

RESTRUCTURING THE U.S. POSTAL SERVICE

Robert Carbaugh and Thomas Tenerelli

From 1775 when Benjamin Franklin was appointed as the first postmaster general of the United States, the agency known as the U.S. Postal Service (USPS) has grown to become an institution that delivers about half of the world's mail in rain, snow, and the dark of night. Employing about 656,000 workers and 260,000 vehicles and operating about 38,000 facilities nationwide, the USPS is the second-largest civilian employer in the United States, after Wal-Mart. If the USPS was a private sector company, it would rank 28th in the 2009 *Fortune* 500 (U.S. Postal Service 2010).

The USPS is obligated to provide a uniform price and quality to all Americans, irrespective of geography. Although the USPS is often mistaken for a government-owned corporation such as Amtrak, it is an independent branch of the federal government; it is controlled by a board of governors and a postmaster general and it is regulated by the Postal Regulatory Commission. The USPS is structured to operate like a business, financing its operations through the sale of postal products and receiving no direct taxpayer subsidies.

The USPS is proud of its efficiency gains. For example, 10 years ago it took 70 employees one hour to sort 35,000 letters. Today in an hour, only two employees process an identical volume of mail. Though the number of addresses in the nation has increased by nearly 18 million in the past decade, the number of employees who

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Robert Carbaugh is Professor of Economics and Thomas Tenerelli is Assistant Professor of Economics at Central Washington University.

handle the increased delivery load has decreased by more than 200,000 (Potter 2010a).

Also, the USPS appreciates its high levels of national on-time performance (e.g., 96 percent for first-class mail) and a 94 percent customer satisfaction score. It also reminds Americans that its services are a global bargain. For example, a 2010 first-class letter mailed in the United States costs 44 cents. The same letter mailed in other countries would cost (in equivalent prices in U.S. dollars) 47 cents in Canada, 64 cents in Great Britain, 77 cents in Germany, 83 cents in Japan, and \$1.25 in Norway.

However, the USPS is currently at a tipping point due to the combined effects of a large recent decline in volume and revenue that is projected to extend into the future, as well as increases in operating costs. Although the USPS has enacted an array of revenue-generating and cost-cutting activities, these measures likely are not sufficient to eliminate the gap between revenue and costs. Will the business model of the USPS crumble, resulting in its operations again being supported by taxpayer subsidies as they were at one point?

This article, which is an extension of Carbaugh (2007), discusses the economic problems of the USPS and possible changes in its structure that would help keep it solvent. It concludes that, given the state of technology, privatization probably is the only long-term solution for the USPS.

Nature and Operation of the Postal Service

Prior to 1971, the government provided postal services through its U.S. Post Office Department, an agency that received annual appropriations and heavy subsidies from Congress. Members of Congress influenced many aspects of the Post Office Department's service operations such as pricing of postal products and selection of managers.

In 1971 Congress replaced the U.S. Post Office Department with a new agency, the U.S. Postal Service. Since that time, the USPS has been an independent agency of the executive branch and it operates as a commercial entity, relying on the sale of postage, mail products, and services for revenue. The USPS is required by law to cover its costs, and it has not received taxpayer subsidies since the early 1980s. However, it does receive an annual appropriation from

Congress of about \$100 million (or 0.1 percent of its \$75 billion operating budget) as compensation for the revenue it forgoes in providing, through congressional mandate, free mailing privileges for the blind as well as absentee-ballot mailing for overseas military personnel. The USPS can and sometimes does borrow funds from the U.S. Treasury, subject to a limitation of \$3 billion per year and a total debt ceiling of \$15 billion. Thus, the 1971 legislation resulted in USPS's operating more like a business than a subsidized government agency.

The mission of the USPS is to provide the American public with trusted universal postal service at affordable prices. Universal service includes uniform prices, quality of service, access to services, and six-day delivery to every part of the country. To assure financial support for these obligations, Congress granted the USPS a statutory monopoly on the delivery of letters (first-class mail). It also restricted mailbox access to USPS mail. The U.S. Supreme Court has confirmed this privilege by ruling that it is illegal in the United States for anyone other than the employees and agents of the USPS to deliver mail pieces to letter boxes marked "U.S. Mail." The USPS maintains that eliminating or reducing its monopoly status would have a devastating effect on its ability to provide the affordable universal service that the country values so highly (U.S. Postal Service 2008b).

