The Future of the U.S. Postal Service

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Structural, legal, and financial constraints have brought the U.S. Postal Service (USPS) to the brink of breakdown in the past decade. Faced by declining business brought about by the e-mail revolution and competition from private express companies, the Postal Service has repeatedly requested assistance from the federal government. This culminated in December 2006 with the passage of the Postal Accountability and Enhancement Act, which introduces modest revisions in the pricing and service policies of the Postal Service so as to make it a self-sustaining government corporation. But will it?

Although the new legislation addresses some of the problems of the Postal Service, more radical changes may be necessary in the future. One possibility is the complete privatization of the Postal Service including the removal of the legal monopoly that it has on the delivery of letter mail, so as to foster competition in the mail delivery. Because these remedies are currently too controversial for Congress to implement, their chances of being enacted in the near future are dim. Instead, what is emerging is a partial approach to privatization in which the Postal Service forms worksharing agreements with private-sector firms to take advantage of their efficiencies. Whether such partial privatization will significantly improve the efficiency of mail delivery remains to be seen. This article discusses the nature and operation of the Postal Service and assesses the merits of its possible reforms.

The U.S. Postal Service

According to critics, it's time to force the U.S. Postal Service to compete. They note that even with a statutory monopoly, the Postal Service can't make ends meet. For fiscal year 2006, the agency lost about $2 billion and these losses are likely to continue (U.S. Postal

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Service 2006). The President's Commission on the U.S. Postal Service forecasted that, even after assuming that postal rates continue to increase with inflation and considering the cost-saving measures currently in effect, the Postal Service will realize an annual deficit of $4.5 billion by 2012, increasing to a deficit of $8.5 billion by 2017 (President's Commission on the U.S. Postal Service 2003).

Also, the Postal Service has accumulated about $75 billion in unfunded liabilities, mostly money promised to employees in retirement and health benefits as the result of generous contract settlements. This is similar to General Motors, Ford Motor Company, and Chrysler, whose legacy costs have pushed them toward bankruptcy. The May 2007 rate hike for mailing a one-ounce letter, to 41 cents, was intended to generate additional revenues to fund these liabilities and the rising operating costs of the Postal Service.

To understand the financial difficulties of the Postal Service, we must first consider its structure and method of operation. The Postal Service is an independent agency of the federal government. According to its 2006 annual report, as the government's largest civilian employer, with a nationwide network that delivers more than 200 billion pieces of mail each year, the Postal Service is a vital part of the nation's communication network. To fulfill its mission, the Postal Service has a massive infrastructure that includes about 735,000 full-time workers and 115,000 part-time workers. Also, the Postal Service's physical network is massive, with about 38,000 retail postal outlets, 446 mail processing facilities, and 215,000 vehicles. The Postal Service handles a wide variety of mail items ranging from correspondence to packages. Almost 90 percent of domestic mail is generated by businesses, with households accounting for the remaining 10 percent (U.S. Postal Service 2006).

Postage rates vary widely, depending on the mail's content, weight, size, destination, and how it is prepared and presented by mailers to the Postal Service. Mail is organized into groupings called classes. The four main classifications of mail consist of (1) First-Class Mail, which includes items such as business and personal correspondence, bills, payments, and advertisements; (2) Standard Mail, which is mainly advertising mail such as catalogs, coupons, and solicitations; (3) Periodicals, which include mailed newspapers and magazines; and (4) Package Service, which is mainly small packages. The authority to set postage rates is granted to the Postal Service's Board of Governors, which announces proposed rates. The federal Postal Rate Commission must review the proposal, but its approval is not required to implement a hike. Thus, the Postal Service is in a good position to pass higher costs along to taxpayers via its requests for additional revenue.

Although the Postal Service competes against private express firms in the delivery of packages and express mail, it has a legal monopoly over both the delivery of letters and the use of the customer's mailbox. The Postal Service maintains that this protection is necessary for it to provide its public service obligations, such as universal service and uniform rates.

Another characteristic of the Postal Service is its break-even mandate. Thus, when the Postal Service proposes changes to postage rates, it projects its revenue requirement for a particular period based on its total estimated costs plus a provision for contingencies, and then proposes rates that are estimated to raise sufficient revenues to meet its revenue requirement. This means that the Postal Service is supposed to be self-financing and receive no regular cash subsidy.

However, the current business model of the Postal Service, which relies on increasing mail volumes to mitigate postal rate increases and cover the Postal Service's rising costs, is at risk in today's environment of greater competition and communication alternatives. In spite of numerous rate increases and cost-cutting efforts, the Postal Service has incurred substantial deficits as its volumes have declined. Moreover, uncertainties such as the effects of a slowing economy, the extent of diversion to electronic alternatives, the rise of private express competitors such as Federal Express (FedEx) and United Parcel Service (UPS), and new mandates to enhance the safety and security of the mail have adversely affected postal finances and will likely continue to do so in the future.

