

Restructuring the U.S. Postal Service

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Mr. Chairman and members of the committee, thank you for inviting me to testify. I will discuss the current predicament of the U.S. Postal Service (USPS) and suggest major reforms.

The USPS is a large business enterprise operated by the federal government. It has more than 600,000 employees and more than \$70 billion in annual revenues. Revenues are supposed to cover the postal service's costs, but mail volume is plunging, and the USPS has been losing billions of dollars a year for more than a decade.

The USPS has a legal monopoly over letters and mailboxes. That policy is an anomaly because the federal government's general economic stance is to encourage open competition in markets. The USPS monopoly means that entrepreneurs are prevented from entering postal markets to try and improve quality and reduce costs for consumers.

While mail volume has fallen, the USPS has expanded its package business. But it makes little sense for a privileged government entity to take business from taxpaying private businesses in a competitive industry. Postal and package markets are evolving rapidly, and the goal of federal policy should be to create a level playing field open for competition and innovation.

Europe is facing the same challenges of declining mail volumes, and it has focused on opening postal markets and privatizing postal providers. America should follow suit. The USPS should be privatized and postal markets opened to competition. Those reforms would give the USPS the flexibility it needs to cut costs and innovate, while creating equal treatment of businesses across postal and package markets.

USPS's Predicament

Congress confers on the USPS monopolies over the delivery of first-class mail and access to mailboxes, the latter of which is a unique protection among world postal systems.

The USPS also enjoys a range of other benefits:¹

- It can borrow up to \$15 billion from the U.S. Treasury at low interest rates.
- It is exempt from state and local sales, income, and property taxes, and from parking tickets, vehicle fees, and other charges.
- It pays federal corporate income taxes on its earnings from competitive products, but those taxes are circulated back to the USPS.²
- It is not bound by local zoning laws, is immune from a range of civil actions, and has the power of eminent domain.

- It has government regulatory power, which it can use to impede competitors.

On the other hand, Congress ties the hands of the USPS in many ways, which prevents it from operating like a private enterprise. Congress restricts the USPS's pricing flexibility, requires it to provide expansive employee benefits, imposes collective bargaining, and prevents it from cutting costs in various ways, such as by reducing delivery frequency and closing low-volume post offices.

The USPS's financial challenges stem from its high cost structure and the falling of first-class mail volume 45 percent from 104 billion pieces in 2001 to 57 billion pieces in 2018.³ That decline has been a blow because first-class mail is the USPS's most profitable product.⁴ The decline in mail volume has been driven by the rise of email, Facebook, Evite, Internet bill paying, and online advertising.

The USPS has lost \$69 billion since 2007 and will likely continue losing money unless there are major reforms.⁵ The USPS has \$110 billion in unfunded liabilities for retiree pension and health care, and its workforce is accruing more retirement benefits every year.⁶ Without major restructuring, the USPS is expected to lose tens of billions of dollars over the next decade. The Government Accountability Office (GAO) has put the USPS on its "high-risk" list for its dismal financial outlook.

Incremental Reforms

The USPS is bleeding red ink and the company's finances will likely get worse. The Trump administration is correct that "USPS's current model is unsustainable."⁷

To its credit, the USPS has taken steps on its own to reduce costs, including reducing employment, consolidating mail facilities, and reducing post office hours. But more needs to be done by the USPS and Congress.

The following are some steps that policymakers should take to improve efficiencies and help stem the losses.

Close Post Office Locations. The USPS operates more than 31,000 post offices.⁸ Low-volume locations should be closed. A USPS estimate from a few years ago found that the bottom 4,500 locations average just 4.4 customer visits a day.⁹ Yet when the USPS tries to close locations it is often blocked by Congress. When private businesses have falling demand for their products they save costs by cutting lower-value activities. The USPS should do the same.

Cut Labor Costs. Labor costs account for more than three-quarters of USPS costs. By some measures, USPS labor compensation is higher, on average, than for comparable private-sector workers.¹⁰ A U.S. Treasury analysis for 2017 found that employee costs at USPS averaging \$85,800 were higher than \$76,200 at UPS and \$53,900 at Fed Ex.¹¹

The USPS has \$110 billion in unfunded liabilities for retiree pension and health benefits.¹² A 2006 law requires the USPS to begin paying down its health care liabilities, but the company has been defaulting on these funding requirements.¹³ Also, the USPS has not made all of its required payments for employee pension costs in recent years.