Although the USPS has a monopoly on the delivery of letters, FedEx and United Parcel Service (UPS) directly compete with USPS express mail and package delivery services, as they make nationwide deliveries of "urgent" letters and packages. Due to the USPS monopoly, however, these services are not allowed to deliver "non-urgent" letters and may not use U.S. Mail boxes at residential and commercial destinations. Also, they deliver packages which are larger and heavier than those the USPS will accept. Moreover, the USPS competes with a variety of electronic alternatives for sending correspondence. While the USPS may have a statutory monopoly, the reality is that there are alternatives for every piece of mail it handles.

The Financial Problems of the U.S. Postal Service

Although the USPS is structured to operate like a self-financing business, this model recently has not worked well. The rise of

e-mail and online bill-paying, competition from private delivery companies like FedEx and UPS, and the recession of 2007–09 have hit the USPS hard. In March 2010, former postmaster general John Potter acknowledged that his agency's efforts to keep pace have fallen short and that technology has made obsolete many aspects of the USPS business model (Potter 2010b).

The numbers reflect Potter's view. After realizing modest profits during fiscal years 2004–05, the USPS lost \$0.9 billion in 2006, \$5.3 billion in 2007, \$2.8 billion in 2008, \$3.8 billion in 2009, and \$8.5 billion in 2010. From fiscal year 2006 to 2009, its debt increased from \$2.1 billion to \$10.2 billion. This resulted in the U.S. Government Accountability Office's placing the USPS on its "high risk" list in 2009 (U.S. GAO 2009a). Simply put, the financial problems of the USPS are not going away as future trends suggest stagnant-to-declining revenue and stable-to-increasing expenses: a fundamental change has occurred in the business outlook of the USPS.

Stagnant or Declining Revenue

In fiscal year 2009, the revenue of the USPS totaled \$68 billion. About 88 percent of this revenue was generated by market-dominant products including first-class mail, Standard Mail, and other products. First-class mail (correspondence, bills, payments, statements, and advertising) generated 52 percent of the revenue and it is the most profitable segment for the Postal Service. Standard Mail (bulk advertising and direct-mail solicitations) generated 25 percent of the revenue. Other market-dominant products (periodicals, parcel post, library mail, and bound printed matter) generated 11 percent of the revenue. The remaining 12 percent of USPS revenue came from competitive products, including Express Mail, Priority Mail, bulk parcel post, and bulk international mail (U.S. GAO 2009b).

However, the revenue of the USPS has been stagnant or declining in recent years. During fiscal years 2008–09, for example, revenue declined from \$75 billion to \$68 billion. Although postage rate increases helped support the total revenue of the USPS, they were more than offset by reductions in mail volume, which resulted in decreases in total revenue.

As mail volume declined by 35 billion pieces (about 17 percent) from fiscal year 2007 to fiscal year 2009, the financial position of the USPS deteriorated. The decline in volume stemmed from

reductions in the use of the highly profitable first-class mail and also Standard Mail. Total mail volume in fiscal year 2010 decreased to about 167 billion pieces, the lowest level since fiscal year 1992. By fiscal year 2020, the USPS estimates, at best, further volume decreases of about 10 percent, to about 150 billion pieces, the lowest level since 1986 (U.S. GAO 2010).

The demand for mail delivered by the USPS has been decreasing as consumers and businesses shift to electronic communication and payment alternatives: in economic jargon, the demand for mail has become more price elastic. For example, Americans are increasingly filing tax returns electronically and electing to receive refunds electronically, rather than resorting to direct mail. Also, the decline in mail volume accelerated with the recession of 2007–09, especially among users in the financial and advertising sectors: to cut costs, many companies have shifted from direct-mail advertisements to online advertising.

In the past, mail volume generally rebounded after recessions. However, the forecasts of the Postal Service and private consulting companies such as Boston Consulting Group (Boston Consulting Group 2010) and McKinsey & Company (McKinsey & Company 2010) imply that much of the recent decrease in volume will remain the case. Both first-class mail and Standard Mail face growing competition from electronic alternatives, increasing the probability that their volume will decline in the future.

The revenue losses of the USPS also have been reinforced by downtrading from first-class mail to Standard Mail, which offers a lower price on postage for the work performed. For Standard Mail, you must do some of the work the USPS would otherwise do, such as preparing, sorting, and entering your mail. To put things in revenue perspective, it takes 2.5 pieces of Standard Mail, on average, to equal the revenue from the average piece of first-class mail.