Although some reforms have been made to improve the efficiency of the Postal Service (Schuyler 2007), they have not resolved the fundamental challenges that it faces. Instead, a stronger revision of the Postal Service's business model may be needed so as to inject additional market incentives into its culture. This might be attempted by complete privatization of the Postal Service, although political realities likely prevent this from occurring in the near future. Instead, the statutory monopoly granted to the Postal Service on the delivery of letter mail could be repealed in order for the Postal Service to compete against private companies that deliver letters. These proposals go beyond the wishes of the Postal Service, which prefers that reforms be minor and remain within its existing authority. In other countries, however, such reforms are already underway. For example, the European Union intends to privatize all of its national postal services by 2009. Also, private-sector couriers have been allowed to capture more than half the mail delivery business in India.

Universal Postal Service

As part of its public service mandate, the Postal Service is required to provide universal service to its customers. This means that it makes postal service available to the entire population of the United States, regardless of distance or one's ability to pay. This requirement is similar to obligations the federal government places on other regulated industries, including telecommunications, railroads, and electric power. The universal service obligation of the Postal Service suggests ubiquity of access to the mail either by delivery or other means, and reasonable access to collection and counter service. Universal service also means that rates are the same regardless of where you send your mail to or receive it from: Everyone in every part of the country gets the same type of mail service for the same price. Thus, a 41-cent stamp is all that is needed to mail a one-ounce letter from, say, Seattle to Boston or any other locale in the United States. Finally, universal service suggests uniform frequency of delivery: People living in cities and rural areas receive mail delivery six days a week.

The modern concept of the Postal Service's universal service obligation did not exist in the early days of the United States. Until the mid-1800s, the Postal Service was considered an intercity carrier that provided no collection or delivery of mail. Service was provided only to towns on post roads designated by Congress. Outlying villages and settlements were not included in the network. City delivery was not introduced until 1863, and then only in 45 cities.

The universality of mail delivery became a theme of the Postal Service with the introduction of "rural free delivery." This was the policy of providing free mail delivery to the homes of farmers out in the country so they wouldn't have to travel into town to get their mail and stamps. Prior to rural free delivery, the 30 million Americans who lived in rural areas had to travel to the nearest post office to send and receive mail, and often these post offices were miles away. Rural free delivery was thus a response to the notion that rural Americans were as entitled to having mail brought to their homes as were their city-dwelling counterparts. Although rural free delivery was introduced in the late 1800s, it was not realized until well into the 1900s. Rural free delivery meant that farmers did not have to live so near a post office and thus began a long and steady decline of rural postal offices throughout the 1900s.

Over time, the nature of universal service has changed. Multiple daily deliveries in cities were eliminated in the early 1950s. Postage rates for local and long-distance letters were not equalized until 1885, and they diverged again in 1932 only to be set equal again in 1944.

The American public has generally favored the preservation of universal service, defined as six-day per week delivery of letters everywhere in the nation at uniform, affordable prices and ready access to post offices in every community. However, the sizable operating deficits of the Postal Service call to question whether this level of service can be maintained in the future. A redefinition of universal service may have to occur that allows for reductions in service, including the closing of unneeded post offices and reducing deliveries on high-cost rural routes from six days each week to five or four days.

The Postal Monopoly

To help the Postal Service fulfill its universal service obligation, the federal government provides it a legal monopoly on the delivery of "letter mail." This policy has resulted in much controversy surrounding the operation of the Postal Service.

Although the Constitution provides the federal government with the power to establish post offices and designate roads on which the mail would pass (i.e., post roads), it does not require that the carrier of mail be a monopoly, much less a government monopoly. Since the late 1700s, however, the government has consistently mandated that a monopoly be granted to its Postal Service on the delivery of letters. This desire initially stemmed from fear of loss of postal revenues from competition at a time when every available dollar was necessary to fund an infant government, especially during times of war. As time passed, the monopoly power of the Postal Service was used to extract revenues that could be used to subsidize frontier postal routes, thus facilitating postal expansion. Monopoly postal revenues also became a source of funds that government officials used to distribute to members of Congress and their friends in order to gain support for favored legislation (Olds 1995).

To discourage competition from private mail companies, the federal government passed several laws during the late 1700s and early 1800s that strengthened the postal monopoly. Fines were imposed on companies that transported mail in violation of federal law. In spite of these fines, private carriers, encouraged by high postal rates of the government's post office, ignored the law and used the rail and steamship lines for mail delivery. By 1844, private companies accounted for two-thirds of the country's mail carriage (Priest 1975).

