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ADVANCES IN NEW INSTITUTIONAL ANALYSIS

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10. The US Postal Service

R. Richard Geddes

INTRODUCTION

Can the US Postal Service be characterized as a firm that was deregulated and is now moving toward re-regulation? To what extent can shifts in US postal policy be understood as a quest for economic efficiency? What theories can help us interpret the evolution of US postal policy, and how are they affected by changing political circumstances? Can those theories also help us understand what is likely to happen next in US postal policy? The purpose of this chapter is to help address this set of important questions.

The US Postal Service (USPS) operates within a unique, complex legal and political environment resulting from decades of institutional evolution. Postal policy has been liberalized, but the form of liberalization in the United States is unique. The USPS is clearly not an example of a firm that was deregulated and is now facing meaningful re-regulation. Rather, its institutional evolution has been a slow, somewhat convoluted process of liberalization. That evolution is too nuanced, however, to be understood as a steady march toward economic efficiency. Rather, theories incorporating both efficiency and redistribution are necessary to understand US postal policy.

In this chapter, I first provide an overview of the current structure of the USPS to give a flavor for the unusual organizational arrangements involved. I review the major reorganization efforts that have affected postal policy in the United States. One salient aspect of postal organization is the degree of contracting out of mail preparation, known as worksharing. This overview suggests that US postal policy has become more liberal over time, even though major aspects of USPS organization inconsistent with a liberalized policy remain. It also shows that US postal reform has taken a course different from that in many other countries.

In the third section, I attempt to answer the second and third questions posed above: what theories can assist in understanding these changes, and how important are efficiency considerations in particular? Two theories of policy change are especially relevant. The first is the public-interest theory, or normative-analysis-as-positive-theory approach (NPT) which views government intervention as a way to correct market failure and improve social welfare. The main alternative is the private-interest theory, also called the economic theory, or ET. This approach portrays the regulatory process as one in which well-organized groups use state power to capture rents at the expense of more dispersed groups. If postal policy can be characterized as trending toward liberalization, then it is necessary to consider the predictions these theories generate regarding liberalization.

In the third section, I find that the NPT does a poor job of explaining the change that has taken place or those elements that have been retained, but that the ET also provides unsatisfying answers to some aspects of US postal reform.

In the fourth section, I address the final two questions: To what extent are these changes the result of unique political circumstances, and what is likely to happen next in US postal policy? I there find that the evolution of US postal policy is too long and protracted to be explained by particular political circumstances. I also find that underlying economic forces are likely to compel the USPS to continue on its course of continued liberalization for the foreseeable future. Although some aspects of postal regulation were made more stringent by recent legislation, it is unlikely that the USPS will ever be substantially re-regulated. The fifth section summarizes and concludes.

THE CURRENT STRUCTURE OF THE US POSTAL SERVICE

Given the activity it undertakes, the USPS is an unusual organizational hybrid. It is a business, providing a commercial service, but remains government owned. Although it offers services that face competition, its core activity is protected by a government-enforced monopoly. Many industries with organizational characteristics similar to the USPS have been deregulated or privatized, both in the United States and internationally. These industries share a network structure in that they have a distribution system of lines, pipes, or routes requiring the use of public rights-of-way, typically with strong physical linkages between component parts. Although other network industries in the United States, including airlines, telecommunications, oil, natural gas, electricity, trucking, cable television and railroads, among others, have all undergone substantial regulatory reform since the mid-1970s, US postal policy appears to have changed little.

Moreover, many other governments have substantially reformed their postal services. For example, New Zealand, Sweden and Finland abolished...
their postal monopolies as of 2002. Australia's monopoly is limited to four times the stamp price only, and may be reduced to the stamp price itself. The European Union has limited all postal monopolies to five times the stamp price and is planning to eliminate them entirely. Many postal services are also moving toward privatization. For example, the Dutch post is 60 percent privatized, while the German post is majority privately owned. Although the USPS has not undergone similar major structural reform, it has been liberalized in other more subtle ways over time. It has operated (or will be operating) under three main organizational regimes since the late 1960s which I characterize as direct Congressional control, under the 1970 Postal Reorganization Act, and under the 2006 Postal Accountability and Enhancement Act.

**Direct Congressional Control**

Prior to 1970, the USPS was the Post Office Department. As a department of the federal government, Congress controlled almost every aspect of the Post Office's operations, a key aspect of which was rates (Tierney 1988: 10). In hearings before Congress, a wide array of mail users would argue against rate hikes, typically relying on emotional, anecdotal evidence (Tierney 1981: 105). Congress was often loath to increase rates when confronted with stirring opposition coupled with little organized response from taxpayers who stood to lose from the large annual deficits that inadequate rate increases would bring. Moreover, delays in rate increases served organized mailers' interests. Delays in the 1967 rate increase, for example, collectively saved mailers $15 million each week. Mailers were also effective at keeping second- and third-class mail rates low relative to first-class rates, which allowed them to benefit from the Post Office's monopoly, and thus from the relatively inelastic demand for first-class mail.

Congress also benefited from the selection of postmasters. Although potentially helpful for their managerial skill and knowledge of local conditions, postmasters were instead often chosen for political patronage under an informal "political advisor" system. The system allowed members of Congress and occasionally local party officials to choose the local postmaster. Given the substantial fringe benefits, attractive retirement packages, and job security associated with a postmaster position, it is unsurprising that the jobs were used to generate political benefits.

