**Final Comments to the President's Commission**
**on the United States Postal Service**
**Submitted by**
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**<u>Question:</u>**
**"*From a public policy standpoint, should a government enterprise with monopoly protections be allowed to compete in the commercial marketplace?"*** *(Commissioner Joseph Wright)*

Recently Deputy Postmaster General John Nolan responded to Commissioner Wright's policy question by proffering that "*universal service*" [mail delivery] might no longer be self-sustainable at "*affordable*" postage rates while advocating that the Postal Service seek to subsidize its mail delivery obligations with profits from increased competitive activities. General Nolan argues that the public policy benefits of preserving the magnitude of the Postal Service's massive infrastructure and status-quo definition for "*universal-service*" outweighs the negative effects created by such incursions into the private sector while claiming to know of *"ways to ensure that competition remains fair "*.

General Nolan's rational for encouraging the postal monopoly to participate in competitive markets is based on a series of fundamentally flawed assumptions:

**Flawed Assumption #1 – The "*ever-increasing delivery network*" is creating an insurmountable economic burden and jeopardizing affordable mail service.**

> *"If declining volumes and revenues, combined with an ever-increasing delivery network obligation, cause the Postal Service to become non-viable due, in part, to an inability to broaden its product line and the services offered, is that investment in people, facilities, equipment, and transportation to be viewed as a sunk cost and written off as the communications needs and business capabilities of the nation change?"*
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> *"There is recognition that a serious financial problem is looming that can prevent the Postal Service from carrying out its mission of universal service at affordable prices…" (DPMG Nolan)*

General Nolan presumes the somewhat intuitive, albeit unfounded notion that the normal growth in postal delivery points poses a significant economic burden, which requires the Postal Service to seek ever-increasing revenues from sources outside its mail monopoly.

- According to the Postal Service's 2002 Annual Report, between 1999 and 2002 the number of total postal delivery points increased by 5.3 million or 4%, while the total number of mail carriers, <u>the only significant cost center that could possibly be impacted by increased delivery points</u>, actually declined by more than 3,300 or roughly 1%.

- The number of delivery points normally increases by roughly 1.7 million or 1% per year, however the geographic territory does not expand, and contrary to conventional wisdom postal services do not enjoy significant <u>economies of scale</u> but instead benefit greatly from <u>economies of density</u>. In effect, increasing the number of delivery points increases delivery density and thus lowers the marginal cost-per-delivery-point system-wide.

- Additionally, notwithstanding claims by postal managers that they lack the flexibility necessary to modify service standards in order to increase efficiency, the agency has maintained a moratorium on new " to-the-door" delivery points for several years. Consequently, the overwhelming majority of recently added points have been either drive-up rural boxes or increasingly, centralized cluster boxes - both significantly less costly to service than conventional door delivery; further driving down the average cost-per-delivery-point on a system-wide basis.

**Flawed Assumption #2 - The Postal Service is capable of subsidizing universal service with profits from competitive activities.**

> *"Certainly, the monopoly on both letter mail and the mailbox is one method that has mitigated the erosion of a portion of postal business to competitors and provides an underpinning for the USO. However, technology is rendering the letter mail monopoly less effective in ensuring that a base volume is available. The ability to expand current products and services and to be allowed to branch out into related endeavors would be another way to help sustain the investment." (DPMG Nolan)*

There is no evidence to support General Nolan's assertion that the Postal Service is a viable market participant capable of deriving profits from its competitive activities. Overwhelmingly the opposite is true and its competitive ventures windup being subsidized by captive monopoly ratepayers…

- Since the Postal Reorganization Act of 1970 (PRA) first encouraged the Postal Service to enter competitive markets some thirty years ago, the agency has squandered countless millions, if not billions of monopoly ratepayer dollars by subsidizing a seemingly endless series of failed commercial follies without creating a single significant success.

