

Improving the U.S. Postal Service as a Public Service Government Agency

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In December 2002, President Bush established the Presidential Commission on the United States Postal Service for the purpose of proposing how the government provision of mail delivery services might be reformed or transformed. If postal reform proceeds incrementally in the form of an improved government agency, what policy changes must be adopted for the Postal Service? I identify two broad goals for postal reform. The first is to define the Postal Service's mission in terms of remedying conditions of market failure. This goal encompasses universal service, quality of service, and reasonableness of rates. The second broad goal is to avoid competitive distortions through the pricing and product offerings of the Postal Service. This goal entails avoiding government production in markets that are or can be served satisfactorily by private firms, as well as avoiding discrimination among mailers and among competitors in secondary markets. I then present specific recommendations that will advance these two broad goals if the Postal Service remains an agency of the federal government. Those recommendations encompass costing, universal service, rate design and mail classification, the postal monopoly, and market entry and exit.

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I. INTRODUCTION

In December 2002, President Bush established by executive order the Presidential Commission on the United States Postal Service.¹ The Commission's mandate is "to examine the state of the United States Postal Service, and to prepare and submit to the President a report articulating a proposed vision for the future of the United States Postal Service and recommending the legislative and administrative reforms needed to ensure the viability of postal services."² Among the topics that President Bush specifically instructed the Commission to evaluate are pricing, service quality, cost control, the effects of price regulation, universal service, the postal monopolies, competition against private firms, and governance and oversight of the Postal Service.³

This mandate for the Presidential Commission will elicit a range of policy recommendations on how to reform the Postal Service. The Postal Service itself prefers to discuss how it might be "transformed," and to that end it produced an inch-thick report in April 2002 called the *Transformation Plan*.⁴ The document outlined three alternative models for the Postal Service: an improved

1 Exec. Order, Dec. 11, 2002, available at <http://www.ustreas.gov/press/releases/reports/executiveorder.pdf> [hereinafter *Executive Order*].

2 *Id.* § 3(a).

3 *Id.* § 3(b). The Executive Order states in section 3(b):

In fulfilling its mission, the Commission shall consider the following issues and such other issues relating to the Postal Service as the Commission determines appropriate:

- (i) the role of the Postal Service in the 21st century and beyond;
- (ii) the flexibility that the Postal Service should have to change prices, control costs, and adjust service in response to financial, competitive, or market pressures;
- (iii) the rigidities in cost or service that limit the efficiency of the postal system;
- (iv) the ability of the Postal Service, over the long term, to maintain universal mail delivery at affordable rates and cover its unfunded liabilities with minimum exposure to the American taxpayers;
- (v) the extent to which postal monopoly restrictions continue to advance the public interest under evolving market conditions, and the extent to which the Postal Service competes with private sector services; and
- (vi) the most appropriate governance and oversight structure for the Postal Service.

Id. The President directed the Commission to submit a final report by July 31, 2003. *Id.* § 4(e). To that end, the Commission is empowered to hold public hearings and otherwise receive information from interested parties in both the public and private sectors. *Id.* § 5.

4 U.S. Postal Service, *Transformation Plan* (Gov't Printing Office 2002).

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government agency, a privatized corporation, and a commercial government enterprise (CGE).⁵ There are endless variations on these three models. In addition, there is implicitly a fourth option: the status quo.

Relatively little public policy analysis has focused on the first of these options, improving the Postal Service as a public service government agency. It is therefore useful to answer the following question: If one starts with the assumption that postal reform will take the form of making a better government agency, what policy changes should be adopted for the Postal Service? This exercise regards the Postal Service as a public service that Congress said “shall be operated as a basic and fundamental service provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress and supported by the people.”⁶ The analysis presumes that Congress will continue to give the Postal Service the mission to “bind the nation together through the personal, educational, literary, and business correspondence of the people.”⁷ Implicit in this public service model is the continuation of the Postal Service’s various monopolies and its universal service obligation (USO).

It is useful to imagine a “better” Postal Service because policymakers might rationally prefer government provision of postal services to other obvious alternatives. There are at least four economic reasons why this could be so. First, although economists tend to ignore the possibility, consumers may place considerable value on having certain postal services supplied by an arm of the federal government. Consumers may have these preferences notwithstanding the economic benefits that economists predict would flow from privatization of a typical state-owned enterprise. The decision after the September 11th terrorist attacks to take airport security screening away from private contractors and entrust it to the new Transportation Safety Administration may be an example of this kind of consumer preference. Economists routinely say, “You can’t dispute tastes.” If that is so, then it is neither consistent nor practical to deny that consumers may prefer to have an employee of the federal government coming onto their property to deliver mail that may contain confidential personal information, checks, and other sensitive matter. Perhaps this preference, to the extent that it exists, is rooted in consumer ignorance about the alternatives. If that possibility were true, it would mean that more ambitious postal reform could not proceed until a massive campaign of public education and persuasion had first freed consumers of their naïveté.