Moreover, Congress mandated numerous details of labor arrangements, from wages to work assignments for particular positions. Postal unions became skilful at lobbying the members of Congress determining those arrangements. Unions exerted considerable political influence by virtue of their large size and broad geographic distribution across Congressional districts. Additionally, the Post Office Department was the single most unionized federal organization. About 90 percent of Post Office employees belonged to a union, versus 21 percent in other federal agencies. Unions used their considerable influence to lobby for higher wages, improved benefits, and more job security.

The postal unions' success under this system was impressive. Only one postal pay bill was defeated in any House vote from 1955 to 1967 (Penno, 1973: 246). When pushing through a pay bill, the unions obtained one of only two overrides of a presidential veto during the entire Eisenhower administration. Numerous statistical studies, discussed below, confirm that postal workers' pay exceeded that for other workers with similar education and experience. Both unions and large mailers thus emerged as powerful constituencies.

The political incentives created by this structure had unfortunate long-run fiscal consequences. Catering to large mailers' interests resulted in low revenues due to low rates, but complying with union interests necessitated high labor costs. Through a direct annual appropriation, taxpayers paid for the annual shortfall between revenues and costs. The real annual charge to the Treasury grew steadily. The Post Office deficit grew from $652 million in 1964 to $1.1 billion in 1967.

Several forces worked in concert to push the Post Office's structure to the breaking point. First, mail volumes were rising with economic growth. Second, although funding capital investment for postal delivery was rarely a top Congressional priority, budgets during the 1960s were particularly inadequate. Funding for the Vietnam War and President Johnson's Great Society programs took precedence. The result was limited (or nonexistent) capital investment and technological progress, which led to high costs. Mail was still sorted by hand, and post office buildings were often inadequate to handle improved mechanization. Floors were sometimes too weak to support heavy machinery, and ceilings were too low to allow large overhead conveyor networks. There was also an unusually high breakdown rate in the transportation fleet. The Post Office responded by hiring more workers but without capital improvements labor productivity remained low.

Changes in transportation modes also increased postal costs. Postal operations were designed to move mail by train, with large facilities located near train stations in downtown areas. During this period, however, railroads were declining in favor of trucks, which faced difficulty in reaching downtown locations.

The system reached a critical point in 1966 when the Chicago Post Office— at the time the world's largest— ceased to function. The backlog
of mail exceeded 10 million pieces. That was far from an isolated incident however. A similar event occurred in Chicago in December 1963, when hundreds of thousands of Christmas parcels were delayed for months. (President's Commission on Postal Organization 1968: 12).

**The Postal Reorganization Act of 1970**

An unusual confluence of interests supported reform. The Post Office itself was a major force in favor of reorganization, since it was promised enhanced modernization and independence. The business community supported reorganization, because it believed that reform would lead to better service and lower rates if improved management tools were applied. Indeed, the commission that Congress established to study the problem, known as the Kappel Commission, estimated that the Post Office could save at least 20 percent of postal costs per year if freed from political control and allowed to operate using prevailing business principles (President's Commission on Postal Organization 1968: 5–6). Large mailers valued the improved predictability and reduced variability of rates that reorganization promised. The main resistance to reorganization came from organized labor, which feared a decline in its hard-won Congressional influence and thus a reduction in power if collective bargaining with a continuing prohibition on strikes were adopted. Organized labor was compensated for its expected losses through a two-part pay raise agreement, and other concessions.

Congress also wanted the Post Office to become financially self-sustaining. It hoped that the imposition of a break-even constraint would strengthen the Post Office's incentives for cost efficiency and reduce its reliance on government subsidies. A break-even constraint would also place the cost of postal services onto mail users rather than taxpayers generally, which would distribute costs more fairly and provide economizing incentives.

Rationalization of the rate structure was envisioned. As the Kappel Commission noted, decades of political rate-setting resulted in an irrational rate structure. It was anticipated that setting rates in accordance with accepted principles of public utility pricing would enhance both the fairness and efficiency of postal rates (President's Commission on Postal Organization, 1968: 145–53).

The 1970 Act also reformed labor relations and working conditions. The Kappel Commission found that the hiring process was exceedingly slow, that senior appointments were politicized, that the promotion system stifled employee motivation, that employees received virtually no rewards for superior performance, that they received little training, and that working environments were often shoddy. It was hoped that independence from Congress would help address these problems.

Overall, the 1970 Act can be viewed as an important step toward liberalization. It moved away from direct taxpayer funding by requiring the USPS to become self-financing. It eliminated direct Congressional control over rates, granting the USPS substantial autonomy in rate-setting. The act also granted the USPS more control over labor arrangements such as wages, working conditions and other managerial decisions. In these and other areas, the 1970 Act represents a step away from typical governmental organization and toward a more utility-like structure.

That structure remained essentially undisturbed for 35 years. The USPS has effectively met its break-even constraint over the long term, with the important exception of unfunded liabilities in the form of postretirement health costs, pension liabilities and workers' compensation. The price of the basic first-class stamp has grown at roughly the rate of inflation. However, it eventually became clear that there were deficiencies in this structure. Rate proceedings were cumbersome. The powers of the Postal Rate Commission were inadequate to the task of regulating a government-owned monopoly. There were concerns about cross-subsidies from metropolitan to competitive products. Important modifications were implemented in the Postal Accountability and Enhancement Act of 2006, which I discuss below.

**The Postal Accountability and Enhancement Act of 2006**

Unlike the 1970 Act, there was no obvious crisis that precipitated the 2006 Act (Public Law 109–435). Rather, the 2006 Act reflects a lengthy process of deliberation and debate. Hearings were held by Congressman McHugh of New York and others for over a decade leading up to its passage. The 2006 Act is essentially two pieces of legislation wrapped into one. One is reform of the USPS regulatory framework. The second is pension reform legislation. I discuss each in turn.