There is debate about whether the USPS should pre-fund its health costs or whether obligations should be moved to Medicare and imposed on taxpayers. However, an equally important issue is

the need to cut retirement benefits going forward. For decades, the private sector has been moving away from defined-benefit pension plans, and very few private employers offer retiree health benefits.¹⁴ Congress should cut USPS retirement health benefits and offer new postal employees a defined contribution pension plan only.

End Collective Bargaining. Collective bargaining agreements cover about four-fifths of the USPS workforce. Such agreements reduce business flexibility. The GAO noted that USPS collective bargaining agreements “have established salary increases, cost-of-living adjustments, and the percentage of health insurance premiums paid by employees and USPS.”¹⁵ Disputes are handled in binding arbitration where there is no requirement for USPS’s dire financial condition to be considered.

The administration’s postal Task Force recommended removing USPS compensation from collective bargaining, noting that other federal workers do not enjoy that privilege.¹⁶ But why not remove collective bargaining from the USPS altogether? Just 6.4 percent of workers in the U.S. private sector are members of labor unions.¹⁷ The goal should be to move the USPS toward private-sector labor and compensation standards.

Narrow the Universal Service Obligation (USO). The federal government has adopted an expansive USO for the USPS including six-day delivery, uniform letter pricing, and other rules.¹⁸ The United States has a more expansive USO than many other countries.¹⁹

An expansive USO might have made sense in a world before email when there was a higher mail volume. Today, it is not paper mail that “binds the nation together,” but rather email and the Internet. That is especially true for younger Americans. For young adults, the number of mail pieces received per week fell from 17 in 2001 to just 10 in 2017.²⁰ Millennials pick up and review their mail far less frequently than older Americans, and they are far more likely to pay their bills online.²¹

Congress should reduce the number of days of mail delivery and provide USPS more pricing flexibility. Another cost-cutting option would be the greater use of cluster boxes for residential delivery.

Ending Cross Subsidies. The USPS is not supposed to use earnings from monopoly products (mainly letters) to subsidize competitive products (mainly packages). However, some analysts think that the USPS is cross-subsidizing based on the way it allocates its institutional or overhead costs. The administration Task Force noted, “the USPS’s ability to price last mile delivery and the delivery of small packages below those of private sector competitors distorts package markets.”²²

In a 2015 study, economist Robert Shapiro found that the USPS uses profits on its monopoly products to subsidize express mail and package delivery.²³ Shapiro estimated that these cross-subsidies are \$3 billion or more a year. From the perspective of private package firms, this is unfair competition. Unlike the USPS, private firms must pay federal, state, and local taxes.

The Task Force noted that the USPS is “distorting overall pricing in the package delivery market” and that “the USPS’s current cost allocation methodology is outdated, leading to distortions in investment and product pricing.”²⁴ In January, the Postal Regulatory Commission (PRC) adopted a rule for the USPS to increase the share of institutional costs allocated to its package business, but the share may be still too low to reflect full costs.²⁵

Over the past decade, the USPS has been capturing an increasing share of the overall U.S. package market.²⁶ This is a concern because the USPS does not pay taxes and is perhaps leveraging its protected postal monopoly to subsidize the expansion.

USPS package delivery has been in the news because roughly one-third of Amazon's massive deliveries go through the USPS.²⁷ Meanwhile, Amazon accounts for about one-quarter of the USPS's package business.²⁸ The details of Amazon's deal with the USPS are private, which is troublesome given that the USPS is a public agency. Analysts figure that Amazon is getting a deep discount compared to published USPS rates, and they have raised questions about whether the USPS is earning a reasonable return on the deal.

Fed Ex and UPS are large users of USPS's last mile delivery. At the same time, the USPS contracts to Fed Ex for air transportation and other services. The USPS is getting increasingly entangled with private businesses. That would be fine if USPS were a private and unsubsidized firm, but it is not.

Fed Ex pays an average \$2 billion a year in taxes to federal, state, and local governments.²⁹ UPS typically owes between \$1 and \$2 billion a year just in income taxes.³⁰ The USPS pays no taxes. That is not a level playing field and it creates fairness problems and distortions.

The USPS is becoming less of a mail company and more of a package company. In 2018, first-class mail revenues were \$25 billion and falling, while shipping and package revenues were \$22 billion and rising.³¹ The future is on the package side of USPS's business, and the best way to embrace that future is with a privatized corporate structure.

Privatization and Competition

The postal and package markets may change dramatically in coming years as new technologies and upstart companies disrupt the major players. Amazon is pressing ahead with its own delivery systems while Uber-style delivery firms may grow in importance.