The federal government reacted to this situation by enacting the Postal Act of 1845, the so-called "private express statues." These laws prohibited private companies from carrying letters for hire, and they essentially remain the law today. They grant the federal government a monopoly in the delivery of "letter mail." Potential competitors can go to jail if they carry letters. However, the monopoly does not extend to other classifications of mail such as newspapers, magazines, advertising, or packages. The private express statutes provide the Postal Service the enviable position of being able to determine the extent of its own monopoly by defining what constitutes a "letter."

The Postal Service has used two arguments to justify its legal monopoly on mail delivery. The first is that mail delivery constitutes a natural monopoly. A "natural monopoly" is defined in economics as an industry where the fixed cost of capital goods is so high that it is not profitable for a second firm to enter and compete. Since the average cost of serving customers is always decreasing, a larger firm will more efficiently serve the entire customer base. A monopoly in this industry occurs naturally because if there is more than one firm in the industry, either the firms will merge to realize economies of scale or one firm will expand its output while its competitors, unable to achieve the firm's lower costs of production, will cease production. Monopoly will always result.

According to the governors of the Postal System, the postal industry has the cost characteristics of a natural monopoly, and thus it is more efficient and less costly for all letter delivery to be provided by the Postal Service than by many firms. For example, mail delivery involves a network, and network externalities suggest that one big network serving a given area will, other things being equal, be more efficient than many overlapping networks providing the same service. Thus, if a competitive postal market is left alone, it is likely that one competitor will eventually win out to control all, or nearly all, of the market. This appears to be the case in a number of advanced countries where postal competition has been introduced, such as Sweden and New Zealand.

However, the Postal Service did not evolve as a natural monopoly, gradually increasing its size, taking advantage of economies of scale, and eliminating competitors. Instead, persistent legislation of the federal government was needed to eliminate private companies that sprang up over the years to meet consumers' demands for faster, more secure, and less expensive delivery service. The notion that a natural monopoly should require legal barriers against competitors in order to survive is unclear. Also, there is virtually no evidence that suggests the Postal Service realizes substantial economies of scale; at best there may be minor economies of scale in delivery of letter mail and in letter processing (Panzar 1991). Simply put, the natural monopoly argument of the Postal Service is not a convincing one.

The most durable argument for the Postal Service's monopoly relates to its universal service obligation. When the private express statutes were passed in 1845, members of Congress argued that private companies would never provide mail service to sparsely populated areas. Instead, they would "skim the cream" by maintaining only profitable routes, thus leaving the government with unprofitable rural routes and substantial losses. Therefore, the principal justification given for legally prohibiting the carriage of letters by private companies was to preserve the implicit subsidy to rural routes.

More recent support of the private express statutes occurred in 1973 when the newly reorganized Postal Service noted that if the private express statutes were repealed, private enterprise, unlike the Postal Service, would be free to move into the most economically attractive markets while avoiding markets that are less attractive from a business standpoint (U.S. Congress 1973). Without abandoning the policy of self-sufficiency and providing the Postal Service massive subsidies, it is hard to see how the Postal Service could meet rate and service objectives in the face of cream-skimming competition against its major product. This argument is still used by the Postal Service to justify its legal monopoly for letter mail.

However, the universal service argument for monopoly power has its limitations. Basic economics suggests that rural customers are unlikely to be without service under competition. Instead, they would simply have to pay the true cost of delivery to them, which may or may not be lower than under monopoly. There are several highly efficient delivery services, such as FedEx and UPS, which frequently cover these same routes. Also, notions of fairness imply that rural customers should not be subsidized by city customers. To the extent that people make choices about where they live, they should assume the cost of that decision. If the cost of providing mail service to rural customers exceeds the cost of providing service to city customers, then rural customers should be expected to pay more. Finally, it is contestable that government monopoly is needed to ensure mail service to rural areas. Instead, the government could award competitive contracts to private firms for that service (Geddes 2005).

Costs of the Postal Monopoly

The Postal Reorganization Act of 1970 requires the Postal Service to be self-financing, which means that it must break even over time and receive no regular cash subsidies. Compared to private express companies, however, the Postal Service receives many subsidies from the government. It pays no federal, state, or local taxes on its income, sales, purchases, or property. Unlike private companies, it is immune from most forms of regulation, such as antitrust, motor vehicle registration, parking tickets, zoning, and land use restrictions. It is also able to borrow money at the lowest possible rate through the U.S. Treasury. Moreover, private companies that compete with the Postal Service in package delivery are hindered by the fact that mailboxes by law are the private resource of the Postal Service. Understandably, private companies facing competition from the Postal Service maintain that they are at a great disadvantage.