In 2006 Congress passed the Postal Accountability and Enhancement Act (PAEA) that was intended to provide increased opportunities for the USPS to generate additional revenue. It granted the USPS greater flexibility to set prices, test new postal products, and retain earnings so that it could finance necessary capital investments and repay its debt. The PAEA terminated the former rate-making structure that consisted of a lengthy and litigious process. Under the new structure, the USPS has broad

authority to announce rate changes that are not in violation of legal requirements. Except for periodic rate increases, however, the actions of the USPS to generate revenue have achieved limited results.

The price flexibility of the USPS is limited by a price cap on the Consumer Price Index that generally applies to market-dominant classes of mail, such as first-class mail and Standard Mail. This implies that the USPS has the flexibility to increase some individual rates either above or below the rate of inflation as long as the average rate of increase for each class of mail does not exceed the cap. The USPS can request that the Postal Rate Commission approve a rate increase that is greater than the price cap on the basis of extraordinary or unexpected circumstances.

Looking forward, increasing postal rates may boost revenue in the short run but would risk depressing mail volume and revenue in the long run, in part by accelerating diversion of mail to competing electronic alternatives. Although the USPS has asked Congress for permission to offer new nonpostal products and services (such as banking and insurance) to generate additional revenue, allowing the USPS to compete with the private sector could result in losses for the USPS and invite complaints about unfair competition. Therefore, the revenue-raising potential of the USPS remains in doubt.

The recent decrease in postal revenue and the expected future trend of revenue losses expose weaknesses in the business model of the USPS, which has relied on growth in mail volume and revenue to cover costs. The USPS has not been able to decrease costs fast enough to offset the accelerated decrease in mail volume and revenue. Moreover, government and private forecasters unanimously agree that the reduction in mail volume of the USPS will be a continuing, long-run problem. Financial insolvency of the USPS would place it in violation of federal law; the ramifications of being in violation are unclear. Although the law is silent on this matter, the risk of a taxpayer bailout of the USPS is high.

Inflexible Costs and Declining Profitability

Not only has the revenue of the USPS been declining, but the trend of its operating costs is upward. A key driver of the cost of delivering mail is the obligation to deliver to virtually every mailing address, regardless of volume, six days a week. Fulfilling this

universal service obligation requires 36,000 post offices, stations, and branches. It also involves 220,000 vehicles, \$2.6 billion in air transportation, and 600 processing facilities. These costs are largely fixed in the short term, and they increase with the size of the postal network, which has grown by an average of 1.4 million new addresses every year. As a result of the growth in fixed costs and increases in other expenses, the total cost per piece of mail rose from 34 to 41 cents from 2006 to 2009. As volume continues to decrease and the number of addresses increases, the cost to deliver each piece of mail will keep rising, while revenue per delivery point falls.

Also, the USPS has to bear many costs that normal businesses do not encounter—for example, not being able to close uneconomic post offices because few members of Congress want a post office closed in their district. The USPS is required to provide adequate, prompt, reliable, and efficient services to all communities, including rural areas and small towns where post offices are not self sustaining. Before closing a post office, the USPS must provide customers with at least 60-days notice before the proposed closure date, and any person served by the post office may appeal its closure to the Postal Regulatory Commission.

Furthermore, maintaining the USPS retail network will become increasingly expensive. Post offices tend to be more costly to operate than other means of serving customers. The average post office transaction costs 23 cents per dollar of revenue in 2009, while the average transaction at a contract postal unit cost just 13 cents, as seen in Table 1. In the past, post offices generated almost all postal retail revenue. Today, however, 29 percent is generated through usps.com and other alternative channels. Post offices recorded 117 million fewer transactions in 2009 than 2008, adding to the network's overcapacity. Yet, with retail revenues forecasted to decline in the future, even more post offices will be pushed into the red.

Wages and benefits account for 80 percent of USPS costs, a percentage that has remained steady over the years despite major advances in technology and automatic postal operations. The USPS estimates that its total workforce costs will increase from \$53.1 billion in 2009 to \$77.2 billion in 2020, assuming no action is taken to reduce workforce costs; annual increases are expected in workers compensation of 2 to 4 percent, health insurance premiums of 4.7 to 5.2 percent, and retiree health benefits costs of 11.8 percent.