The 2006 Act implemented three main regulatory policy changes. First, it granted the USPS the authority to change postage rates, within limits, without seeking prior regulatory approval. Under the 1970 Act, the USPS was required to submit proposed rate changes to the Postal Rate Commission prior to a rate change. The ensuing rate hearing often took many months. The 2006 Act divides USPS products into market dominant (meaning those where the delivery monopoly applies), and competitive products. The USPS may increase prices in the market dominant category, provided that rates do not rise faster than the consumer price index. For competitive products, the USPS may price as it wishes long.
as each product covers its costs, and if all competitive products together make an appropriate contribution to USPS' "institutional" or overhead costs. One purpose of this arrangement is to avoid the cross-subsidization of competitive products with revenue from monopolized products. This change will also give the USPS more flexibility to set rates.

Second, the act created a new regulator with enlarged powers and a new name, the Postal Regulatory Commission. The Act required the new Commission to establish "a modern system for regulating rates and classes" that meet a variety of objectives, such as enhancing incentives to reduce costs and increase efficiency, to create predictability and stability in rates, and to maintain financial stability.57 The new Postal Regulatory Commission's powers include improved information-gathering authority (including subpoena power), the authority to control USPS service standards, control over new product offerings, and enhanced ability to prevent cross-subsidies from monopolistic to competitive products. The Postal Regulatory Commission is directed to issue regulations prohibiting unfair competition by the USPS. The new Commission also has the power to change which products fall into market dominant versus competitive categories by adding new products to the lists, removing products from the lists, or transferring products between lists.58 Also, the USPS is to be covered by the federal antitrust laws and is subject to commercial lawsuits.59

Third, the act limited the Postal Service's delivery monopoly to six times the stamp price. This creates a reserved area of monopoly power for the USPS. It may not introduce much competition, but this change does set the stage for gradually introducing competition by reducing the stamp price multiple over time. Additionally, it clearly defines the scope of the Postal Service's delivery monopoly, which had been a past concern.

Regarding pension reform, in 2003 Congress concluded that the formula used to determine the Postal Service's contribution to pensions for workers covered by the Civil Service Retirement System (CSRS) was flawed.60 Congress retroactively changed that formula in the Postal Civil Service Retirement System Funding Reform Act of 2003.61 That act had the effect of reducing the Postal Service's pension contributions, but it directed the annual savings be placed in an escrow account pending further legislative action. The 2005 act also shifted responsibility for increased CSRS pension payments for certain USPS retirees who had served in the military from the Treasury to the USPS. The effect of these two major changes was to reduce the Postal Service's annual pension contributions.

The 2006 act eliminated the escrow account and shifted the pension responsibility for the USPS employees with military service back to the Treasury. It also directed that the savings the USPS realized from its reduced pension contributions help pay down the Service's unfunded retiree health care liabilities.

These changes may not appear to represent a uniform movement toward liberalization. Similar to the 1970 Act, however, the 2006 Act moved USPS regulation a step closer to that of a public utility. The adoption of price cap regulation and enhanced regulatory authority mimics a public utility approach, as does the separation of monopolistic and competitive products. The elimination of sovereign immunity protection moves the USPS closer to legal structure of a private firm. The 2006 Act thus lays the groundwork for future privatization and de-monopolization.

There is however another important process that has also been operating for many years to liberalize the USPS: worksharing. Although it is used in a few other countries, worksharing has played a particularly important role in the liberalization of US postal policy.

Worksharing in the US Postal Service

Worksharing occurs when private mailers prepare the mail so as to lower costs to the USPS. Mailers in turn receive discounts for preparation. Worksharing takes many forms, including presorting, drop shipping, bar coding, palletizing and containerizing the mail. The United States utilizes worksharing discounts more extensively than any other country.62 Unique institutional circumstances encouraged worksharing in the United States. Prior to the Postal Reorganization Act of 1970, and the creation of the Postal Rate Commission, mailers were able to produce mail in a presorted sequence due to computerization of mailing lists (Cohen et al., 2001). Mailers petitioned the old Post Office to provide them with a discount for pre-sorting the mail but the Post Office refused.

After the 1970 Act, mailers again petitioned for discounts. Although the new Postal Service resisted the discounts, the 1970 law required that the newly created Postal Rate Commission approve product offerings. The Postal Service feared that its rates and classifications would be opposed by large mailers unless it included a pre-sort discount. The USPS began offering discounts for pre-sorted first-class mail in 1976.

Inflation was high during the 1970s, so USPS costs were rising rapidly. It thus frequently requested higher rates to cover rising costs. There were a total of five postal rate cases during the 1970s, which provided opportunities for large mailers to air their concerns about higher rates.

The USPS expanded worksharing discounts in response to that criticism. Worksharing was thus a way to ameliorate the impact of large rate increases on high-volume mailers. Also, mailers were able to bring compelling evidence before the Postal Rate Commission that the costs avoided
by the USPS due to worksharing were substantial, which led to steeper worksharing discounts over time, in some cases over three times higher than the USPS wanted.