A rate structure based on cross subsidization is another source of inefficiency for the Postal Service. It is often argued that for the Postal Service, high-density urban mail delivery subsidizes low-density rural delivery. The subsidy from urban to rural users is mainly due to the distance the mail travels and the costs of delivering it. Although costs vary with distance and destination, all letter mail is priced at the same rate based on average cost. This is, in effect, a subsidy for rural and long-distance delivery that is paid for largely by shippers of letter mail within urban areas. Such cross subsidization would not occur in a competitive market where price reflects the actual cost of service. However, not everyone agrees with this argument. They note that as a group, the cost of serving rural routes is about the same as urban routes. The reason is that rural carriers typically drive their vehicles along an entire route while urban letter carriers park their vehicles and then walk a route. The per letter delivery costs of driving tend to be less than the per letter costs of walking, thus offsetting the effects of urban density on delivery cost (Bernard et al. 2002). The high gasoline prices of 2007 provide support for this argument.

Another concern comes from private express companies, which maintain that letter mail delivered by the Postal Service cross subsidizes some or all of the other classifications. This allows the Postal Service to transfer revenue it derives from its monopoly on letters to battle in more competitive markets such as packages, overnight mail, and express mail. By cross-subsidizing its package service, for example, the Postal Service can offer artificially low prices for its delivery and thus realize an unfair competitive advantage over private couriers. Normally, this cross subsidization would be considered predatory monopolistic conduct, and illegal. But the Postal Service is exempt from antitrust law (Smith 1999).

The Postal Service also faces challenges in containing its operating cost. Because the Postal Service receives indirect subsidies from the government, such as freedom from taxation and regulation, and because its goal is to break even rather than to earn a competitive rate of return, it has less incentive than private companies to use capital and resources efficiently. Subsidies make government products and service appear artificially cheap, resulting in an overallocation of resources that could be used to produce greater benefits elsewhere in the economy. Economic theory maintains that such a misallocation reduces national economic welfare below that achieved by a competitive market. When private companies produce and sell a product or service, there is some benefit to society from the taxes that result. This benefit is not gained when the government produces the same product or service.

Finally, the Postal Service must deal with "X-inefficiency." In constructing a firm's cost curve, economists assume that the firm pays prices for inputs and uses the technologies that allow it to realize the lowest average cost of whatever level of output it desires to produce. X-inefficiency occurs when a firm's actual cost of producing any output is greater than the lowest possible cost of producing it. Presumably, firms in competitive industries are under pressure from rivals, forcing them to be internally efficient to survive. But monopolists are sheltered from competitive forces by barriers to entry, and that absence of pressure tends to result in X-inefficiency (Leibenstein 1966).

Consistent with the principle of X-inefficiency, the costs of the Postal Service are noticeably higher than they need to be because of its limited incentive to hold down labor costs. Postal workers generally belong to well-organized and politically savvy labor unions that extract generous packages of wages, benefits, and work rules. This results in postal workers receiving a "compensation premium," earning greater wages and benefits than workers performing comparable work in the private sector. The wage premium is about 21 percent and the total compensation premium, including wages and benefits, is about 34 percent (Wachter 2004). In other words, unionized postal workers receive 34 percent more in compensation than is received by comparable private-sector workers. The attractiveness of this compensation premium is reinforced by the fact that Postal Service jobs are highly sought after, and once obtained, are held onto. Applicant queues are long, and the quit rate is all but nonexistent. Employees represented by postal unions have a very high degree of job security, a generous benefit package, and wages that have kept up with inflation.

Cost increases have also resulted from failure of the Postal Service to significantly increase productivity, which has risen only 11 percent in 30 years (Congressional Budget Office 2005). For example, postal work rules tend to discourage cooperation between management and labor to increase productivity. The reward for a letter carrier who finishes his or her route early is to be assigned to finish another route.

Moreover, innovations of private express companies have shown many ways for getting products more efficiently from one location to another. They paved the way to express mail and overnight door-to-door delivery of packages with friendly customer support to boot. Although the Postal Service has spent billions of dollars on automation and information technology, productivity has not increased as quickly or by as much as the Postal Service hoped. Simply put, the gains from Postal Service automation continue to be small compared to overall its labor costs, and are not high enough to justify the postal compensation premium (Lendard 1994).

If the Postal Service operated in a competitive market, it would have to get serious about cutting costs. Stamp prices would decrease, or at least would increase at a slower rate than they have. Despite new technology, such as modern readers/sorters that process over 30,000 pieces of mail per hour, stamp prices have risen with inflation since 1970. The increase in mail volume combined with scale economies should have resulted in the average price of a stamp falling in real terms. Rather than make the tough choices that it takes to cut costs, the Postal Service repeatedly does what it always does when revenue gets tight—lobby for an increase in stamp prices.