TABLE 1
TRANSACTION COSTS OF THE U.S. POSTAL SERVICE, 2009

Outlet Type	Average Cost per Dollar of Retail Revenue
Average Post Office* (Postage and Packages Only)	\$0.23
Contract Postal Unit	0.13
Online Postage (Click-N-Ship, PC Postage, eBay)	0.8–0.12
Kiosk (Automated, Self Service)	0.12
Stamps by Mail, Phone, Internet	0.08
Retail Partners	0.2–0.7

*Average cost for all retail transactions at a post office is \$0.31–\$0.39 per dollar of retail revenue.

SOURCE: U.S. Postal Service (2010: 8).

Health care in particular will grow at a pace well above inflation-capped price increases for market-dominant classes of mail. While the USPS has collaborated with its unions to structure compensation options, federal statutes hamper its ability to craft a market-based benefits package (U.S. Postal Service 2010).

A significant portion of USPS costs stems from PAEA, which requires the USPS to prefund its future retirees' health benefits at an accelerated rate of about \$5.4 billion per year for the first 10 years of the 50-year liability; any remaining obligation is to be amortized over the subsequent 40-year period. Prefunding health benefits is unique to the USPS within the public sector, and it is not required in the private sector. The effect of this massive accounting charge is to temporarily increase the total costs of the USPS by 9 percent a year. As mail volume and revenue have declined in recent years, the USPS has experienced a cash shortage and has been on the verge of not being able to fulfill this accounting obligation. As a temporary solution, the federal government enacted legislation in 2009 that allowed the USPS to reduce its payment to its retiree health-benefits fund by \$4 billion, from \$5.4 billion to \$1.4 billion, for the year 2009. However, the USPS must repay this sum after fiscal

year 2016. As for fiscal year 2010, there is significant uncertainty as to whether or not the USPS will have the cash required to fulfill its prefunding obligation for retiree health benefits (Kosar 2010).

Despite rising health obligation costs, the USPS was able to reduce its operating costs by about \$6 billion in response to the rapid decline in revenue during 2008–09. Through aggressive cost cutting, the USPS reduced the number of employees and overtime, renegotiated with suppliers to obtain more favorable terms, reached agreements with its unions to expedite the adjustment of delivery routes, imposed a moratorium on new construction, provided retirement incentives for about 30,000 employees, and eliminated nonessential programs and projects. However, even ignoring the accelerated health prefunding obligation, these decreases in costs were less than the decreases in revenue, resulting in increasing losses for the Postal Service and an increase in outstanding debt.

Moreover, the productivity of the USPS decreased in 2009, following eight straight years of productivity growth. Postal Service economists use a single indicator called total factor productivity (TFP) to measure productivity. It measures the change in the relationship between output (mail volume) and inputs (labor, materials, and capital assets): output minus resources used equals TFP. During 2008–09, TFP decreased 0.9 percent. In spite of a record reduction of 115 million work hours, efforts to efficiently utilize material such as supplies and services, and efforts to maximize the return on capital investments, the USPS was unable to completely offset the 12.7 percent drop in mail volume resulting from the poor condition of the economy and the movement to online communications. Therefore TFP declined (U.S. Postal Service 2009).

The self-financing model of the USPS survived for many years as mail volume and revenue increased with a growing economy. In recent years, however, mail volume and revenue have decreased and it appears that this will be a continuing problem. Despite cost-cutting efforts, the USPS has not been able to reduce costs fast enough, or generate sufficient revenue to offset the accelerated decline in mail volume and revenue. For most businesses, there is nothing unusual in this scenario; they must constantly adapt to market changes and evolving technology. However, the flexibility of the USPS to adapt to changing market forces is greatly hampered by congressional restrictions placed on it.

The Role of the Postal Unions

Concerning labor compensation and benefits, USPS contracts are with four labor unions—American Postal Workers Union, National Association of Letter Carriers, National Postal Mail Handlers Union, and National Rural Letter Carriers Association. More than 85 percent of the USPS career employees are covered by non-incentive-based collective bargaining agreements which include COLA-based raises. Non-bargaining employees, who represent only 15 percent of career employees, receive pay increases through a pay-for-performance program; these employees do not receive automatic salary increases, nor do they receive COLAs or locality pay. Table 2 highlights the compensation and benefit payments of the USPS during fiscal year 2009.

