor would have to pay. This applies to package delivery and overnight mail quite clearly. But it can also apply to supplemental services such as electronic commerce, professional packaging, copying, printing, stationary and office supplies, and on and on. If such new business operations do not have to bear a proportionate share of overhead costs, then they can be priced to undercut private market competitors.

This established network can also be used to provide one stop shopping convenience for customers, who could buy envelopes and packaging materials, copy their correspondence, print mailings, then send packages, overnight mail, and mass or individual mailings all at one site. The USPS can also market the "U.S. Government" brand name, providing public relations impressions of security, reliability, and long-term endurance. Excessively costly advertising and public relations can maximize this. Again, if the USPS were simply providing a government service of first class monopoly mail, this would not be such a problem. But if it were to take the U.S. Government brand name into private, competitive markets, this would be another artificial and unfair competitive advantage.

The information about customers and their preferences that USPS can gain from its mail monopolies can also be used to benefit other businesses outside those monopolies. The USPS certainly has access to names and addresses for marketing and a sense of what zip codes could be best marketed for different products. Innovation and research developed and financed through the mail monopolies can also be applied to other services, particularly package delivery and overnight mail.

The USPS, in fact, has been slow to maximize all these opportunities, most likely because it is not a profit-maximizing, incentive-having business, but an inefficient, nonprofit, government-related agency. But if the USPS is now going to aggressively exploit competitive market business opportunities, the cross subsidies and other advantages are a major problem, for several reasons.

- First, the practice amounts to post office socialism. The U.S. government should not be running businesses that provide products and services in private competitive markets where private firms are fully capable of doing the job. Countries around the world that wrongly developed such state owned enterprises (SOEs) in the past are now busily privatizing them, with the strong encouragement of the U.S. But through the USPS, we are now going backwards to this terrible, failed policy ourselves.

- Second, with the enormous and artificial privileges of the USPS, it may well drive the private firms out of the markets it enters.⁵ All of the special privileges discussed above may provide a cost advantage of well over 50% for some products or services, and maybe as high as 100%. As a result, the USPS can win in the market even when it is vastly more costly and inefficient. The result could then be a government takeover of the markets the USPS chooses to enter, expanding big government and post office socialism even further.
- Third, this practice is unfair to the private firms already competing in these markets. The government should not be using its powers to drive these firms out of business. That is quite simply an abuse of power. Indeed, the predatory pricing often pursued by the USPS would be illegal under the antitrust laws if pursued by any other company precisely because it is unfair competition.
- Fourth, this practice is costly to regular mail consumers. They are effectively being forced to pay higher than necessary stamp prices to subsidize USPS adventures outside its mail monopoly in private competitive markets. Moreover, they are being forced to carry virtually all overhead costs while USPS businesses outside the mail monopoly get a free ride. Indeed, with international USPS operations not covering anywhere near their share of overhead, USPS is effectively engaged in post office foreign aid as well as post office socialism.
- Fifth, if public policy interests suggest a subsidy, it should be the other way around. The Postal Rate Commission, or Congress, should require that the competitive products pay for a greater portion of the fixed network costs than the captive, monopoly products. This would allow captive customers (the proverbial “Aunt Minnie”) to benefit from having the competitive products subsidize the universal mail service for which the postal network primarily exists. It is nonsensical from a public policy standpoint to allow competitive postal products to avoid covering the fixed costs of the postal network.
- Finally, with a less efficient USPS winning through artificial privileges, costs for the economy as a whole would rise, and productivity would effectively fall. Ultimately, this means lower economic growth and national income.

T H E P O S T O F F I C E S O C I A L I S M B I L L

Rep. John McHugh (R-NY), Chairman of the Postal Service Subcommittee of the House Government Reform and Oversight Committee, has introduced legislation to reform

⁵ At a postal conference in 1998, in describing how the Postal Service did during the UPS strike of 1997, Postmaster General Henderson stated that “the mother of all Posts woke up, and when she did, she slapped two to three hundred businesses out of the universe.”

the Postal Service. His bill, H.R. 22, The Postal Modernization Act of 1999, primarily seeks to grant commercial-like freedoms (such as new product development and more autonomy in setting postal and nonpostal rates. In addition, in an attempt to provide safeguards the bill seeks to separate the postal monopoly services from the nonmonopoly services and the nonpostal services. This separation, however, will not work adequately to solve the problems discussed above.

Under HR 22, all revenues from postal monopoly services would go into a Postal Services Fund, which would finance those services. Rates on all monopoly services must be high enough to cover costs. USPS would set the rates for such services subject to a maximum cap. That cap would prevent USPS from raising its rates above a narrow range determined by inflation plus an adjustment factor set by the Postal Rate Commission (PRC) to reflect productivity changes and other costs factors. USPS can increase its rates for monopoly services each year within a range of 2 percentage points above or below this adjusted index. It can also seek a waiver from the PRC to set its rates above this range if necessary to cover the costs of the monopoly services.

Revenues from all competitive postal services and products, such as package delivery and overnight mail, would go into a Competitive Products Fund, which would finance all such services and products. Rates for each of these products and services must again be sufficient to cover the costs of providing the service or product. Moreover, the revenue from all competitive products combined must be sufficient as well to make the same relative contribution to USPS overhead as the monopoly services do.

The USPS would be free under the bill to introduce new competitive postal products merely by filing a showing with the PRC that it is indeed a competitive postal product and that revenues will cover attributable costs. The PRC can then seek to block introduction of the product if it feels these requirements are not met.