Long-Run Problems of the Postal Service

Whether or not the Postal Service can break even in the short term by raising rates or deferring investments, there is growing consensus that it faces a perilous long-term prospect that puts the preservation of universal service at risk. The most important problem in the future for the Postal Service is the pressure it faces from competition from various electronic communication service providers. Better alternatives to letter mail keep appearing, such as the telephone, e-mail, fax, and electronic bills, statements, and remittances. Looking at postal services around the world, fewer and fewer countries depend on a monopolistic letter delivery business for survival. Moreover, private delivery companies dominate the market for packages greater than two pounds, and are making inroads into the market for small packages and express mail.

The long-run problems of the Postal Service include an outdated business model, which relies on growth of mail volume to cover the rising costs of its expanding delivery network (Crew and Kleindorfer 2003). This model is not aligned with current market realities that limit the Postal Service's ability to remain self-supporting while providing affordable, high-quality, and universal service. In particular, first-class letter mail, the bread and butter of the Postal Service, is in decline and is expected to remain in decline because of the increasing use of electronic substitutes.

The Postal Service is hampered by several serious problems. First, is the inability of the Postal Service to attract highly qualified management. This is largely because of a salary cap on postal executive salaries that is tied to the federal executive schedule. The Postal Service contends that this cap constrains its ability to provide compensation that is comparable to that in the private sector for managerial, executive, and officer-level positions, thus making it more difficult for the Postal Service to retain and recruit key talent who has the interest and ability to help it become a successful business.

Second, an outdated regulatory regime is also detrimental to the Postal Service. The Postal Service and its governors maintain that the regulatory model established by the Postal Rate Commission is based on control rather than market-based principles. For decades, they have complained about their 10-month adversarial process to adjust rates, when private-sector competitors not only can change rates on short notice or seasonally, but also can offer special contract deals for high-volume customers. The Postal Service contends that the sluggish rate-determination process provides it no chance to respond to competition, to alter rates with periods of low usage, or to set prices in accordance with demand, instead of costs. Moreover, the Postal Service has also faced substantial regulatory obstacles when it tries to be innovative and introduce new products and services that would enhance its revenues.

Third, the Postal Service also suffers from rising labor costs. Currently, about 80 percent of the total cost of operating the Postal Service stems from labor costs. These costs are associated with about 735,000 full-time postal employees, more than 80 percent of that number being unionized. When management and labor cannot agree on a package of wages, benefits, and work rules, a binding decision is made by arbitration. The Postal Service maintains that arbitrators, who are not accountable, tend to simply split the difference, which promotes higher costs (President's Commission on the U.S. Postal Service 2003).

Fourth, the Postal Service lacks two major incentives for cost containment: It has no profit motive and is unable to go bankrupt. Top management gets the same compensation whether or not costs are reduced. It also appears reluctant to confront postal unions with difficult issues relating to the reduction of costs by revising work rules that lead to greater output per worker or cutting postal jobs. In fact, management has a great disincentive to control labor costs. After each major contract is negotiated, management salaries rise by a percentage roughly equal to bargaining-unit increases, surely a major disincentive for tough bargaining. In the absence of growth in mail volume, substantial productivity increases will be required to offset cost due to rising wages.

Fifth, the Postal Service has huge unfunded employee obligations of about $75 billion over the 10-year period 2006–15, of which retiree health benefits constitute $50 billion to $60 billion (Congressional Budget Office 2006). These liabilities reflect postal employees having among the most attractive benefits packages in the nation. The current pay-as-you-go approach to funding these benefits will likely lead to more dramatic and frequent postal rate increases in the future.

Finally, the Postal Service suffers from too many and too old postal facilities. Post offices are often centers of community activity, and efforts by the Postal Service to move, consolidate, or close them to adapt to changing market conditions are controversial and met by resistance. The Postal Service is prevented from closing small post offices solely because they operate at a deficit, and it must go through an elaborate and time consuming community consultation process before closing an office. The Postal Service contends that over half of its 38,000 facilities do not render sufficient revenues to cover their costs, and complains that political factors prevent it from modernizing its retail and distribution systems.

Should the Postal Service's Monopoly Be Removed? Should It Be Privatized?

These problems cast doubt on whether the Postal Service, as currently structured and operated, can be viable in the future. What could be done to reform the Postal Service? As expected, the Postal Service has been willing to propose only modest reforms of its business model. Its objective is to become a "commercial government enterprise," which implies preserving government ownership of the Postal Service, maintaining its legal monopoly on the delivery of letters and access to the mailbox, but allowing it to operate under increased businesslike conditions. There are several elements of this commercialization strategy (U.S. Postal Service 2005):

- Lifting the moratorium on closing post offices, streamlining the process for more closures, and reducing the number of processing centers.
- Negotiating service agreements and volume discount prices with the biggest mailers, exploring seasonal discounts and premiums, and phasing in new rates on a more predictable basis.