- The Postal Service generates only 15.5% of its total revenues, and less than 12% of its gross profit (contribution to institutional cost) from all its non-monopoly services combined (Priority Mail, Express Mail, Mailgrams, Parcel Post, International Mail, Money Orders and Box/ Caller Service). As a timely point of reference, one might note that the employees of major airlines that are still fortunate enough to have jobs recently took wage cuts in larger percentages than the non-monopoly share of Postal Service revenues.

- The Postal Service derives 88% of its total gross profit directly from monopoly services at an average margin of 41% while non-monopoly services barley average a 30% gross margin.

- With overhead (institutional cost) calculated at 39% of revenue, and non-monopoly services averaging a mere 30% margin, clearly these non-monopoly activities are not providing any significant subsidy to the agency's universal service obligation (USO) and fail to even cover their fair share of overhead.

- Disturbingly, 66% of the total non-monopoly contribution to institutional cost is derived from Priority Mail, a product frequently criticized for being aggressively misrepresented to the American consumer as a 2-day expedited service while failing to meet that expectation as much as 25% of the time.

- Although the agency's often-criticized accounting practices make it impossible to confirm, it is both possible and plausible that the overhead required to administer its non-monopoly competitive activities well exceeds their collective contribution to overhead, especially considering the agency's massive advertising budget, legions of marketing representatives and layer-upon-layer of "product" related managers.

- The reverse subsidy of competitive products becomes even more evident when considering the agency's two lowest margin non-monopoly products, International Mail and Parcel Post, gross margins of 10.8% and 12.4% respectively. The leanest of private sector enterprises would be hard pressed to survive on such thin margins. There can be no doubt that captive monopoly ratepayers have been directly subsidizing these products for many years, not the other way around.

- In recent years the Postal Service has made countless attempts to enter emerging growth and small business markets totally unrelated to its core mail delivery mission. It develops commercial real estate, rents post office roof tops for antenna sites, sells stationery, envelopes, mailing labels, tee shirts, ball caps, jackets, sweatshirts, vests, passport photos, money orders and prepaid calling cards. The agency provides data and remittance processing services, sells information technology and digital signature services; maintains a commercial website at www.usps.com offering electronic bill payment services, online greeting cards and printing services as well as a host of other e-commerce related services.

Collectively, these mostly failed or failing ventures have cost captive monopoly ratepayers countless millions of dollars without producing a single revenue source worthy of footnoting on its financial reports. Every single one of these commercial attempts were financed and subsidized by captive monopoly ratepayer dollars.

**Flawed Assumption #3 - The greater good is served by distorting markets and dislocating private enterprises in an effort to artificially hold down postage costs.**

> *"How does one make sense of a structure that calls for government ownership of the Postal Service while structuring it to compete in the marketplace? Go back to the mission of the Postal Service and ask if it is an important one to carry out even in this changing environment. I think the answer to that is "yes." With that as a given, it only makes sound public policy to ensure that the costs of fulfilling that mission are minimized for the benefit of all. Maintaining the monopoly and allowing the Postal Service to compete in a defined portion of the marketplace are two important parts to the achievement of that objective."*
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> *"Selling greeting cards, packing services, soft drinks, passport photos, etc., are all examples of products or services offer by the Postal Service at retail that have caused problems in this regard, yet would appear natural for an organization to undertake to maximize the return on its retail investment in order to fund the universal service obligation." (DPMG Nolan)*

The affordability of postal costs is strictly contingent upon controlling expenses, adjusting service levels and improving productivity, none of which would benefit from postal management's distracting focus on competitive activities. If the time comes when users of the mail can no longer support mail delivery then certainly good public policy mandates that the burden of maintaining service levels not be borne solely by those with which the Postal Service chooses to compete.

- The Postal Service will always be the high-cost provider in any market it attempts to enter. It has a highly paid unionized workforce, large bureaucratic management structure, expensive employee benefits, and costly work rules. The only way the Postal Service can ever obtain commercial success in a competitive market is by cross-subsidizing those commercial efforts with captive monopoly funds and/or by leveraging its governmental status for unfair competitive advantage – neither of which makes for good public policy.