Worksharing has evolved into a large, complex schedule of rates that reflect the wide variety of ways that mailers can reduce costs. There are now about 250 distinct worksharing rates.\textsuperscript{51} Most discounts relate to advertising material. It now includes virtually all mail classes. Mailers can now preset and drop ship mail at four different levels, the most refined being one of the 24,000 local delivery units (known as destination delivery units, or DDU), where letter carriers depart on their routes.\textsuperscript{52}

As noted, worksharing was introduced and expanded to provide mailers with an incentive to undertake mail preparation they can complete at lower cost than the USPS. However, it has the effect of moving production from the USPS to the private sector, and has therefore liberalized the US postal market without legislative action. This stands in contrast to postal liberalization in other countries, which required legislation. Some commentators suggest that worksharing may be more effective in liberalizing the postal market than de-monopolization.\textsuperscript{54}

The amount of mail that is workshared in the United States has grown over time and is now significant. Figure 10A.1 in the appendix displays the percentage of first-class mail (which accounts for the majority of USPS revenue) that is now workshared.\textsuperscript{55} That share was 12 percent in 1980, 33 percent in 1990, 47 percent in 2000 and 55 percent in 2006. The worksharing percentage is even greater in other mail classes. As of 2001, advertising mail was 96 percent workshared, periodicals were 94 percent workshared, while package services were 73 percent workshared (Cohen \textit{et al.}, 2004: 16).

As might be expected from enhanced competition, worksharing has helped to lower USPS costs. According to one estimate, the cost reduction from all worksharing was $15 billion in 1999, or almost 25 percent of total USPS costs (Cohen, 2003: 19). This is at least partly due to the smaller workforce that is necessary when mail is workshared.

There are other signs that worksharing in the United States has liberalized the postal market. For example, one effect of per sort discounts for first-class mail has been the development of third-party consolidators in many major US cities, which now produce about a third of all presorted first-class mail. These 'presort service bureaus' also barcode, sort, and often transport the mail for mailers who do not wish to do so.

Liberalization or Re-regulation?

Several aspects of this institutional evolution are noteworthy. It suggests a slow movement toward a more liberalized structure. Given the trend toward a public utility structure and worksharing, it cannot be characterized as deregulation and subsequent re-regulation. The protracted nature of the reform process is also noteworthy. Postal liberalization in the United States was first examined in the late 1960s, and is ongoing today.\textsuperscript{26} The hearings leading to the 2005 Act were begun in the early 1990s. In contrast, the deregulation of other industries, such as trucking and airlines, was essentially complete in several years. Maximum price regulation in the oil industry, for example, came and went in one decade.

Finally, postal services cannot be characterized as an industry with organized, politically powerful producers and weak consumers. Although employees are well organized through unionization, mailers are also organized through such groups as the Direct Marketing Association, Newspaper Association of America and the Parcel Shippers Association, among others. This is likely to have an important effect on the process of reform. Moving to the second and third questions addressed in this chapter: how much is structure and change in the USPS best understood? Below I examine several possible explanations, and assess their power in explaining US postal policy.

US POSTAL SERVICE ORGANIZATION: PUBLIC OR PRIVATE INTEREST?

There are two main approaches to the regulation of industry that help explain these changes. The first is a public-interest approach, also called \textit{Normative Analysis} as Positive Theory, or NPT (Joskow and Noll, 1981). The NPT posits that regulation is supplied when it is normatively required (that is, in the public interest) to maximize social welfare. Here regulation corrects market failure, such as negative externalities or natural monopoly. Because there are no obvious, unusual negative externalities generated by postal delivery, this approach suggests a focus on correcting potential natural monopoly. The NPT implies that liberalization will occur when technological or demand characteristics change so as to eliminate this particular market failure (Peltzman, 1989: 18).

A second main approach focuses on the benefits intervention bestows on private parties. Intervention in a market here occurs in response to the demands of politically influential groups. Economic rents, or wealth, are redistributed to politically powerful consumer and producer groups so as to maximize political support. This is sometimes referred to as the economic theory of regulation, or the ET. There are two main forces that can plausibly lead to liberalization under the ET: (a) if the difference between the regulated market equilibrium and the unregulated market equilibrium...
diminishes so that the political gain from intervention falls, and (b) if the wealth available for redistribution declines.

Postal Liberalization and Alternative Theories of Regulation

How well do these theories accord with the details of US postal liberalization? To be consistent with the NPT, either the demand or the technological characteristics of postal delivery would have to change so as to eliminate preexisting natural monopoly conditions. This raises the critical question of whether or not postal services were a natural monopoly prior to the 1970 Act. There is now a literature concluding that postal services are not, and never have been, a natural monopoly. Sidak and Spulber (1996: 43–55), for example, systematically analyze the various components of postal service, which include (a) contracting for long-distance transportation; (b) regional sortation and transportation, and (c) local pickup, sortation and delivery. They systematically demonstrate that none of these activities have natural monopoly characteristics. Indeed, postal services are a paradigmatic case of a highly contestable market, and those types of delivery service that do not fall under the monopoly are competitive (Geddes 2003: 25).

An alternative public-interest explanation is sometimes offered, which is the desire to provide the same quality of delivery service (such as six-day-per-week delivery) to all parts of the nation at a uniform price, known as 'universal service'. This justification suggests that a government-enforced monopoly is necessary in order to guarantee universal service. That is because private competitors would enter only on dense urban routes and 'skim the cream' that is necessary to cross-subsidize sparse, rural money-losing routes. If competition were allowed, it is argued, rural homeowners would not receive mail service.

As a public-interest justification, however, the universal service explanation for intervention is weak (Sidak and Spulber, 1996: 70–4; Geddes, 2003: 209–16). Moreover, for this concern to explain US postal policy under the NPT, reforms such as the 1970 Act should have weakened universal service provisions. Instead, universal service at uniform rates has been a particularly durable aspect of postal structure.