- Revamping contract talks with postal unions to escape binding arbitration, and encouraging reasonable settlements with the public's interest paramount.
- Redefining universal service by adjusting service levels and the number of delivery days to a more affordable level.
- Changes in the incentive structure to allow the Postal Service to retain any excess earnings, and eliminate the limit on executive pay tired to the federal executive schedule.
- Expanded freedom to use Postal Service assets for entering related markets and developing new products with skeptical scrutiny from the Postal Rate Commission.

Although this commercialization plan provides a more flexible business model, it does not resolve the fundamental problems of the Postal Service. This is because the plan alone does not subject the Postal Service fully to the discipline of a competitive market. Without such discipline, postal management is unlikely to cut costs and initiate new product innovations that are needed to make the Postal Service a successful commercial enterprise. To introduce additional market-based incentives to postal delivery, the monopoly of the Postal Service on the delivery of letter mail could be removed, as well as its control over mailboxes. Also, the Postal Service could be privatized.

In its complete form, privatization would consist of the transfer of ownership and control of the Postal Service from the public to the private sector. All portions of the Postal Service would be transferred, from mail collection to delivery. This could be accomplished by selling the assets of the Postal Service to private firms. Without a government monopoly, private firms would be free to enter and compete for business. Proponents of this approach argue that incentives of profit-oriented firms would result in costs lower than those of the Postal Service. They cite studies concerning a variety of industries that have generally found cost reductions of 20 percent to 50 percent that resulted from privatization and increased competition. Among the sources of the cost savings are better management techniques, greater incentives to innovate, incentive pay structures, more efficient deployment of workers, better and more productive equipment, and greater use of part-time and temporary employees (Hilke 1992).

However, privatization of the Postal Service is controversial. Opponents believe that certain parts of the economy, including postal delivery, should remain closed to market exploitation in order to protect them from the unpredictability and ruthlessness of the market. For example, a private mail company will serve the needs of those who are most willing and able to pay, as opposed to the needs of the majority. Opponents also believe that the profit maximization goal is not compatible with postal delivery. They note that private couriers tend to face a conflict between profitability and service levels, and may overreact to short-run events by cutting back on staff costs to stem losses. They also contend that the profit motive has an inherent tendency toward corruption, such as embezzlement that was recently practiced by employees of Enron. Simply put, the profit motive should be subordinated to the social objective of providing a stable system of mail delivery whose existence is of strategic importance to the nation.

Indeed, the Postal Service is not an easy candidate for complete privatization. Despite its limitations, most Americans depend on the Postal Service for routine communications and do not relish the notion of plunging into the unknown via privatization. Also, postal unions see privatization as a threat to the generous work rules and compensation levels of their members. To have any chance of being implemented, an attempt to privatize the postal system would have to be far more than a business plan that makes financial sense. It would result in a political battle would include powerful, opposing interest groups which influence the legislative process (Hudgins 1996).

Although complete privatization of the Postal Service has met strong resistance in the United States, a wave of postal privatization is sweeping Europe, Australia, New Zealand, Japan, India, and elsewhere. Efforts to privatize foreign postal systems are altering universal service and rates, the extent of postal monopoly, and the regulation of postal prices. Consider these examples:

- Although New Zealand has not shed its government-owned postal services company, in 1986 it abolished its postal monopoly, allowing for full competition. The government requires its New Zealand Post to maintain universal service, but not to charge uniform rates.
- In 1994, the Netherlands privatized most of its postal service when it sold off 52 percent of it to private investors. Though mostly privately owned, the postal service company maintains a monopoly over the carriage of letters weighing 500 grams or less.
- Like the Netherlands, Germany partially privatized its postal services through a public stock offering. In 2002, the government sold 31 percent of Deutsche Post in a public offering. The firm retains a monopoly in the carriage of letters weighing 200 grams or less and costing no more than five times the basic stamp price, although the monopoly is scheduled to end in 2007.
- In 2005, the postal monopoly enjoyed by the French national

carrier La Poste was reduced from letters weighing less than 100 grams or costing three times the basic stamp price to letters weighing less than 50 grams or costing 2.5 times the basic stamp price.
- In 2003, the European Union reduced its mail monopoly for all members by reducing the size of a letter that national carriers are allowed to monopolize from 350 grams to 50 grams, thus opening up an additional 18 percent of the market to competition (National Association of Letter Carriers 2005).

Similar to the United States, efforts to privatize foreign postal systems have encountered stiff resistance, especially from postal workers who fear loss of jobs as well as customers in rural areas who fear reduction in service.

If privatization is to be seriously considered in the United States, many issues would have to be resolved. Would the U.S. government retain ownership in the privatized company, and would it be a majority or minority owner? Could foreign companies become part owners of the privatized company? Should the privatized company become employee-owned in order to improve incentives for workers to increase productivity? What should be done to treat fairly the 850,000 people who work for the Postal Service in terms of wages, benefits, and pensions? Questions such as these constitute formidable obstacles that would have to be overcome if the Postal Service is to be privatized.