Unfortunately, this legislative framework would not solve most of the problems we have discussed. The USPS would still be engaging in private enterprise, perpetuating post office socialism. The USPS would still provide nonmonopoly postal services, such as package delivery and overnight mail, in private markets competing with private firms who are fully capable of servicing the market themselves.

While HR 22 seeks to insulate competitive postal and nonpostal services and products from the special legal privileges enjoyed by the postal monopoly services, the bill clearly fails to do so. The opportunities for cross-subsidies from the postal monopolies to other services and products remain rampant.

A key insulating barrier for HR 22 is the requirement that rates for competitive postal services, which the USPS can still provide directly, be sufficient to cover their attributable costs, while rates for the monopoly postal services be sufficient to cover their costs. These rules are expected to prevent cross-subsidies and prevent predatory pricing.

But attribution of costs within USPS to different products and services is far from an exact science. There is broad scope for judgment on such issues, which means broad scope for abuse. Where USPS faces stiff competition, attribution of costs will be minimized so USPS can charge lower rates and undercut competitors. Where USPS faces little or no

competition, attribution of costs will be maximized so USPS can recover funds to subsidize the more competitive areas.

Another breach in the supposed separation arises from the offering of package deals by USPS for both monopoly and competitive postal products, primarily for business. There is just no foolproof way to untangle the costs and revenues for the different services in such package deals. Through these packages, the USPS can again undercut the competitive services and overprice the noncompetitive.

Moreover, USPS could still use its mailbox monopoly to favor its competitive services over competitors. USPS can use the mailbox for overnight mail, small packages, and general advertising mail, but its competitors cannot. The USPS can also provide its competitive postal services with a guaranteed stream of capital from its mail monopolies, its credit line at the U.S. Treasury, and its right to issue federally backed debt in the credit markets. This capital also will enjoy the low cost rates of federal borrowing.

Through all of these and other means, all of the legal privileges of the USPS previously discussed can still be used to subsidize the competitive postal products. This would effectively allow USPS to still engage in predatory pricing to advance competitive postal products, financing the losses with the profits and legal privileges from the monopoly postal services.

Moreover, the bill contains several provisions that only worsen the problem. One provision states that a competitive postal service may be subsidized by postal monopoly revenues if the competitive service is subject to a universal service obligation, requiring USPS to provide the service to anyone in the country. But all of the USPS competitive postal services are subject to the universal service requirement. This one loophole itself obliterates all of the supposed separation between the monopoly postal services and the competitive postal services.

Another provision allows the Competitive Products Fund to borrow from the Postal Service Fund. At a minimum, this allows the competitive postal products a pipeline to use all of the privileged credit facilities of the USPS. By granting such credit on particularly favorable terms, the USPS can effectively use its monopoly profits to subsidize the competitive postal products.

Still another provision allows the USPS to enter into negotiated service agreements with particular mailers to offer them volume discounts and other favorable contract rates. This creates a mechanism by which the USPS can engage in predatory pricing in competitive markets subsidized by funds from the monopoly services.

The USPS is still left with virtually unlimited authority to enter into nonpostal businesses, with no effective separation from the postal monopolies, unless HR 22 retains the explicit ban in the bill on the USPS entering into competitive businesses.

Consequently, HR 22 thoroughly fails to separate the USPS postal monopoly from the competitive products and services, and, therefore, fails to solve any of the significant problems posed by the trend toward post office socialism. Rather, the bill actually establishes firmer,

broader and more express authority for the USPS to engage in nonpostal businesses and nonmonopoly postal services than ever before. As a result, the bill adds to, rather than solves, the problem.

The central fallacy underlying the bill is that it seeks to model its regulatory framework for USPS on the telecommunications industry. But at the same time, it fails to address the fundamental problem of the USPS monopoly, which is incompatible with more extended competitive, market activities. In the phone industry, the monopoly was directly addressed and removed as a condition to the granting of commercial freedoms.

To resolve the basic problem, policymakers must first address the fundamental policy issue of whether the USPS is a government agency providing a public service to the Nation, or a profit-seeking commercial enterprise only concerned with the bottom line. HR 22 only hardens the paradox, which allows it to distort the marketplace at the expense of regular mail users. If the USPS is a government agency providing a public service, then it needs to be restricted to that service and kept out of the competitive commercial marketplace. If it is a profit seeking commercial enterprise, then it must give up its monopoly and other special government privileges.

Once this basic issue is resolved, then, besides solving the problem of post office socialism, all of the serious mail problems that the bill fails to address can be solved appropriately. As it stands now, HR 22 does nothing to address the problems of cost and quality of service in mail delivery by USPS. It fails to do anything to improve the productivity of the postal workforce, a priority issue if cost and quality performance is to be enhanced.

C O N C L U S I O N

Congress should reject H.R. 22 as it adds to rather than solves the problems of post office socialism. The USPS seems to think it must expand to providing associated products and services outside its mail monopolies in order to survive in the modern marketplace. While this is a dubious notion for a nonprofit, government, public service agency, even if true it would only show how outdated the postal monopoly has become.

For as long as the USPS retains its postal monopolies, and other government ties, it cannot be allowed to engage in providing products and services outside of those monopolies. Providing such products and services through a government run enterprise like the USPS in competitive markets that the private sector is perfectly capable of serving simply amounts to outdated, counterproductive, post office socialism. That in turn would unfairly harm private entrepreneurs through an abuse of government power, impose higher costs on consumers, and retard the economy.

Congress, in fact, should actually enact legislation returning USPS to providing only its traditional postal monopoly services, until it agrees to give up its current monopoly protections and other special legal privileges. Once it agrees to such a change, the USPS can be free to pursue any markets in whatever combinations it chooses.