In considering benefits, unions have been able to negotiate lucrative packages from the USPS. Not only are federal (and state) government retiree benefits higher than those of the private sector, but the USPS pays a higher percentage of employee health benefit premiums than other federal agencies—about 80 percent versus 72 percent. Also, the USPS pays 100 percent of employee life insurance premiums, while other federal agencies pay about 33 percent.

As for total compensation, in 2009 the average USPS worker received about \$79,000 in wages and benefits (Office of Management and Budget 2010: Tables 10.2 and 10.3). This compares to \$59,900 of wages and benefits received by the average worker in the private

TABLE 2
U.S. POSTAL SERVICE COMPENSATION AND BENEFITS
EXPENSES, 2009
(Millions of Dollars)

Compensation	\$39,208
Retirement	5,917
Health Benefits	5,294
Workers' Compensation	2,223
Other	512
Total	53,154

SOURCE: U.S. Postal Service (2009: 44).

sector in 2009. Although these data are not adjusted for factors such as worker skill and working conditions, they suggest that the Postal Service unions have done well for their members. This pay advantage is most pronounced in benefits, which are expected to increase in the future due to growing pension and health care costs (Edwards 2010).

The data above are consistent with the research of Wachter, Hirsch, and Gillula (2001), who found a total compensation premium (wages plus benefits) of 44 percent for postal workers compared to workers in the private sector. Their analysis breaks down as follows. First, using a cross sectional wage regression and 1998 data, they found a 36 percent “wage only” premium for postal workers compared to private sector workers. Importantly, their analysis controls for a variety of measures of skill, working conditions, and training differences across occupations in addition to controlling for the usual background (e.g., education, hours, and experience) and demographic variables included in standard wage regressions. Thus, inclusion of these variables in the analysis attempts to answer the question: How much more does a postal worker get paid compared to another worker with the same characteristics and the same working conditions and whose job requires the same skills?

Meanwhile, again using 1998 data, Wachter, Hirsch, and Gillula (2001) find a total compensation premium that is about 8 percentage points higher than the “wage only” premium, after comparing benefits (including health, life, and accident insurance; the value of paid leave; and retirement plans) of bargaining unit postal workers to those of private sector workers. They conclude that the postal premium cannot be accounted for by unusually high unmeasured skill among postal workers. To the contrary, postal jobs and postal workers appear to have low levels of unmeasured skill as compared to their private sector counterparts. Finally, they find evidence of lower quit rates (almost three times lower) and higher application rates for postal jobs compared to private sector jobs. Both are consistent with a pay premium for postal workers relative to private sector workers.

Another comparison involves the USPS and its competitors, UPS and FedEx. According to the USPS, the wages and benefits that it pays its workers are generally comparable to those paid by FedEx and UPS (U.S. Postal Service 2008a). However, analysts

note that the management of UPS and FedEx has much more flexibility in how they use their labor inputs, which adds to worker productivity, as acknowledged by John Potter in his requests for greater organizational flexibility. This tends to enhance the cost competitiveness of these firms relative to the Postal Service.

The USPS will negotiate with its four largest unions on collective bargaining agreements that will expire in 2010 and 2011. These agreements include items such as cost-of-living adjustments, work rules, and layoff protections. The collective bargaining process is subject to binding arbitration if needed, as federal legislation forbids both postal workers the right to strike and management the right to a lockout. The ability of the USPS to ameliorate its labor cost burden is hampered largely due to the legally mandated arbitration process between the USPS and its labor unions that inhibits each of the following: wage reductions, the hiring of part-time workers, and outsourcing. The USPS also will need to consult on compensation and benefits with three management associations representing most of its other employees.

Restructuring of Foreign Postal Services: Lessons Learned from Abroad

Declining markets and inability to cut costs are not unique to the USPS, as postal services in other countries have experienced the same problems. How have these countries restructured their postal services?

Market liberalization, which results in a shift away from the traditional government-run monopoly model of postal operations, has been a successful process in many countries. For skeptics, the idea of liberalization is fraught with fears of post-office demise, a decline in either the quality or universality of postal service, and/or a significant increase in postal prices. However, these fears have not materialized in the countries which have liberalized their postal services. Rather, these liberalizing countries have shown the ability to offer affordable, reliable, universal, and increasingly efficient postal-delivery services.