Worksharing and Partial Privatization

Although the Postal Service thus far has successfully lobbied against proposals for its complete privatization, it has gradually accepted the concept of partial privatization. This leaves intact the basic governing structure of the Postal Service but allows for its shifting some work to the private sector. For example, private firms who submit the lowest bids do almost all of the long-haul trucking for the Postal Service. Moreover, air transportation is provided under contract and a sorting facility for express mail is operated under contract. A number of contract stations also exist for postal retail services (Cohen et al. 2003).

Moreover, the Postal Service has adopted "worksharing" as a method of capturing some of the private sector's efficiencies. Worksharing refers to the exporting of work that otherwise would be performed by the Postal Service to private-sector mailers, such as State Farm Insurance and Bank of America. Thus, it reduces the Postal

Service's workload for a given amount of mail. About 75 percent of the domestic mail volume is workshared by mailers, especially for-profit businesses. Nonprofit entities such as charitable organizations and associations also generate substantial quantities of workshared mail.

Key worksharing activities include barcoding and preparing mail so it can be sorted by the automated equipment of the Postal Service, which reduces manual sorting and other Postal Service handling of the mail; presorting mail, such as by ZIP Code or specific delivery location to reduce the number of times the Postal Service must sort the mail to route it to the addressee; and entering mail at a Postal Service facility that is generally closer to the final destination of the mail. Also, mailers must perform numerous other worksharing activities, such as updating and properly formatting addresses to improve their quality and accuracy, thus reducing the amount of undeliverable and forwarded mail, as well as improving the Postal Service's ability to use its automated equipment to sort the mail.

In its support of worksharing, the President's Commission on the U.S. Postal Service has noted that those who can perform postal work best and for the best price should have the job, regardless of whether the best provider is the Postal Service and its existing workforce or a private-sector company. This greater integration of the public and private postal networks adds value to both. It also holds the possibility of allowing the Postal Service to focus on its true core competency: delivery of the mail the first and last mile that makes the Postal Service unique (President's Commission on the U.S. Postal Service 2003).

Because worksharing helps reduce the Postal Service's costs, rate discounts are given to mailers. These discounts equal the difference between the rate for a single piece of first-class mail, weighing up to 1 ounce, and the corresponding rate applicable to workshared mail. Discounts vary depending on the worksharing activities that are performed and the degree of presorting, among other things. To qualify for worksharing rates, mailers must perform worksharing activities and meet minimum volume requirements for bulk mailings, such as mailings of at least 500 letters sent via first-class mail that may include credit card bills, utility bills, advertisements, and bank statements. Aside from first-class mail that is workshared, other workshared mail may include bulk mailings of advertisements, magazines, local newspapers, or packages.

According to the Postal Service, worksharing benefits itself, mailers, and the nation. By improving the operations of the Postal Service, worksharing helps minimize its workforce and infrastructure, thus reducing its costs of operation. Rate discounts due to workshared activities also stimulate mail-volume growth, which can help the Postal Service achieve operating efficiencies. Analysts estimate that without worksharing, Postal Service costs would be about 25 percent higher (U.S. General Accounting Office 2003). For mailers, worksharing reduces total mail-related costs, helping to keep postage rates more affordable. Finally, to the extent that business mailers pass along lower prices to their consumers when their mail-related costs are decreased by worksharing, economic welfare increases for the nation. In spite of these advantages, worksharing has generally been opposed by postal unions that fight against contracting out any Postal Service functions. The postal unions contend that the discounts given to big mailers rob the Postal Service of billions of dollars a year, revenue that could be recovered if the work were brought back in-house.

The Future of the Postal Service

Recognizing that the business model of the Postal Service had become obsolete, in 1995 members of Congress began calling for reform legislation. However, it took until December 2006 for the Postal Accountability and Enhancement Act to be signed into law, the first major change to the Postal Service since 1971. This law aims to stabilize postal rates for households and bulk mailers and to provide the Postal Service with the tools to act and compete as a modern business against UPS and FedEx. However, change will not come immediately because some parts of the law will take as long as three years to implement, and changes to postal service standards could take longer (U.S. Congress 2006).

In return for putting more responsibility on the Postal Service to keep costs in line and keep a close eye on the bottom line, the legislation gives the Postal Service additional flexibility in the process of setting rates. It directs a newly created Postal Regulatory Commission to divide Postal Service products into two classes: (1) market-dominant (monopoly) products such as first-class mail and parcels, standard mail, periodicals, and bound printed matter; and (2) competitive products such as priority and expedited mail, bulk parcel post, bulk international mail, and mailgrams. Regarding the setting of rates, the new law requires the Postal Service to ensure that revenue from each competitive product covers its own costs. This requirement prohibits the Postal Service from using revenue from market-dominant products to subsidize competitive products, a practice that private-sector carriers have long criticized. However, the Postal Service will be able to alter rates, just as commercial business do, and can negotiate discounts and worksharing agreements for individual shippers (Kosar 2007).