Congress should privatize the USPS, repeal its legal monopolies, and give the company the flexibility it needs to innovate and reduce costs. We should allow entrepreneurs to compete in the postal industry.

Privatization may sound radical to American policymakers, but a privatization revolution has swept the world since the 1980s. Governments in more than 100 countries have transferred thousands of state-owned businesses to the private sector. Railroads, airports, postal systems, and other businesses valued at more than \$3 trillion have been privatized.³²

Many academic studies have been done on these reforms, and the results are clear. In his book examining hundreds of reforms, finance professor William Megginson concluded, "Private ownership must be considered superior to state ownership in all but the most narrowly defined fields or under very special circumstances."³³ Furthermore, "the weight of empirical evidence on the state versus private ownership question . . . now strongly supports those who believe that private ownership is inherently more efficient than state ownership. This is true even for natural monopolies."³⁴

With regard to postal reforms, Europe has led the way. The European Union has pressed its member nations to open their systems to competition, and some nations have privatized their

main postal companies.³⁵ The United States ranks near the bottom of the Consumer Postal Council's 26-country "Index of Postal Freedom."³⁶

The Netherlands privatized its postal company in the 1990s, and then opened postal markets to competition in 2009. Britain opened postal markets to competition in 2006 and privatized the Royal Mail with share offerings in 2013 and 2015.³⁷ Some countries, such as Austria and Italy, have sold shares in portions of their national postal companies.

Germany began privatizing Deutsche Post with a stock offering in 2000 and opened its postal markets to competition in 2008. A 2019 European report by the Escher Group on the future of postal services said, "Deutsche Post DHL is the most admired postal operator in the world."³⁸

However, European postal markets are no nirvana. They face the same challenges as the U.S. market with plunging letter volumes. But traditional postal firms (universal service providers or USPs) are making large changes. A major 2018 report by the European Commission about the continent's postal markets found the following changes:³⁹

- "many USPs have re-engineered postal networks and processes to cut costs."
- "pressure from both letter volumes decline and competition in the parcel segment . . . have led to the use of new and more flexible employment models such as on-call work, temporary agency work, performance-related pay contracts as well as outsourced models."
- "increased competition has forced national postal operators to modernise their wage structure, e.g. introduce performance pay and other types of more flexible contracts."
- "reductions in required delivery speed for USO letters . . . and required delivery frequency."
- "allowing USPs to shorten delivery routes by, for instance, delivering to a common street mail box instead of to the door."
- "closing down of post offices . . . the density of the postal retail network declined in 23 out of 32 countries."
- "regulators loosening requirements with respect to price regulation."

Most European letter markets still have high USP market shares, but competition is slowly growing. The Commission report noted, "the (high) concentration in the addressed letter market is declining . . . In 2016, in eight countries at least 15 per cent of the postal market was comprised by non-USP postal operators. At least six out of these eight countries had end-to-end competition"⁴⁰

An example of a private competitor to a USP is CityMail in Sweden, which delivers mail to more than half of the nation's households every third day.⁴¹ Interestingly, "Sweden has not had post offices at all since 2002," as postal retail sales have moved to other businesses such as grocery stores.⁴² Similarly in Germany, Deutsche Post "has few stand-alone branches now, having sold almost all of its 29,000 buildings. Most branches are in other businesses."⁴³

Postal and delivery markets are changing rapidly, and private companies have more flexibility than government bureaucracies to deal with the new challenges. With the rise of the Internet, the claim that mail is a natural monopoly needing special protection is weaker than ever.

The USPS has suffered huge declines in demand for its most profitable product, first-class mail. In a similar situation, private businesses would try to change direction and enter new markets. In

Europe, traditional postal companies are expanding into parcel and express services. The Commission report found, “to compensate for lower scale economies, postal operators have made the pursuit of economies of scope as a key target.”⁴⁴

That makes sense for the competitive environment of Europe. But for the USPS, it cannot diversify as freely as private businesses can, nor would we want the USPS entering other industries and unfairly competing with private businesses. As a tax-free entity, it would be distortionary for the USPS to enter, say, banking or grocery delivery.

The way to solve the dilemma is to open postal markets, privatize the USPS, and allow it to compete freely. In recent years, the USPS has contracted out an increasing share of intermediate processing and transportation activities to private providers.⁴⁵ Thus, the USPS is becoming more “privatized” all the time. The logical next step is to fully privatize the USPS and provide it with more flexibility to meet the challenges ahead.