⁵ In previous writings, I have analyzed and recommended the last two organizational forms as models for reform of the Postal Service. See J. GREGORY SIDAK & DANIEL F. SPULBER, PROTECTING COMPETITION FROM THE POSTAL MONOPOLY 158-59 (AEI Press 1996). My conception of a commercial government enterprise, however, differs substantially from the Postal Service’s.

⁶ 39 U.S.C. § 101 (a).

⁷ *Id.*

Second, no matter how good a proposed restructuring of the Postal Service looks on paper, the recent experience from other network industries—such as telecommunications, electricity, and airlines—is a reminder that large-scale policy initiatives can produce unintended consequences that are worse than the status quo. It should not be surprising, therefore, that Congress and the President may wish to approach postal reform incrementally. That is not to say resignedly that more ambitious reformation or transformation of the Postal Service is impossible. Rather, a preference among policymakers to undertake incremental reform may be an acknowledgment that “ideal” policy initiatives of a more ambitious nature often reveal themselves to contain warts, and that experienced politicians consequently are leery of them.

A third and related hypothesis is the most obvious public choice explanation: Politics may constrain the feasible set of outcomes in the sense that one or more interest groups may have the political influence to block more expansive change, such as privatization. This possibility is especially plausible in the case of the Postal Service. It has 800,000 voters in its work force, and Congress regularly enacts omnibus appropriations bills that contain riders prohibiting the closure of specific post offices, typically in small towns.

Fourth, the characterization of the status quo may be misleading. As noted above, there are three broadly defined ways to organize the Postal Service: a public service government agency, a commercialized government enterprise, or a privatized corporation. The Postal Service obviously is not the third form. But is it currently closer in form to the first or the second? A strong case can be made that the Postal Service today operates as a public service government agency in name only. In other words, the operations of the Postal Service today may have strayed so far from the agency’s legislative mandate, and the enterprise may be so immune from effective oversight by any political entity, that it is most appropriate to say that the Postal Service enjoys the privileges and immunities of its governmental status without bearing the full public service responsibilities that are the justification for such status. The Postal Service’s current desire to be transformed into a commercial government enterprise would simply continue an existing trend. If the challenge of postal reform is seen from this perspective, then the Postal Service’s problems are evidence of the undesirability of organizing it *as a commercialized government enterprise*; those problems are not necessarily evidence that the Postal Service would be unable to improve its performance if it operated as a government agency that sought to discharge at the lowest cost a highly focused public-service mandate. In this sense, the challenge of postal reform is not to transform the Postal Service into a completely new kind of enterprise, but rather to return it to what Congress intended it to be.

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Today, the Postal Service is an enterprise that defines the extent of its own monopoly, revenue target, prices, and quality of service. Together, these powers make the Postal Service neither fish nor fowl. It clearly does not face the same kinds of constraints that competition and regulation impose on the typical private utility operating in a critical network industry such as telecommunications or electricity. Nor is the Postal Service today truly a disinterested provider of a narrowly defined public service.

The Presidential Commission will receive many specific recommendations for improving mail service in the United States. Two overarching principles can help the Commission determine whether specific recommendations would advance or retard economic welfare. The first principle is to define the Postal Service's mission so as to *remedy conditions of market failure*. This task encompasses universal service, quality of service, and the reasonableness of rates. The second overarching principle is to *avoid competitive distortions* through the pricing and product offerings of the Postal Service. This goal entails avoiding government production in markets that are or can be served satisfactorily by private firms, as well as avoiding discrimination among mailers and among competitors in secondary markets.

From these two general principles flow a number of specific recommendations for making the Postal Service a better public service government enterprise. Those recommendations encompass universal service, costing, rate design and mail classification, the postal monopoly, and market entry and exit. Collectively, these recommendations indicate that Congress must increase substantially the powers of the Postal Rate Commission (PRC) to oversee the Postal Service.