The ET offers an alternative approach to liberalization. It suggests a search for exogenous changes that resulted in the elimination of economic rents or changes in the unregulated market structure that reduce gains from intervention. Although there is no evidence of meaningful changes in the unregulated market structure (with low entry barriers it has always been quite competitive), the evidence is supportive of rent dissipation prior to the 1970 Act. As noted, because of restrictive work rules, lack of innovation, and other causes, organizational arrangements prior to 1970 became unwieldy, drastically increasing the cost of providing mail service as well as the direct subsidy, eventually leading to collapse. This appears to accord well with the ET, but a refinement by Becker is particularly relevant (Becker, 1983). Becker argues that deadweight losses act as a constraint on inefficient regulatory policies. Since neither winners nor losers in the redistributive process would oppose changes that reduced deadweight loss, Becker's approach suggests that the political process will tend toward efficient modes of redistribution. Such intervention-induced cost increases are particularly relevant for the 1970 postal reorganization. Pelzman provides a summary of Becker's approach that aligns closely with the 1970 reform:

In Becker's framework the loss of rents (from cost increases) reduces the pressures for continued regulation of this industry relative to other industries, and the higher price increases the counterpressure from consumers. Suppose further that the cost increase has in fact been induced by regulation. Then the deadweight losses emphasized by Becker become especially important. There is now not only attenuated support for continued regulation but also the potential for major gains in political utility from deregulation. These would come from the elimination of the cost increase attributable to regulation. For a structurally competitive industry, the lower costs would translate into higher producer and consumer surplus in the short run and higher consumer surplus in the long run, thus raising the possibility that the coalition pushing for deregulation would include some producers. (Pelzman, 1989: 20:1)

This refinement of the ET is helpful for understanding postal reform. The 1970 Act was, by all accounts, driven by the inefficiencies of the pre-act structure, implying that the political benefits from deregulation were high. Also, as noted, the coalition for reform included producers interests in the form of the Post Office itself. The details of the 1970 reform thus accord well with the ET.

The use of worksharing discounts is also consistent with the basic form of the ET as well as Becker's approach. Large mailers represent organized customers who would otherwise resist rate increases; their acquiescence can be obtained by blunting rate increases via discounts. Worksharing discounts also have an important efficiency component, however. To the extent that presorting and drop shipping are performed more efficiently by private firms than by the USPS (as suggested by the postal wage premium), then deadweight loss from the extant government-owned monopoly postal organization is reduced. This is also consistent with Becker's approach. Worksharing discounts have flourished even though they have been opposed by postal unions.

Both theories appear at a loss to explain the 2006 Act however. In contrast to 1970, there was no catastrophic increase in costs prior to 2006 that
precipitated congressional action. Nor were there any dramatic decreases in demand that would diminish rents. Rather, as noted, the 2006 Act was the end result of a long period of deliberation and debate. The Becker contribution to the ET, with its emphasis on the efficiency-reducing aspects of reform, is here similarly unhelpful. One might argue that worksharing discounts had the effect of reducing USPS revenue, which would reduce the rents available for redistribution to other parties and perhaps inspire added liberalization. Figure 16A.1 indicates however that worksharing has increased steadily since 1978, so this application of the ET has difficulty explaining the timing of the 2006 Act.

A separate literature may be helpful in understanding the 2006 reform. This approach evolved from work by Kenneth Arrow and emphasizes the essential indeterminacy of democratic political systems and how those systems evolve to address instability (Arrow, 1930). One implication of this literature is that much liberalization takes place without legislative action, as courts and regulatory bodies may interpret statutes in ways not envisioned by Congress. This approach suggests that legislative action will be reactive since Congress is forced to respond to circumstances that are changed by the regulator (Fordjohn and Shiapan, 1989). This may help explain both the content and the ponderous pace of passage of the 2006 Act, as Congress felt compelled to address worksharing discounts and other policies that had grown under Postal Rate Commission oversight.

Theories of Regulation and Unchanging Postal Structures

Those aspects of postal structure left unchanged by liberalization in the United States may be as noteworthy as those that changed. Unlike postal liberalization in many other countries, US reform has focused on developing a utility-like structure while retaining the dual monopolies (over delivery and the use of the mailbox), government ownership, and uniform national rates (within particular weight/class categories). Any comprehensive theory of regulation/liberalization must address these aspects of USPS institutional structure that resist reform.

It is difficult to reconcile the retention of government ownership, monopoly power and uniform rates with the NPT’s explanation of liberalism. Under the NPT, the retained features should help address natural monopoly problems. But such explanations are unsatisfying given the lack of evidence of natural monopoly in this industry. The ET however offers an explanation: those aspects of postal structure that are retained, although they may generate some deadweight loss, assist in the creation and distribution of economic rents to influential groups. Their retention, and the continuing political benefits from them, may also help explain the slow pace of reform in this industry.

A key prediction of the ET is that economic rents will in general be spread among several competing groups (including politically influential consumers, in this case large mailers) rather than being captured by only one constituency group, such as producers. Rent spreading among consumers, for example, manifests itself through prices that attenuate differences in marginal cost across consumer groups. In general, regulators are able to gain political benefits from reducing prices for some high-cost customers at the expense of other customers. The economic theory predicts that there will be a tendency for high-cost consumers (such as rural postal customers) to receive a relatively low price/marginal cost ratio, which constitutes a cross-subsidy from low-cost to high-cost consumers. Keeping those predictions in mind, I now examine three persistent aspects of USPS structure, which are monopoly power, uniform rates and government ownership.

