

## COMMUNICATIONS

### ABOLISHING THE POSTAL MONOPOLY: A COMMENT

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First class postage rates have been raised once again in an effort to curb the Postal Service's financial problems. This scenario, which has taken place regularly every two or three years, has resulted in first class rates rising faster than inflation. In most industries, an "easy" solution of this kind is not possible because businesses must compete to survive. But then, as Miller (1985) emphasizes, the Postal Service is facilitated by a monopoly on first class mail. Where did the monopoly come from in the first place? Should the Postal Service be allowed to keep avoiding the realities of the marketplace?

My view of the beginning of the postal monopoly is pragmatic, as is Miller's, but I also view the growth of this public monopoly as cyclical rather than constant. Miller says that the Constitution gives only Congress the right to conduct postal business. Furthermore, he says the Postal Service took on itself the responsibility for defining a "letter" and thereby cinched its own monopoly. I believe the Post Office felt the need to do so historically because there has always been a sizable contingent which did not respect the monopoly provision, especially if service was poor and rates high. Periodic challenges have taken place, often under the benign neglect of the government if not its official sanction. The historical record suggests that

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the freedom to communicate efficiently has been regarded as more important by Congress than the government's monopoly.

Miller asks, "Is the postal monopoly justified?" He answers that the standard economic justification is that the Postal Service production process satisfies certain technical conditions termed "increasing returns to scale" so that its average costs decline with volume. This should enable it to provide mail service on an exclusive basis cheaper than any other combination of firms. Miller doubts that the econometric evidence shows that the Postal Service is a "natural monopoly" and notes that if it were, it should be able to produce postal services at the lowest possible cost. Therefore, it would not need the protection of legislation. This is a good argument.

In fact, the Postal Service assumes that it is an efficient "natural monopoly" but nevertheless complains about creamskimmers. This is ludicrous. Its price not only exceeds its average cost for first class mail but it actually exceeds the costs of beginning entrants operating at low volume. Under the "natural monopoly" assumption, the average cost of these new entrants—because they operate at low volume—should be much higher than the average cost of the monopolist. The Postal Service is caught on the horns of a dilemma: either the Postal Service is not much of a "natural monopolist" or it is in violation of the terms of reorganization because its price is above its average cost. If we note that a Minnesota firm delivers third-class mail, which is already a low-rate mail, in rural areas at a price below that charged by the Postal Service and still earns a profit, it is not difficult to conclude that the Postal Service is extremely inefficient.

Parenthetically it does little good to use the relatively modern concept of "natural monopoly" first coined by Henry C. Adams around 1910, to justify a government monopoly that dates back almost to the founding of this country. Underscoring this point even more, the concept of "natural monopoly" is today being discredited by economists (see Hazlett 1985).

From my work I have found that technically the Postal Service produces under "increasing returns to scale," or "decreasing average costs."<sup>1</sup> These estimates of the coefficients of the production and cost

<sup>1</sup>Using a weighted measure of total mail volume  $Q$  for all classes of mail and the Cobb-Douglas production function, I have estimated the parameters of the production function for the Postal Service as follows:

$$Q = 4.81 L^{1.46} K^{0.09} \quad \text{adj. } R^2 = 56.1\%$$

(0.908) (0.224) (0.059)

where  $L$  and  $K$  are quantities of labor and capital. The standard errors are in parentheses. The sum of the exponents of  $L$  and  $K$  is 1.55, which indicates increasing returns to

functions, however, are *irrelevant* for a business which is not forced by competitive incentives to be efficient. Indeed gross inefficiencies in management and production render estimates of the coefficients useless for determining economies of scale or the nature of costs. In a government-owned enterprise not subject to competitive pressures or the profit motive, resources are not utilized efficiently nor are costs minimized, thereby violating an important assumption for estimating coefficients of production and cost functions from regression analysis.

The X-efficiency literature (the classic article being Leibenstein 1966), which I believe is applicable to this case, suggests that competition in all postal activities would lead to lower costs because it would improve the incentives to operate efficiently. In short, the inefficiency of a government monopoly such as the Postal Service is so large that it offsets any economies of scale that otherwise might be enjoyed.