However, before Congress acts on these or any other specific recommendations that the Presidential Commission might embrace, it is appropriate for the PRC to conduct a comprehensive economic examination of the Postal Service. Such an examination would provide the objective, factual foundation that is necessary to reduce the currently high level of uncertainty surrounding the likely outcome of specific policy proposals.

II. UNIVERSAL SERVICE

Universal service exists as a policy because it is regarded as a public good that would be undersupplied by private firms. The Postal Service should have the responsibility to discharge a universal service obligation (USO), but it should not be the governmental entity that defines the USO. Currently, however, the definition of the Postal Service's USO is vague and its cost is unknown. This arrangement invites the possibility that the Postal Service will continually

expand its interpretation of the USO to consume all free cash flow that the agency can generate.

The PRC should supply a precise definition of the USO and require from the Postal Service an objective measure of the cost of the USO. There is a realistic possibility that the conventional wisdom about the costs of universal service is erroneous. For example, economists at the PRC have found empirical evidence that the cost of mail delivery in rural areas is virtually the same as in urban areas, in part because of the clustering of mailboxes along rural highways.⁸ The PRC should interpret the USO in light of the availability and affordability of other media of delivery and communications. Thus, the PRC should have the power to revisit the definition of the USO in light of changes in technology, consumer demand, or other relevant factors.

The quality of universal service depends on at least three considerations: (1) the definition of the scope of core services entitled to universality, (2) the ubiquity, or “reach,” of delivery, and (3) the frequency of delivery. In network industries subject to price-cap regulation, a regulated utility is expected to show improvements in productivity over time without any degradation in service quality. Whether or not a price-cap regime is adopted for the Postal Service, the PRC should have the authority to set productivity and service-quality targets for the Postal Service. The expectation should be that both productivity and service quality would rise over time.

Universal service depends not only on these three service-quality considerations, but also on the reasonable and nondiscriminatory pricing of core services that have been determined to be entitled to universality. Pricing issues will be addressed in greater detail in a separate section below.

The definition of universal service also should address the availability of retail and collection functions that are currently supplied by post offices. Some of those functions could be, and already are, supplied by private firms—such as the sale of postage over the Internet by Pitney Bowes, the leasing of private delivery boxes in retail outlets such as Mailboxes Etc., the placement of post offices in existing retail establishments such as Wal-Mart stores, and the collection of outgoing letters and parcels. It is not clear that all of these retail services would

⁸ See Robert H. Cohen, William W. Ferguson & Spyros S. Xenakis, *Rural Delivery and the Universal Service Obligation*, in REGULATION AND THE NATURE OF POSTAL AND DELIVERY SERVICES 161 (Michael A. Crew & Paul R. Kleindorfer, eds. 1993). A draft report by several of these same authors updates and confirms these results. See Robert H. Cohen, Matthew Robinson, John D. Waller & Spyros S. Xenakis, *The Cost of Universal Service in the U.S. and Its Impact on Competition* (Office of Rates, Analysis and Planning, Postal Rate Commission, Draft Mar. 25, 2003), available at <http://www.prc.gov/main.asp?Left=about.asp&Right=home.asp>. See also RICK GEDDES, *SAVING THE MAIL: HOW TO SOLVE THE PROBLEMS OF THE U.S. POSTAL SERVICE* 19 (AEI Press 2003).

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need to be provided on a universal basis in a given region by the same entity that provides universal *delivery* services.

Disaggregating the definition of the USO by core delivery functions and core retail and collection functions would help to identify the specific components of universal service that are subject to market failure. The total cost of universal service might be found to be smaller than previously believed, and the funding of universal service could be more productively targeted to the specific activities that truly are subject to market failure.

The PRC also should have the authority to close post offices. At a minimum, the PRC should be authorized to approve or reject the Postal Service's proposed closures and to order such approvals to take effect. This power should not be subject either to lengthy judicial review or to congressional micromanagement through appropriations riders or other means

Thus, the USO should be thoroughly reevaluated, taking into account electronic substitution, among other market factors. It cannot be expected, however, that Congress would enact legislation giving sufficient detail to make a new USO definition operational. An alternative public forum would likely be necessary to accomplish that task, and the undertaking may require greater research and deliberation than is possible during the short duration of the Presidential Commission.⁹ A rulemaking before the PRC would be the appropriate vehicle for assembling a public record.

III. COSTS

The accurate measurement of costs is critical to the proper operation of the Postal Service as a public service government agency. Along with demand estimates, cost data are the principal inputs in the rate-setting process. Accurate cost data are also necessary to evaluate the burden of providing universal service. Currently, the Postal Service has too much control over how it calculates and reports its costs.