A defining aspect of the USPS is its delivery monopoly. Through the private express statutes of 1845, the USPS obtained a legal monopoly over most of first-class and a portion of Standard Mail. Legally enforced monopoly power is critical for the creation of economic rents. Without monopoly power, competitors would rapidly enter all sectors of the USPS market, and any super-normal profits would be eliminated. There would be no economic value left for redistribution.

The Postal Service defends its monopoly power. In 1970, Congress considered elimination of the monopoly as part of reorganization, and requested that the Board of Governors conduct a ‘thorough reevaluation’ of the restriction. The Board recommended that the prohibition be retained. The Governor’s defense of the monopoly was based partly on the theory of natural monopoly, and partly on the traditional justification of providing below-cost service to rural customers (Prist, 1975: 69).

The ET provides an explanation for the retention of monopoly power, since a number of well-organized groups benefit. The most important beneficiary may be organized labor, which receives rents in the form of high relative wages as documented by numerous empirical studies. For example, Smith (1976, 1977) finds that postal workers are paid more than their comparable private sector wage, as mandated by the 1970 act. Similarly, Perloff and Wachter (1984) found that, in 1978, postal salaries were 21 percent higher than for similar workers in the private sector. Wachter and Parloff (1991) again found a postal wage premium of 21 percent using 1988 data, while Hirsch et al. (1999) found a wage premium of 29 percent.

Moving to rates, neither the 1970 nor the 2006 act disturbed the policy of uniform nationwide rates for each weight/class combination, regardless
of distance or customer density. For example, any letter weighing less than one ounce will currently be delivered first-class anywhere in the United States for 42 cents. To the extent that there are differences in the unit cost of serving rural versus urban customers, there is an intra-class cross-subsidy from urban to rural customers.

The desire to maintain these cross-subsidies through uniform rates and the monopoly power are intimately related. If private competitors entered on all routes where prices exceed cost the Postal Service would be left with only the least profitable customers. Stated differently, since profit-maximizing firms will compete until price equals cost, uniform rates would have to be abandoned if the private firms' statutes were repealed in the presence of cost differentials, and entry were allowed on all routes.

It is difficult to reconcile this policy with a public-interest approach. Aside from monopoly itself, the economic inefficiencies from cross-subsidy induced by uniform rates are well known. Such rates result in over-consumption on high-cost routes and under-consumption on low-cost routes. The USPS has also offered a transaction cost justification. For example, Priest (1975: 72) states, "The Governors further assert that with any varied pricing structure "regulatory red tape" will proliferate and the public will become confused." And p. 70: "The Postal Service must charge uniform rates. The Postal Service has found, according to the Governors, that it is only practicable to set rates "according to simple, published formulas of great generality." Such justifications seem tenuous. Market forces, in the absence of monopoly prohibitions, would act to conserve on such transaction costs. If the reduction in confusion brought about by uniform rates actually offset higher costs due to sub-optimal pricing, then competitive private companies would adopt them. Moreover, given the availability of electronic mail, facsimile machines, lower long-distance telephone rates and plane fares, and lower cost overnight services, rural customers are unlikely to be isolated if asked to pay their true cost of delivery.

The FT provides an explanation for the endurance of the uniform rate. A uniform rate pricing structure is consistent with rent-redistribution within a class of mail. If costs are not constant across various customers within a class, then uniform rates create an intra-class cross-subsidy. As noted, politically effective rent distribution will tend to smooth or eliminate cost differences across customer groups. In the limit the regulator will totally ignore cost differences and set prices equal for different customer groups regardless of cost, as in the case of postal rates within a class. Additionally, since rural customers are a smaller numerical group, this is consistent with the prediction of rent-redistribution toward the politically effective group. Indeed, the Postal Service opposed elimination of uniform rates even though Congress in 1970 offered to pay it directly for any money lost on rural routes.

However, it is likely that monopoly power facilitates important cross-subsidies across classes of mail as well. Since it is difficult to measure the costs attributable to a particular class of mail, it is hard to gauge the size of inter-class cross-subsidies. However, evidence reported in Geddes (1998) suggests that the 1970 act increased rates in heavily monopolized first-class mail and decreased them in competitive parcel post mail. This is consistent with greater inter-class cross-subsidy from monopolized to competitive classes. Overall, although the public-interest justification for monopoly power and uniform rates is unclear, the retention of those features is consistent with politically beneficial rent redistribution.

The final reform-resistant aspect of USPS structure is government ownership, which was unaffected by either act. This is noteworthy given that there has been successful privatization across a wide range of industries around the world, and in postal services in other countries. As with monopoly and uniform rates, the main public interest argument for retaining government ownership again appears to be universal service (Tierney, 1988: 32). This justification for government ownership raises the question of why universal service concerns cannot be addressed via contracts with private firms. The government could easily contract with a private firm to provide service to rural areas if so desired.

Consistent with the FT, however, government ownership facilitates better control over rent spreading to various groups than does private ownership, particularly through the pricing structure (Peltzman, 1971: 146). When a firm is privately owned it focuses on profit-maximization as its objective, which essentially creates an agency problem in the redistribution of rents. That is, private firms are profit-maximizers that naturally engage in profitable price-discrimination across customer classes, which undermines the political objective motivating both inter-class and intra-class cross-subsidies. As long as the USPS provides service to low-density customers, the political desire to cross-subsidize them and to cross-subsidize across mail classes will be more easily achieved through government ownership than private.

WHAT'S NEXT FOR US POSTAL SERVICES?