- General Nolan implies that it was "good public policy" when, for example, the Postal Service devastated nearby small passport photo businesses by offering sales-tax-free passport photos processed by monopoly paid for postal-workers equipped with cameras capitalized by low-cost loans from the U.S. Treasury at property-tax free monopoly funded post office facilities.

  Although dubiously favorable economic policy for the Postal Service, this hardly represents good public policy, and is even worse policy if in fact the Postal Service actually loses money on every passport photo it sells, as is likely the case. Information gleamed from the most recent rate case indicates it costs the Postal Service more than 20-cents on the dollar to sell postage through its own "retail network" [read post offices] versus 2-cents on the dollar for postage sold through drug stores and supermarket chains – one can only imagine the true cost of having a postal clerk process someone's passport photo or provide custom packaging services.

**Flawed Assumption #4 - A level-playing field can be maintained by balancing various competitive advantages and disadvantages.**

> *"Indeed, although some of the Postal Service's competitors have expressed concern that a more liberalized Postal Service will unfairly tip the competitive balance against them, there are ways to ensure that competition remains fair."*
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> *Maintaining the monopoly and allowing the Postal Service to compete in a defined portion of the marketplace are two important parts to the achievement of that objective. Supporting provisions of any law enacted to provide this capability can be added to help ensure as level a playing field as possible without losing the fundamental objective sought. (DPMG Nolan)*

General Nolan perpetuates the mythical "level playing field" so frequently cited in policy discussions about commercial government enterprises and assumes lawmakers, regulators and postal officials can somehow *dance on the head of a pin* in order to maintain a delicate balance between the ever-changing public interest derived from the attempt to subsidize current "*universal service*" levels and the economic distortions created by the postal monopoly being unleashed upon various private markets.

- Private sector efficiency and survival is driven by competition for capital, human resources and facility location(s) as much as by competition for market share. Government sponsored enterprises compete only for market share; they are not concerned with bankruptcy nor do they compete for capital resources. It is the fear of death that drives private-sector efficiency, not the desire to capture market share.

- The Postal Service has vast capital resources, virtually unlimited when compared to small businesses. Any competitor with unlimited capital resources can buy their way into the market of their choosing.

- The belief that competitive advantages inherent to a government enterprise are capable of being mitigated by offsetting restraints erroneously assumes governmental advantages have an equal effect on all participants within a market and across multiple markets. For example the vast capital resources and retail network available to the Postal Service impact a small retailer far differently than a large retailer like Walmart.

- The Postal Service has had a long history of abusing its regulatory powers to disadvantage competitors. For example, in 1999 it foisted draconian regulatory requirements upon its competitors operating private mail and parcels centers without providing any substantiated justification or requisite regulatory impact analysis. More recently it nearly destroyed the emerging online-postage industry by forcing vendors to charge high sign-up fees and administer an overly cumbersome registration procedure while refusing to pass-on any of the potential savings expected from more efficient mail processing.

**Conclusion:**

In the end, the cost of providing postal services at various service levels is what it is. If demand for those services is diminishing, public policy dictates that the massive scale of the Postal Service, pricing structures, service levels, and efficiencies must be adjusted to meet the reduced demand.

Allowing or encouraging a governmental monopoly to freely enter competitive markets is not only poor public policy, but a dangerous one as well. An aggressive, massively capitalized Postal Service free to disrupt small-business markets could easily cause irreparable harm to this important job-creating segment of our Nation's economy.

Masquerading the cost of providing postal services by siphoning money from other private sectors of the economy for the sole purpose of institutional preservation does not serve the greater good, nor will it prove effective in the end.

A desire to maintain the Postal Service's massive size and current "universal service" levels does not trump our Nation's free-market and pro-competitive policies.