The revenue requirement is the starting point for any rate case. Currently, however, the Postal Service sets its own revenue requirement, something that no state public utility commission would permit any telephone company or electric utility to do. The PRC should be able to reject the Postal Service's proposed revenue requirement and order an alternative revenue requirement of its own determination. For this and other ratemaking purposes, the PRC must have the power to subpoena the Postal Service to produce cost information and other relevant data. These reforms would simplify and expedite rate cases before the

⁹ Consequently, I do not recommend here how universal service should be defined.

PRC: If the PRC had subpoena power to force the Postal Service to supply accurate and complete cost data, then the Postal Service, knowing that the PRC had that power, would supply better data from the outset of a rate case.

The PRC should establish, outside a rate case, the general methodology for calculating attributable costs and institutional costs, and for allocating institutional costs to classes of mail. Rulemakings to determine this kind of methodological question are commonplace at state and federal regulatory commissions. By way of comparison, the most controversial and time-consuming question that the Federal Communications Commission (FCC) has faced since passage of the Telecommunications Act of 1996 has been the determination of the proper cost-based *methodology* to use to price competitor access to the local network.¹⁰ The FCC has addressed this methodological question in multiple rulemakings, even though state commissions are ultimately responsible for setting actual rates. The PRC should similarly establish general rules on costing methodology that the Postal Service and other parties must follow in all subsequent rate cases.

Regardless of the methods used to calculate the revenue requirement and categories of costs, the Postal Service needs the operational flexibility to cut large categories of costs. As implied by the earlier discussion of universal service, the Postal Service would have greater flexibility to reduce the cost of operating uneconomic post offices if the PRC had the authority to close them without congressional interference. More generally, the PRC should be empowered to disallow the recovery through rates of any cost item—including labor costs and capital expenditures—that it determines to be excessive, imprudently incurred, or otherwise unjustified. This kind of regulatory power is commonplace among state public utilities commissions.

IV. RATE DESIGN AND MAIL CLASSIFICATION

Rate design and mail classification can be improved by both procedural and substantive reforms. These reforms would change significantly the nature of the relationship between the Postal Service and the PRC.

A. *Increase the Power of the Postal Rate Commission*

The PRC should have greater powers over rate design and mail classification. It should streamline rate cases by deciding costing methodologies and mail classifications in separate proceedings. The PRC also should have the power to impose binding rates that the Postal Service cannot veto. The current veto power

¹⁰ See, e.g., Jerry A. Hausman & J. Gregory Sidak, *A Consumer-Welfare Approach to the Mandatory Unbundling of Telecommunications Networks*, 109 YALE L.J. 417 (1999).

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of the Board of Governors is unprecedented among regulatory agencies. In addition, the PRC should have the final authority to establish mail classifications.

B. *Do Not Fund the USO with Monopoly Rents*

The Postal Service should not fund its USO with monopoly rents from any class of mail subject to the Private Express Statutes. From a consumer welfare perspective, it would be regrettable if the nation's commitment to providing mail service to rural and other high-cost segments of the population were to deny *all* consumers of monopoly mail services the substantial benefits of having First-Class mail service at the price that would be charged in a competitive market. The traditional purpose of a statutory monopoly is to prevent cream skimming of high-margin customers by competitors who bear no USO. A statutory monopoly should not exist to charge a monopoly price to all customers of a core service.

There is no clear correspondence between the USO revenue deficiency and the monopoly rents generated for the Postal Service by the statutory monopoly over the delivery of letters. Funding the USO through monopoly rents sacrifices consumer welfare in classes of mail that provide the subsidy. Monopoly mail should make a reasonable contribution to the recovery of the Postal Service's institutional costs, but consumers should not be forced to pay monopoly prices for such mail.

C. *Rate Discounts Should Be Available to All Mailers and Be Based on Avoided Costs, Not Negotiating or Lobbying Skill*

In keeping with the goal of charging nondiscriminatory rates, the Postal Service should not offer negotiated service agreements (NSAs) or "contracts" to single mailers. Such agreements are simply means of engaging in price discrimination for the benefit of favored mailers; they are not in keeping with a government-provided public service.

A government public service should not engage in negotiating rates with selected mailers. First, the concept of an NSA—that the USPS would negotiate the rate with a selected mailer—is inconsistent with the principle that the PRC should have the final say in setting rates.