It is important to note that while significantly increasing postal-service flexibility and opening up the postal market to competition, liberalization also has involved continuing government regulation of postal markets after the reform. Typically the regulator not only

mandates that universal service obligations are met, but also requires that markets previously dominated by an incumbent postal operator remain competitive. In addition, the government mandates service standards and pricing, in some cases. In New Zealand, for example, the government has a “deed of understanding” with the New Zealand Post under which it must maintain a specified number of post offices, keep the price of a stamp below NZ\$0.45, and refrain from implementing a rural service fee. Also, the New Zealand Post must provide 95 percent of households with letter-delivery service six days per week in addition to other minimum service standards (Geddes 2005).

The countries with the most extensive history regarding postal liberalization include Australia, Germany, New Zealand, Sweden, and the Netherlands. In these countries, liberalization has been achieved through commercialization of the postal service, a process that retains ownership by the government but introduces modern practices involving management, labor compensation, finance, marketing, and capital investment. Examples of commercialization are an initial reduction and eventual elimination of the postal monopoly, increased incentives for executive performance, and greater flexibility of management to increase efficiency and profitability. Liberalization also has occurred through corporatization of postal services, which results in stock ownership by the government and/or private sector and the new stock company’s operating under corporate law. If corporatization evolves to the point where stock is owned entirely by the public, the postal service becomes privatized.

One common manifestation of postal liberalization is diversification into nonpostal activities. Consultants at Accenture have found that diversification not only has a measurable impact on the performance of international posts, but also is what ultimately distinguishes high performers from low performers. They found five key areas of diversification that provide sizable opportunities for postal services: parcel services, logistics, retail with banking, integrated marketing, and document management. Finally, they note that building sizeable businesses in any of these areas requires resources, the development of new capabilities (often with the support of acquisitions or partnerships), time, and profound alterations in the postal business model in order to reduce and make more variable the legacy postal cost model

(e.g., the labor mix). They also found that as international posts are still building these businesses and implementing these changes, they tend to generate below-average profitability compared to industry benchmarks (Accenture 2010). Table 3 provides examples of foreign postal services, their ownership, and the extent of diversification into non-mail activities.

In the early stages of liberalization, most of the five countries from the above list reduced their postal monopoly and thus opened their postal services to competition. The exceptions are Germany and the Netherlands, which partially privatized their postal services by selling ownership shares to the public. When Germany and the Netherlands eliminated their postal monopolies in 2008 and 2009, they joined New Zealand (1998) and Sweden (1993) in having liberalized markets with no postal monopolies whatsoever. In addition, the United Kingdom (2006), the European Union (2011), and other countries have either implemented or announced plans to repeal their postal monopolies.

Based on these countries, some patterns have emerged regarding the outcome of postal liberalization. Overall, prices have not risen, productivity has increased, costs have decreased, the universal service

TABLE 3
FOREIGN POSTAL SERVICES, 2008

Country/Post	Ownership of Shares (% Government Owned/ % Privately Owned)	Non-Mail Revenue as a Percentage of Total Revenue
Australia (Australia Post)	100/0	44
Germany (Deutsche Post DHL)	31/69	87
Netherlands (TNT)	0/100	62
New Zealand (New Zealand Post)	100/0	44
Sweden (Posten AB)	100/0	47
United States (USPS)*	—	13

*The U.S. Postal Service is not currently corporatized.

SOURCE: Dieke, Niederpruem, and Campbell (2008); see also Accenture (2010).

obligation continues to be met, service quality measured by on-time delivery has not dropped, and overall customer satisfaction (though difficult to measure) seems to have increased. Table 4 provides examples of price reductions resulting from postal liberalization.

Germany's former postal monopoly, which has gone the furthest insofar as privatization is concerned, epitomizes many of the efficiencies gained by liberalization. Deutsche Post World Net was transformed by modernizing its compensation structure and importing managers from other industries, modernizing the mail and parcels network within Germany, and developing new products such as hybrid mail and e-commerce. Deutsche Post World Net has interests in not only the traditional mail and parcels business but also express mail logistics, banking, and more (Crew and Kleindorfer 2003).

It appears that the confluence of market forces in the face of a few critically maintained postal regulations has created an effective environment for maintaining affordable, reliable, and increasingly efficient postal delivery services. Is this really a surprise given economists' understanding of markets and their efficiency?