The administration’s 2018 reform proposal argued, “a privatized Postal Service would have a substantially lower cost structure, be able to adapt to changing customer needs and make business decisions free from political interference, and have access to private capital markets to fund operational improvements without burdening taxpayers. The private operation would be incentivized to innovate and improve services to Americans in every community.”⁴⁶ The administration further noted, “A private postal operator that delivers mail fewer days per week and to more central locations (not door delivery) would operate at substantially lower costs.”⁴⁷

In a 2017 report, the GAO found that most of the postal experts they interviewed said that relaxing USPS monopolies “could induce USPS to become more efficient and increase innovation across the postal market.”⁴⁸ The experts “generally stated that the prospect of competitive pressure would stimulate USPS to be more efficient through both cost-cutting and general restructuring.”⁴⁹

Privatization would also improve corporate governance. The USPS is overseen by a Board of Governors, but the Board has not been fully staffed for years. There are currently just 2 of 9 appointed positions filled. This situation is typical of Washington dysfunction these days, which is unlikely to improve any time soon.

Another common failure of federal business ownership is underfunded capital investment. The USPS’s low cash flow is forcing it to defer needed investment. That pattern is also evident with Amtrak and our air traffic control system. The Task Force noted that the USPS is hamstrung in making necessary investments and that “projected liquidity constraints limit its ability to compete with the private sector in the development and implementation of new delivery technologies.”⁵⁰ Privatization would allow the USPS access to debt and equity markets for needed long-term investments.

A privatized USPS would pay federal, state, and local taxes. Members of Congress often express concern when major companies do not pay taxes. The USPS is a \$70 billion company that does not pay taxes. Paying taxes would put the USPS on a level playing field with other businesses.

A privatized USPS within a competitive environment should gain greater flexibility for pricing, service standards, closing facilities, and other changes. Congress could impose a USO on a privatized USPS, but it should substantially narrow the mandate, such as by allowing fewer delivery days.

Other countries typically have narrower USOs than we do. Some countries have more cluster boxes, some exclude bulk mail from universal service requirements, and some allow more flexibility in pricing.⁵¹

To put a privatized USPS on a level playing field with competitors, Congress could provide it with a line-item subsidy in the federal budget for a USO, although that may not be needed.⁵² Postal companies have an incentive to provide universal service because the value to customers of the service increases the more addresses that are served.

Abroad, some liberalized systems subsidize a USO while others do not.⁵³ The 2018 European Commission report found, “one third of surveyed USPs received direct subsidies for the USO net cost.”⁵⁴ For the United States, a former PRC expert argued that USPS’s “monopoly is not necessary to preserve universal service.”⁵⁵

USPS supporters fear that rural areas would be left out unless the government required universal service. But some economists argue that may not be the case.⁵⁶ Rural postal routes can be as cost-effective as urban routes because rural letter carriers use roadside boxes whereas urban letter carriers usually walk their routes.

Markets are changing and making a monopoly government postal model defunct. Household-to-household personal letters have plunged to just 3 percent of total mail volume today.⁵⁷ Advertising represents 62 percent of the entire household mail volume.⁵⁸ Bills and other business statements are the second largest type of mail, but they are being replaced by electronic payments, which now account for about 60 percent of all bill payments.⁵⁹ There are 290 billion emails sent around the planet every day.⁶⁰

The administration Task Force found that the USPS’s current business model “is unsustainable and must be fundamentally changed if the USPS is to avoid a financial collapse and a taxpayer-funded bailout.”⁶¹ The GAO said that a “comprehensive package of actions is needed to improve USPS’s financial viability.”⁶² That comprehensive package should be privatizing the USPS and opening U.S. postal markets to competition.

The 2019 Escher Group report said that the European postal “market is more competitive than ever, with the always-on consumer ushering in a tidal wave of change.”⁶³ Congress should begin ushering in such changes in America.

Thank you for holding these important hearings.

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⁵ U.S. Treasury, “United States Postal Service: A Sustainable Path Forward,” Report from the Task Force on the United States Postal System, December 4, 2018, p. 2.

⁶ U.S. Treasury, “United States Postal Service: A Sustainable Path Forward,” Report from the Task Force on the United States Postal System, December 4, 2018, p. 58.

⁷ Executive Office of the President, “Delivering Government Solutions in the 21st Century: Reform Plan and Reorganization Recommendations,” June 2018, p. 69.

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²¹ U.S. Postal Service, Office of Inspector General, “Millennials and the Mail,” July 20, 2018, pp. 5, 6.

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