Second, rates for a government-provided postal service should be based on the costs of providing the service, not on the negotiating skill or gamesmanship of the particular mailer. NSAs conflict with the fundamental objective of the Postal Reorganization Act, which was to "get politics out of the Post Office" and instead base rates on costs, not lobbying skill. It is easy to conceive of one

mailer receiving a better rate than a similarly situated second mailer, due solely to the former's negotiating prowess or influence. As Professor John Panzar has shown in testimony before the PRC, there is no assurance that all classes of customers will benefit when a non-profit-maximizing firm such as the Postal Service engages in price discrimination.¹¹ And the Postal Service recently testified before the PRC that it currently lacks the infrastructure to handle more than a small number of NSAs, meaning that the likelihood of discrimination is great.¹²

Likewise, volume discounts unrelated to costs should not be allowed. A volume discount not based on costs would, by definition, treat larger mailers more favorably than smaller mailers. It would also tend to favor national mailers over local businesses, which may have smaller mail needs.

Furthermore, any private regulated firm negotiating a single-customer service contract would have a thorough, detailed understanding of the costs of serving that customer and of the savings or additional revenues that it would hope to gain. The Postal Service, however, is not organized to make these calculations. The Postal Service has no way to measure the costs that it actually incurs in serving a particular mailer. This is because the Postal Service's costing systems are based on estimates and extrapolations of large numbers on a class or subclass basis. These estimates and extrapolations are virtually worthless in determining the costs incurred by the Postal Service in handling any particular mailer's mail. As a result, the Postal Service appears to be institutionally incapable of making the kind of detailed, *a priori* cost analysis that any regulated private firm routinely performs before engaging in any negotiated contract.

Postal management may argue that NSAs provide incentives to mailers, such as through volume discounts, to mail more volume. This rationale has no merit for a public service government agency. The Postal Service does not have accurate information about either its own costs or the mailer's demand function and business plans. There is no reason to think that an NSA would not affect other private firms that compete with the favored mailer or that an NSA would somehow remedy a condition of market failure and not distort competitive markets.

For example, if the Postal Service were, via an NSA, selectively to reduce its rates for subclass *X*, it would artificially stimulate demand for greater mail output. That increased volume would have consequences beyond the superficial analysis of the unit revenue and unit cost of that volume alone. For example, it

¹¹ Testimony of John C. Panzar on behalf of the Postal Rate Commission, Experimental Rate and Service Changes to Implement Negotiated Service Agreement with Capital One Services, Inc., Dkt. No. MC2002-2 (Postal Rate Comm'n filed Jan. 16, 2003).

¹² Postal Rate Commission, Dkt. No. MC2002-2, Transcript Vol. 10, p. 1938 (Mar. 6, 2003, Cross-examination of USPS witness Michael K. Plunkett).

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is possible that, for some types of mail, a volume increase could also increase the costs of providing universal service because of the increased need to make delivery to all points. Unless the Postal Service's costing is completely reliable, that stimulation of demand could cause the cost of universal service to be overstated.

The possible overstatement of the cost of universal service would be particularly problematic if there were no market failure to be remedied by such discriminatory stimulation of mail volume. For example, there is no market failure in the supply of advertising: newspapers, magazines, television (over the air, cable, and direct broadcast satellite), radio, Internet websites and advertisements, billboards, and telemarketing are all substitutes for direct mail as a means of informing consumers about products and services that are offered for sale. Consequently, there is no reason to stimulate the demand for advertising mail. To the contrary, such pricing would distort competition in the advertising market between direct mailers and other carriers of advertising. If, because it lacked reliable cost data, the Postal Service priced direct mail below its true long-run incremental cost, then firms purchasing advertising would be encouraged to use a service that they valued less than the resources required to produce it. Meanwhile, sales of advertising would shift away from competitively supplied substitutes, which would have to cover their costs and earn a competitive return, lest they be discontinued by the private firms producing them.

D. Eliminate the Content Restriction Across Classes of Mail

Apparently for historical reasons, the Postal Service has long engaged in price discrimination based on the content of the mail. In particular, postal regulations require most forms of personal and personalized correspondence to be mailed at First-Class. For example, current postal regulations require, as a general matter, the following types of mail to pay First-Class rates:

- mail sealed against inspection
- mail containing handwriting
- actual and personal correspondence
- bills and statements of account

It is evident that these categories include a vast amount of mail, not all of which necessarily must arrive at its destination within the times set forth in the service standards for First-Class mail.