TABLE 4
CHANGES IN POSTAL PRICES INTERNATIONALLY

Country	Structural Reform	Changes in Real Prices for Single-Piece Letter
Netherlands (1989–2005)	Privatization	Down 20%
Germany (1989–2005)	Privatization	Down 21%
Sweden (1995–2005)*	Commercialization	Up 29%
New Zealand (1987–2004)	Commercialization	Down 30%
United States (1987–2005)	No Significant Reform	Down 2%

*Analyzing real price trends in single piece letters is somewhat misleading. For example, such analysis does not capture the significant price reductions in Sweden to large mailers, a trend likely to be replicated in other countries as markets are opened up. For further details on the Swedish situation, see Falkenhall and Kolmodin (2005).

SOURCE: Crew and Kleindorfer (2008: 124).

Commercializing the U.S. Postal Service

The difficulties facing the USPS are widely recognized: a significant decrease in the volume of items being mailed due to competition from e-mail, fax machines, and package delivery services as well as the effects of the recent recession, and a rise in expenses as wages and benefits have increased and communities have expanded so that there are more addresses requiring mail delivery.

The short-term challenge for the USPS is to reduce its costs fast enough to offset the decreases in volume and revenue, so that it can cover its operating costs and continue as a self-funding government agency. Over the long term, the challenge is to restructure USPS operations, networks, and workforce to reflect fundamental changes in mail volume and revenue and to better exploit opportunities for revenue growth.

To meet these challenges, Potter (2010) requested greater flexibility to begin a process of commercializing the USPS. Maintaining that no single option will be able to eliminate the projected deficits of the USPS, his plan for action includes a number of factors:

- Establishing a more flexible workforce that results in decreasing compensation and benefits expenses through retirements, early retirements, and reduced benefits.
- Increasing the authority of the USPS to control its labor costs. Currently, federal law requires the USPS to maintain compensation and benefits for all employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector, although arbitration hearings can be subjective on this matter. Also, current law does not require arbitrators to consider the financial condition of the USPS when rendering collective bargaining decisions. As long as the USPS continues to be in the hands of government, it is difficult to imagine Congress standing up to the postal unions and providing the USPS the labor flexibility it is requesting.
- Consolidating postal retail outlets and mail processing networks in order to reduce excess capacity. However, it is difficult to accomplish this goal. In 2009, for example, the USPS proposed consolidating about 3,000 postal outlets but, following congressional complaints, the number under consideration was reduced to 157 (DeHaven 2010).

- Generating revenue through new or enhanced products such as parcel services, cell phones, or banking services. Federal postal law currently limits the USPS to selling postage stamps, stamped paper, cards, envelopes, and the like. The USPS, under its current management structure, has a poor track record of expanding into products or services not protected by its monopoly.
- Providing the USPS with additional pricing flexibility that would enable it to generate more revenue. Currently, federal law allows the USPS to raise postage annually at a rate that does not exceed the Consumer Price Index. Although increasing postal rates may provide a short-term boost to revenue, it could risk depressing mail volume and revenue in the long term by accelerating diversion of mail to electronic alternatives.
- Changing funding requirements for retiree health benefits: eliminating prefunding, which results in higher current financial burdens in exchange for lower financial burdens in the future, and replacing it with a pay-as-you-go system.
- Reducing mail delivery from six days to five days per week. Notably, the revenue per delivery of the USPS has declined 20 percent from 2000 to 2009, paralleling the decrease in the number of mail pieces delivered per address. However, this request is meeting substantial resistance from the four postal unions, which do not want to see the six-day delivery schedule reduced, and from members of Congress who do not enjoy fielding calls from constituents angry over reductions in postal services.

Each of these possibilities has limitations, and there is no guarantee that they will be approved by the government. Therefore, the ability of the USPS to successfully commercialize its operation without added flexibility remains in doubt.

What the USPS needs is greater freedom when it comes to pricing, moving into alternative lines of business, cutting costs, and the like. It also needs a new institutional framework which provides incentives for postal managers to embrace changing market forces. These are things that privatization can provide. However, Congress has no immediate plans to give up control over the USPS. The question remains: If the Postal Service is unable to meet its financial challenges, will it again become a government agency subsidized by beleaguered taxpayers?