I here address the two final questions: Does US postal liberalization reflect changing political circumstances, and what is the likely future course of liberalization? Regarding the first, the pace of change in US postal services has been notoriously slow and deliberate. Although the details
of any regulatory reform may reflect the political equilibrium at the time of passage, it is unlikely that particular political circumstances were the main driver of US postal reform. Congressional hearings prior to the 2006 Act absorbed a period of time when control of the House, Senate, and the Presidency all changed hands. The overall process of liberalization has spanned decades and numerous administrations as well as changes in congressional control. Nor does postal reform appear to be correlated with broad deregulatory movements in the United States. There was a strong movement toward deregulation of network industries, including trucking, railroads and airlines, in the late 1970s and early 1980s, but postal policy remained essentially unaffected. Additionally, the 2006 Act was passed not long after widespread dissatisfaction with deregulation of network industries was sowed by California’s efforts to deregulate electricity. Worksharing has also displayed stable, continuous growth regardless of the political situation. It is thus unlikely that liberalization is attributable to changing political circumstances.

Regarding the future, it is likely that US postal liberalization will continue. One among several reasons is the rising use of electronic bill presentation and payment (EBPP). This is the process by which companies bill consumers and/or receive payments electronically, which reduces the need to send bills and checks through the mail. The major effect of EBPP on mail volume appears to be through bill payment, which was flat for many years but has begun to decline (Flynn, 2005: 2). There are signs that EBPP is growing in popularity. Between 2000 and 2003, for example, bills and statements from businesses to households grew at 3.3 percent per year, while first-class mail volumes declined. EBPP is distinct from electronic banking, which has a separate effect on mail volume. As customers become more comfortable with these alternative electronic methods of transacting, their usage rates will rise, negatively impacting mail volumes.

Also, the growing importance of advertising and business matter in the US mail stream affects postal liberalization. Advertising’s share of total mail rose from 42 percent in 1987 to 48 percent in 2002. Advertising mail volume grew at 2.8 percent per year during that time, while non-advertising mail grew at 1.1 percent. Household-to-household or “personal mail” declined from 5 percent to 3 percent of all mail during that time. The remainder is either business-to-household or household-to-business.

These developments are important because advertising material, which is normally sent as Standard Mail, has significantly higher demand elasticity than first-class mail (Geddes, 2005: 222). Advertisers have a variety of ways of reaching their customers. The shift toward advertising material suggests that mail volumes will be more sensitive to future rate increases, which will lead to more liberalization as the USPS seeks to meet its break-even requirement by cutting costs. Because advertising material is more heavily workshared, the shift will naturally lead directly to more private involvement in mail preparation. Also, because advertising material makes a small contribution to the Postal Service’s overhead costs, this shift is likely to necessitate downsizing of the labor force if the break-even constraint is to be met. Finally, if other media (such as cable TV) offer a more cost-effective way for advertisers to reach their customers, then there may be massive substitution out of direct mail marketing. These forces all suggest that postal liberalization is likely to continue.

SUMMARY AND CONCLUSIONS

The US Postal Service has undergone a long process of liberalization. Both the 1970 and the 2006 Acts moved the USPS toward a more businesslike, commercialized structure. Because it moves work into the private sector, worksharing in the United States has also played a significant role in liberalizing US postal services. There is no indication that postal services in the United States have been or will be regulated.

Many of these developments are consistent with a private-interest theory of regulation, but one in which minimizing deadweight losses plays a vital role. There are many aspects of USPS organizational structure that were unaffected by either Act, including the delivery monopoly, government ownership and uniform rates. Those elements that are retained can be understood as mechanisms for retaining and redistributing economic rents to politically influential groups, in particular organized labor. The best way to think about USPS institutional evolution may be as moving toward liberalization subject to the constraint that the loss of rents to both large mailers and employees is mitigated.

The process of liberalization of the USPS is likely to continue. Electronic alternatives to physical mail delivery are more commonplace, and consumers are more comfortable with their use. Advertisers have access to numerous alternatives.

NOTES

1. See the chapter by Sharon Oster and commentary by Henry Hazama in Selden (1994) for a detailed discussion of this organizational form.
2. This means that competitors are able to compete as long as they do not charge less than four times the prevailing stamp price, thus creating a residual area of service for the incumbent.
3. After a vigorous discussion, the European Parliament determined that postal monopolies in all European Union countries must be abolished by the beginning of 2001. See http://www.freeeuropepost.org/pdf/Resolutions.01.03.04.doc, visited 20 April 2008.
4. There were minor acts in intervening years but they did not institute major institutional changes.
5. These mailers were usually high-volume users such as advertisers.
7. First-class mail is mainly personal letters, while second class is mostly periodicals and third class is mostly advertising material.
9. See President's Commission on Postal Organization (1968), Address-Contractor Reports, vol. 4, part 7, page 44. See also Postel (1995) 51 on high postal per-unitization rates.
11. Those liabilities total about $72 billion. See Geddets (2002: 216, Table 1).
12. See Schlyer (2007) from which this discussion borrows.
13. The set this first-class mail letters and sealed parcels; first-class mail caric periodicals; standard mail; single-piece parcel post; media mail; bulk printed matter; library mail; special services; and single-piece international mail, as market dominant products (39 USC § 3621(a)(1)-(10)). The set item priority mail, expedited mail, bulk parcel post, bulk international mail, and magazines as competitive products (39 USC § 3621(a)(11)-(13)).
14. Under the new law, rates may be increased faster than the CPI in "extraordinary and exceptional circumstances".
15. 39 USC § 3602(b).
16. 39 USC § 3642(b).
17. That is, it will not benefit from sovereign immunity protections as it has in the past. Specifically, the act prohibits the USPS and other federal agencies acting in concert with it or on its behalf, from engaging in conduct with respect to any product not covered by the statutory postal monopoly that constitutes an unfair method of competition. In addition, the act expressly prohibits the USPS from engaging in conduct that constitutes an unfair or deceptive act or practice. This latter change is important, as there have been concerns about the accuracy of USPS advertising in the past.
18. See Schlyer (2007: 3) from which this account borrows.
20. Delegating power to the mailer transporting the mail so that it enters the delivery process closer to its destination, thus bypassing USPS handling and transportation operations.
21. France has had working delivery for many years. See Coleman et al. (2007). The Postal Service's system of discounts, however, is more extensive than La Poste's.
22. Ibid. These rates were typically the result of a rate case, where mailers, postal management, and writers all had input into a process overseen by the Postal Rate Commission. Because of their impact on work performed inside versus outside the USPS, these rates often generated intensive debate.
23. Those levels are the 21 regional bulk mail centers (BMCs), the 69 area distribution centers (ADCs), the 900 sectional center facilities (SFFs), and the 24,000 local delivery units (DLUs). It is currently not possible to drop ship First-class mail.
24. In his testimony before the President's Commission on the Postal Service, witness Robert H. Cohen stated that:

The United States letter monopoly is among the least liberal in the world because it is not subject to price or weight limitations. The US, however, allows worksharing, which has grown steadily and substantially over time. As a result, much of the value chain is now in the hands of mailers and third-party consolidators, and, due to worksharing, the US has the most liberalized postal market in the industrialized world. Because even total liberalization of the monopoly may not be effective in creating postal competition (e.g. Sweden and New Zealand), worksharing may be a more effective way to introduce competition into a postal market.
25. First-class mail is also particularly important to the USPS because it makes a large contribution to USPS institutional or overhead costs, which are costs that cannot be attributed to any particular mail class. For example, it takes about three pieces of Standard Mail, which is mostly advertising, to make the same contribution to institutional costs as one piece of First-class mail. See Geddets (2002: 222).
26. This protection process is evident in postal liberalization in many countries.
27. See Olsen (1965), Stigler (1971), Potterman (1976), and Becker (1983) among others.
28. Also see Geddets (2002: 216-220) for a discussion of why postal services are not naturally monopolistic. National security, rather than natural monopoly, was the original reason for government intervention. See Price (1975).
29. The focus here is on the use of the intervention in economic activity to redistribute wealth to politically effective groups. An alternative strand of the literature, developed by public choice scholars such as James Buchanan, William Niskanen, Gordon Tullock and others, emphasizes monopsony and monopolization of the power of the state to extract rents for the benefit of political actors such as elected officials and bureaucrats. This approach may be more helpful in explaining postal policy prior to 1910, when Congress directly controlled the Post Office. The post-1970 structure is also consistent with the FT in that two small, well-organized groups, large mailers and employees, were benefiting at the expense of efficently poorly organized taxpayers who made up the annual deficit.
30. There is a sense in which the FT's focus on redistribution, and the NPT's focus on efficiency is subsumed by Becker's approach. For a refinement of this notion, see Kestler (1982).
31. The 2006 Act clearly reduced some inefficiencies in postal product structure, such as cross-subsidies to competitive mail classes, but these are relatively minor compared to those addressed in 1970. Moreover, those inefficiencies likely existed for some time prior to the 2006 Act.
32. Potterman (1989: 11-1) demonstrates this important result:

Suppose a regulated firm, X, sells to two customers, A and B. Suppose further that A and B have equal demands and equal political weight (that is, their utility enters the regulator's utility function in the same way), but that the marginal cost (MC) is higher for serving A than for serving B. Now recall the general result that X will not get maximum profit, for simplicity call this "fix" on maximum profit, T, and assume it is fixed. Since X cases only about the idea of T, not its distribution among A and B, and since A and B are politically equal, the regulator has only one remaining task: to make the price (P) and B (P and P). For A, the consumer surplus, is simply equal to possible given T. The result will be lower P, MC = P, is large enough to permit price to be sufficient, and thereby A's and B's price for the high cost customer to get the low P.MC = P. On the cost-benefit and political importance of the two buyers.
34. Specifically: "It shall be the policy of the Postal Service to maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy." 39 USC § 3623(b) (1996).
35. 39 USC § 3623(b) (1996). An example is Postal Post, which is posted according to zones.
36. See, for example, Coas (1947).
37. Miller (1983: 151) states, "The existence of large common costs in enterprises like the
Postal Service makes it impossible to allocate total costs to individual services in a non-discriminatory manner.\(^\text{38}\) In a survey of the literature on state ownership by Audie Shihide, the Postal Service was portrayed as a paradigmatic case of how contracting with private firms can address these concerns: A common argument for government ownership of the postal service is to enable the government to force the delivery of mail to sparsely populated areas, where it would be unprofitable to deliver it privately (Freese, 1988). From a contractual perspective, this argument is weak. The government can always bind private companies that compete for a mail delivery concession to go wherever the government wants, or it can alternatively regulate these companies when entry is free. It cannot be so difficult to write the appropriate contract or regulation; after all, the government now tells the US Postal Service where it wants the mail to be delivered. (Shihide, 1994: 186)

REFERENCES

Regulation, deregulation, re-regulation


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APPENDIX

Figure 10.4.1 Percentage of first-class mail volume that is workshared

Figure 10.4.2 First-class mail