Content should not be the basis upon which rates are set for letter mail. Letter mail classifications should reflect only quality and cost characteristics, such as the speed of delivery, the costs of handling different shapes, and the degree of

privacy. There is no reason to believe that the current classifications of mail are the same ones that would be offered by a competitive postal marketplace. It is noteworthy that neither FedEx nor UPS prices its overnight letter products on the basis of content.

By requiring all “personalized” correspondence to be mailed at First-Class rates, the current content restriction harms the public interest in several ways. First, it raises costs to mailers, by forcing them to pay higher First-Class rates when they might be willing to pay lower rates for a lower delivery speed or quality of service. This effect also artificially increases the Postal Service’s costs by obligating it to provide faster, more costly First-Class service when a less costly, slower service would better suit the needs of certain mailers.

Second, the content restriction denies mailers choice. By forcing mailers into the “one-size-fits-all” of First-Class Mail, the Postal Service prevents mailers from having the opportunity to trade a lower cost for a slower speed service. The only real option available is the First-Class postcard rate, but that alternative suffers from serious size and privacy limitations. It is certainly plausible, for example, that an elimination of the content restriction in the current rate structure would induce greater product differentiation based on speed and quality of service. Currently, there is a substantial jump in price from First-Class mail to priority mail, but there is not a substantial improvement in product quality.

Third, the content restriction may force captive First-Class mailers to pay monopoly rates. For example, the markup (contribution per piece to overhead) for First-Class mail far exceeds that of Standard mail. Today, the PRC estimates that the average First-Class letter contributes 18.4 cents to institutional (overhead) costs, while the second-largest letter class—Standard Mail—contributes about 8.1 cents.¹³ That contribution amounts to a surcharge or tax of more than 10 cents per letter stemming directly from the content restriction.

As stated earlier, there is no reason to believe that a freely competitive market for letter mail would establish a content restriction or would price services on the basis of content. More likely, a competitive letter market would price on the basis of factors such as speed of delivery, shape (where, say, flat-sized pieces cost more to process, transport, or deliver than letter-shaped pieces), and service quality and reliability. It is likely that the service offering the faster, more secure delivery would have both higher costs and a pricing premium. Mailers would be free to choose whether they wanted to pay for that extra service.

¹³ Postal Rate Commission, Opinion and Recommended Decision, Dkt. No. R2001-1, Appendix G, Schedule 1 (projections for fiscal year 2003).

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Eliminating the content restriction in letter mail would reduce a substantial hidden tax, promote mailer choice, and help to realign the pricing structure for mail according to the service being delivered. Today, letter mail constitutes over 90 percent of the mail stream, which means that this reform would lead to the more efficient pricing of the vast majority of the mail.

For public policy reasons related to content, Congress does direct that certain types of mail—most notably nonprofit and periodicals—receive lower rates. Those preferential rates rest on additional policy issues that are outside the scope of this essay.

V. POSTAL MONOPOLY

The Postal Service has monopolies over the delivery of letters (the Private Express Statutes) and over access to the customer's mailbox. Currently, the Postal Service defines by regulation the scope of its own letter monopoly. This peculiar arrangement appears to be unique in the regulation of monopoly in the United States. Plainly, the Postal Service has no incentive to construe its monopoly narrowly. The Postal Service created an exception for "extremely urgent" mail only under the implicit threat that Congress otherwise would amend the statutory letter monopoly to permit firms such as Federal Express and United Parcel Service to deliver overnight mail. To the extent that the Private Express Statutes and mailbox monopoly are to be interpreted through the promulgation of regulations, the PRC should be the federal entity issuing those regulations. It should do so after a rulemaking process that includes a right of private parties to petition for rulemaking. On appeals of final agency actions by the PRC, the Department of Justice should urge the U.S. Court of Appeals to construe the Private Express Statutes and the mailbox monopoly as narrowly as possible.

The PRC also should enunciate the legal standard for predation and other acts of monopolization that would apply to the Postal Service's activities in markets outside its statutory monopoly. Recent academic research explains why a more demanding legal standard for anticompetitive conduct by state-owned enterprises is appropriate.¹⁴ Policy makers in Europe have taken note of this analysis. The Organization for Economic Cooperation and Development (OECD) has recognized that public enterprises, including posts, pose a greater threat of an-

¹⁴ See David E.M. Sappington & J. Gregory Sidak, *Incentives for Anticompetitive Behavior by Public Enterprises*, 12 REV. INDUS. ORG. (forthcoming July 2003); David E.M. Sappington & J. Gregory Sidak, *Competition Law for State-Owned Enterprises* (AEI Working Paper, Dec. 2002); David E. M. Sappington & J. Gregory Sidak, *Are Public Enterprises the Only Credible Predators?*, 67 U. CHI. L. REV. 271 (2000).