Conclusion

The USPS has faced escalating problems for years, squeezed by the rise of online bill-paying and e-mail and competition from private delivery companies, and being hit hard by the recent recession. Former postmaster general John Potter has acknowledged that technology has rendered obsolete many aspects of his business model and that technological innovation is not going away. Although Potter made attempts to commercialize the USPS by cutting costs and increasing revenue, those efforts have fallen short.

Moreover, it is unlikely that attempts to commercialize the USPS will come to fruition. Why? Based on current practice, the USPS will remain under the scrutiny of the federal government, because the USPS is part of the executive branch. With members of Congress making decisions about USPS operations (e.g., whether uneconomic post offices should be closed), it will remain less than fully commercialized and thus will have less business flexibility than a private company.

Simply put, the governance structure of the USPS is flawed, and its ability to realize commercial success is very limited. A better approach would be for U.S. lawmakers to follow the example of countries which have rejected the concept of government-enforced monopoly on mail delivery and exposed their former monopoly mail providers to competition.

Looking forward, there are several keys to successful liberalization of the USPS. First, it must be given the flexibility to adjust and adapt to market forces in the most cost-efficient and profitability-enhancing ways possible. To achieve this end, USPS operations must be de-politicized and government influence over the USPS must be largely eliminated. While corporatization has achieved this goal in many international posts that have successfully liberalized, it does not provide the additional benefits of privatization, as discussed below.

Also, incentives for successful operations must be an instrumental part of the organizational structure of the USPS. However, neither the Potter plan nor corporatization provides sufficient incentives for postal executives to take full advantage of any gains in flexibility. Partial-to-complete privatization (nongovernmental ownership of a stock company) creates incentives for profitability for several reasons. First, privatization creates a publicly traded stock whose

price creates a barometer of corporate effectiveness. It also creates shareholders who apply pressure on executives to perform and who can punish executives who do not. In addition, privatization increases public scrutiny of postal operations once the USPS joins the quarterly ritual of earnings announcements and their associated public commentary in the business media and elsewhere. While partial privatization creates some of the needed incentives, the greater the degree of privatization (public versus government ownership of the stock) the greater will be the incentives.

While full privatization is preferred, partial privatization is an attractive initial option. One reason is that it tends to be politically more acceptable and therefore has a greater chance of being implemented. Moreover, partial privatization likely will begin an inevitable process of moving toward full privatization as voters and politicians increasingly realize that the benefits of privatization far exceed any costs in terms of price and/or service reliability.

Although liberalization will result in the elimination of many regulations, the remaining regulations should be restricted to satisfying a few key goals. The first goal is to maintain certain priorities and principles embraced by the population—candidates include the universal service obligation, service standards, and price caps. The purpose of this first goal is to alleviate any concerns about postal liberalization and privatization. The second goal is to have effective antitrust regulation of the newly private post. The large size of the post office, diversification into new markets, and any maintained postal monopoly will create the potential for unfair business practices which must be vigorously monitored. The third goal is that any remaining postal monopoly must be clearly delineated.

Lastly, the postal monopoly must be removed eventually. Removal of the postal monopoly creates an added incentive for effective operation of the USPS. However, complete removal of the monopoly does not need to occur at the onset of privatization. Alternatively, the postal monopoly can be eliminated over time. Such a policy alleviates the concerns of the public, politicians, and capital markets about the successful continued operation of the USPS. This increases the acceptance of privatization by each of these essential groups. Also, as with partial privatization, it likely begins an inevitable process of properly aligned incentives, postal profits, and increasing public scrutiny which culminates in enormous political pressure for complete removal of the monopoly.

Germany and the Netherlands offer relevant case studies. When they partially privatized, they initially maintained the government monopoly but eventually progressed to complete privatization and complete removal of the monopoly. Currently, Germany and the Netherlands are two of the most effective international posts on at least one important benchmark—non-domestic revenue. These countries were number one and two, respectively, in Accenture’s analysis of “non-domestic revenue” as a percentage of total revenue among 24 international posts in 2008 (69 percent and 68 percent, respectively, with the remaining posts all falling below 36 percent).

Given the state of technology, privatization is probably the only long-term solution for the Postal Service. However, the USPS is currently so burdened with government interference that investors likely would not touch it. If the U.S. government were to eliminate onerous regulations and if the Postal Service were to revise its business model along the lines recommended by former postmaster general John Potter, then privatization might become more feasible, and investors might become more interested.

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