But back to the question of the original justification for the government monopoly. Government ownership cannot really be separated from the postal monopoly as Miller tries to do. The Post Office was a government enterprise because the government wished to use it to aid economic development. This was to be done by performing numerous activities in the so-called public interest through the Post Office because private enterprise would not undertake them voluntarily. These public-service chores were designed to bind the nation together with universal communication service at uniform rates, especially in rural areas. Specifically the plan was as follows. It was first decided that certain public services needed to be supplied by the government. To do this, a government-run Post Office was instituted. Because these public services demanded funding over and above the revenues normally commanded by a delivery service, a machinery for raising additional funds was needed. Subsidies from the public treasury could be used as a last resort, but it was thought that it would be more desirable for the Post Office to be substantially self-funding. In effect, a monopoly on first class mail was instituted

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scale, a technical characteristic of a natural monopoly. My estimate of the parameters of the total cost function is as follows:

$$C = 5.87 Q^{0.606} \quad \text{adj. } R^2 = 21.7\%$$

(1.383) (0.156)

where C = total costs. The exponent of Q is 0.606, which indicates that the average cost function declines with increasing quantity, another technical characteristic of a natural monopoly. Further details will appear in my forthcoming monograph on deregulating the Postal Service, which is being published by the Cato Institute.

to allow the Post Office a competitive advantage that would assure that sufficient revenues were generated.

At this present point in history, however, the original reasoning evaporates. The present-day situation is such that the completion of the original public service tasks, as well as the changing communications technology, have reduced the postal mission to a daily delivery chore. It is unlikely that the Postal Service would still be a monopoly if it were not owned by the government. Why should the government rather than the private sector now deliver the mail? The burden of proof for the postal monopoly, as Miller correctly states, now lies on the government just as it did in the beginning.

Miller correctly notes that the actual costs of the postal monopoly are difficult to measure because they apply primarily to first-class mail while the Postal Service delivers four classes of mail and is either unable or unwilling to allocate costs adequately to all types of mail. The discrepancy between the Postal Service's actual costs and what they could be if they operated efficiently are also difficult to measure for lack of data, but it is suspected by many that this discrepancy may be very large (in excess of 50 percent).

The lack of incentives reduces efficiency which in turn leads to a failure to hold down wages, innovate successfully, and utilize labor efficiently. How has the Postal Service been able to cover up its excessive costs (approximately \$14 billion per year)? Bakers cover their mistakes with whipped cream; doctors bury theirs; the Postal Service raises first-class postage rates.

The solution proposed by Miller to the chronic financial difficulties in the Postal Service is to repeal the private express statutes and thereby end the postal monopoly. This is a sensible and timely idea. Miller's solutions will restore efficiency to the mail delivery service.

One fear of this policy solution, mentioned frequently in congressional hearings and addressed by Miller, is that rural residents will lose service or be faced with higher rates. Miller tries to allay the fears of rural residents by pointing to the experience in airline deregulation. Miller shows concern for rural mailers by suggesting that, should there be a significant diminution in rural postal services as a result of deregulation, a subsidy program for rural delivery could be implemented. This would be similar to the program that supports rural air service. The costs of this subsidy are estimated at \$26 million per year, a small price to pay for such an appealing remedy.

What, however, will become of the Postal Service and its 700,000 employees? Without further changes in the Postal Service, I doubt it could survive repeal of the private express statutes. By itself this action, I predict, will speed up the demise of the Postal Service and

possibly put a greater strain on the public treasury. Is there a way of launching the Postal Service that will increase its chances for survival? I think so. Repeal of the private express statutes, accompanied by other deregulatory measures, needs to be coupled with divestiture and privatization. Privatization will remove taxpayer liability from the Postal Service's mismanagement and also provide the incentive for the Postal Service to succeed. Divestiture will open up the postal industry to competition at many levels and divide the Postal Service into several smaller companies which would be more easily managed and provide more opportunities for different forms of innovation. Deregulation, the most important part of which is repeal of the private express statutes, will free the Postal Service to compete in any line of business it wants to enter on an equal footing with other private businesses, and also remove from the Postal Service other special government granted privileges.

### References

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