ticompetitive behavior than do private firms producing the same services.¹⁵ In 2001, the European Commission found that Deutsche Post had used profits from its state-granted monopoly in letter mail services to subsidize efforts to dominate the parcel delivery business in Germany by pricing below cost and undercutting competitors.¹⁶ The PRC should adopt regulations that prohibit anticompetitive pricing of this nature.¹⁷

VI. MARKET ENTRY AND EXIT

Currently, the Postal Service appears to maximize output (number of pieces of mail) or some combination of output and other goals, all ostensibly in the furtherance of its USO. Because neither loss-minimization nor profit-maximization is required of the Postal Service, the enterprise has an incentive to engage in a continual “mission creep” into categories of mail (as well as non-mail products and services) that have less and less to do with “binding the nation together” through universal mail delivery. This economic prediction is consistent with anecdotal evidence that the management of the Postal Service seems to focus on volume maximization. A colleague and I wrote in 1995: “The Postal Service no longer seeks to plug gaps in the provision of public services. Rather, it seeks to divert business from private firms in existing and emerging industries.”¹⁸

A March 2003 report filed by the Postal Service at the PRC supports this assessment and concedes the inherent riskiness of the agency’s ventures into such non-postal services as prepaid calling cards and electronic bill payment.¹⁹ The Postal Service stated:

Like any venture that depends on creating value and attracting revenue, the Postal Service needs the room to try new things, spread risk, stimulate innovation, and have flexible access to marketplace skills through partnerships. As with any new business initiative, it is reasonable to expect that some offerings

¹⁵ ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, COMMITTEE ON COMPETITION LAW AND POLICY, PROMOTING COMPETITION IN POSTAL SERVICE 55 (Series Roundtables on Competition Policy No. 24, DAFPE/CLP(99)22, Oct. 1, 1999).

¹⁶ Case COMP/35.141, *Deutsche Post AG*, 2001 O.J. (L 125) 27 at ¶ 36.

¹⁷ In 2002, the U.S. Court of Appeals for the Ninth Circuit held that the Postal Service cannot invoke (almost all categories of) sovereign immunity to defeat antitrust claims. *Flamingo Indus. (USA) Ltd v. U.S. Postal Serv.*, 302 F.3d 985, 988-89 (9th Cir. 2002). The Ninth Circuit found that the Postal Service lost its sovereign status upon enactment of the Postal Reorganization Act of 1970, which provided: “The Postal Service shall have the . . . power to sue and be sued in its official name.” *Id.* at 989 (quoting 39 U.S.C. § 401(1)).

¹⁸ SIDAK & SPULBER, *supra* note 5, at 158-59.

¹⁹ See U.S. Postal Service, Report on Nonpostal Initiatives (filed Mar. 10, 2003, Postal Rate Comm’n).

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will meet planned objectives while others will not. Undertaking new services requires a look forward and thus involves inherent risk.²⁰

Previous ventures illustrate how risky the Postal Service's entry into non-postal markets can be. In 1998, the General Accounting Office found that, from 1995 through 1997, the Postal Service lost more than \$84 million on its development and marketing of non-postal products.²¹ In addition to prepaid telephone calling card and electronic commerce services, those money-losing non-postal products included a remittance service, REMITCO, which the Postal Service ultimately scrapped.

The PRC should have the authority to approve, disapprove, or impose conditions on the Postal Service's entry into new markets. The proper analysis concerning product development and market entry should consist of two questions. The first question is, "Is there a market failure that necessitates that a government-owned enterprise produce a particular good?" If there is no market failure at all, or if there is a market failure that can be rectified by means other than the production of the particular good by a government-owned enterprise, then the Postal Service should not produce that good. If there is a market failure, the second question should be, "Will provision of the product by the Postal Service enhance its ability to deliver its core services?" The burden of proof should be on the Postal Service. The Postal Rate Commission should give public notice of the Postal Service's application to enter a new market, and interested parties should be entitled to file comments and reply comments in support of, or in opposition to, the application.

A government enterprise like the Postal Service may enjoy privileges and immunities that would give it a competitive advantage over private firms in the production of many goods and services. But such privileges and immunities should be granted to advance only the inherently governmental functions of the enterprise, not its commercial functions. By way of comparison, Federal Prison Industries employs low-paid federal prisoners to make products that by statute must be purchased by agencies of the federal government. But the inherently governmental function of rehabilitating and training convicts at less than minimum wage would not justify Federal Prison Industries' production of every good that could conceivably make a marginal contribution to the agency's revenue adequacy. To the contrary, these privileges to undercut efficient competitors and allocate government procurement contracts exist to permit Federal Prison Industries to achieve its inherently governmental mission of rehabilitating and training federal prisoners. The Postal Service's product developments and mar-

²⁰ *Id.* at 10.

²¹ GENERAL ACCOUNTING OFFICE, U.S. POSTAL SERVICE: DEVELOPMENT AND INVENTORY OF NEW PRODUCTS (GAO/GGD-99-15, Nov. 24 1998).

ket entry should be judged with a similar view to whether this public service government agency is advancing its essential mandate.

The PRC also should have the power to compel the Postal Service's exit from any market that is outside the core services covered by its USO. The PRC should issue an order to exit after an evidentiary proceeding. The PRC should be able to commence such a proceeding on its own motion or in response to a petition filed by an interested party. In a rulemaking, the PRC should establish the economic and other factors relevant to deciding whether the Postal Service must exit a market. In the same rulemaking, the PRC should allocate the burden of proof.

VII. CONCLUSION

Much can be done to make the Postal Service a better public service agency of the federal government. Two overarching principles should guide specific recommendations for postal reform. The first principle is to define the Postal Service's mission so as to *remedy conditions of market failure*. This task encompasses universal service, quality of service, and the reasonableness of rates. The second overarching principle is to *avoid competitive distortions* through the pricing and product offerings of the Postal Service. This goal entails avoiding government production in markets that are or can be served satisfactorily by private firms, as well as avoiding discrimination among mailers and among competitors in secondary markets. A stronger Postal Rate Commission is necessary to ensure that the Postal Service operates consistently with these two general principles.

From those two principles flow a number of specific recommendations for making the Postal Service a better public service government enterprise. Those recommendations encompass universal service, costing, rate design and mail classification, the postal monopoly, and market entry and exit:

Universal Service

- The PRC should supply a precise definition of the USO and require from the Postal Service an objective measure of the cost of the USO.
- The PRC should have the authority to set productivity and service-quality targets for the Postal Service.
- The USO should be thoroughly reevaluated, taking into account electronic substitution, among other market factors.
- The PRC should have the power to close post offices.

Improving the U.S. Postal Service as a Government Agency

Costs

- The PRC should be able to reject the Postal Service's proposed revenue requirement and order an alternative revenue requirement of its own determination.
- The PRC should have the power to subpoena the Postal Service to produce cost information and other relevant data.
- The PRC should establish, outside a rate case, the general methodology for calculating attributable costs and institutional costs, and for allocating institutional costs to classes of mail.
- The Postal Service should have the operational flexibility to cut large categories of costs.
- The PRC should be empowered to disallow the recovery through rates of any cost item—including labor costs and capital expenditures—that it determines to be excessive, imprudently incurred, or otherwise unjustified.

Rate Design and Mail Classification

- The PRC should streamline rate cases by deciding costing and mail classifications in separate proceedings.
- The PRC should have the power to impose binding rates that the Postal Service cannot veto.
- The PRC should have final authority to establish mail classifications.
- The Postal Service should not fund its USO with monopoly rents from any class of mail subject to the Private Express Statutes.
- Rate discounts should be available to all mailers and be based on avoided costs, not negotiating or lobbying skill.
- Volume discounts unrelated to costs should not be allowed.
- The content restriction in letter mail should be eliminated to reduce a substantial hidden tax, promote mailer choice, and help realign the pricing structure for mail according to the service being delivered.

Postal Monopoly

- To the extent that the Private Express Statutes and mailbox monopoly are to be interpreted through the promulgation of regulations, the PRC should be the federal entity issuing those regulations.

- On appeals of final agency actions by the PRC, the Department of Justice should urge the U.S. Court of Appeals to construe the postal monopolies as narrowly as possible.
- The PRC should enunciate the legal standard for predation and other acts of monopolization that would apply to the Postal Service's activities in markets outside its statutory monopoly.

Market Entry and Exit

- The PRC should have the authority to approve, disapprove, or impose conditions on the Postal Service's entry into new markets.
- The PRC should have the power to compel the Postal Service's exit from any market that is outside the core services covered by its USO.

These proposals would benefit consumers and increase economic efficiency. The Postal Rate Commission would become a more effective regulator, and the Postal Service would become a better public service government agency.