Moreover, the legislation limits rate increases for market-dominant products to the percentage change in the Consumer Price Index, to keep rates from rising above inflation. However, the law imposes no price cap on competitive products whose prices reflect market conditions and are set by the Postal Regulatory Commission. Sponsors of the legislation hope that by capping market-dominant rates, consumers will benefit from smaller, regular, and more predictable rate increases. This will allow mail shippers to better forecast their costs. The establishment of a rate cap for the Postal Service is intended to increase incentives for the Postal Service to become more efficient. However, the American Postal Workers Union, a critic of the new law, contends that the rate cap will make it more difficult to bargain for higher salaries, resulting in an artificial cap on postal workers' wages. This comes at no surprise in view of the large compensation premium that Postal Service workers receive relative to the compensation of private-sector workers (Schuyler 2002).

The legislation also provides for a reduction in the Postal Service's revenue requirements that are built into requests for rate increases. For example, the law transfers responsibility for military service benefits payable to postal retirees to the Treasury Department, as is the practice for federal government agencies. It also redirects money set aside for postal retirement costs to a new trust fund that will finance retiree health benefits. Moreover, the legislation achieves some savings on worker injury claims by requiring employees to take sick time for three days before filing for workers compensation. The Postal Service can use these savings to keep postal rate increases in check, to pay down debt, and to fund retiree health costs.

To improve the transparency and accountability of the Postal Service, the legislation requires postal officials to make many of the same financial disclosures as public companies. The Postal Regulatory Commission will have the power to issue subpoenas that forge deeper into the Postal Service's activities than its previous regulator (O'Driscoll and Hoskins 2006).

The Postal Accountability and Enhancement Act is intended to solve the structural, legal, and financial constraints that have brought the Postal Service to the brink of breakdown. Rather than creating a new Postal Service based on the principle of privatization, the legislation is incremental in that it allows the Postal Service to continue its transformation efforts and cost-cutting measures. However, the legislation did not include any of the workforce cost-decreasing measures recommended by the President's Commission, including major changes to collective bargaining, salary comparability, and fringe benefits, all of which are strongly opposed by postal unions. Nor did the legislation address the problem of allowing the Postal Service to rationalize its outdated facilities network. Simply put, the legislation fails to address the major cost problems that have pushed the Postal Service toward financial breakdown.

Whether the legislation will work will depend on the ability of the Postal Service to deliver cost-effective services to households, businesses, and nonprofit organizations. It remains to be seen if the new legislation can offset challenges such as continued declines in the volume of first-class mail, the use of fax machines, e-mail, and Internet commerce, as well as increased competition from private carriers. These factors will likely continue to burden the Postal Service and present challenges to its business model, thus requiring more stringent reforms in the future.

Conclusion

The business model of the Postal Service faces great challenges. They stem from secular changes involving the substitution of electronic media, such as e-mail, for letter mail as well as competition that the Postal Service faces from private express companies. Also, as a governmental enterprise, the Postal Service lacks two major incentives for cost containment and service improvement: It has no profit incentive, and it is unable to go bankrupt. Recognizing these inadequacies, the Postal Service has favored a plan to transform itself by initiating incremental reforms to make it operate more like a business.

However, privatization is likely to be much more effective than public enterprise in providing incentives for the Postal Service to succeed commercially. Although the Postal Service has privatized some of its operations vis-à-vis worksharing, its efforts have not gone far enough to make it an efficient organization. At a minimum, additional privatization will be necessary. This might consist of preserving the Postal Service monopoly on the last mile delivery, while opening up the acceptance, transport, sorting, and processing of mail to much greater competition. Although additional worksharing tends to promote greater operating efficiencies, it is only those operations that are workshared.

Conceivably, the entire Postal Service, not just pieces of it, could be privatized through a carefully structured sale of the entire operation to private owners. The Postal Service could be set up like a private corporation with the announcement that it will be completely privatized within the next several years. During this transition period, its chief executive officer and board of directors would be delegated the responsibility of achieving this objective. However, management of such a liquidation would be extremely difficult, especially given the enormous size of the Postal Service. Instead, partial privatization will be the likely path that the Postal Service will follow in the near future, especially in the work of expanding worksharing agreements with private-sector firms.

Will the monopoly of the Postal Service on the delivery of letter mail and access to the mailbox be removed? Will the Postal Service be completely privatized? The answer is not in the foreseeable future. In 2003, the President's Commission on the U.S. Postal Service recommended decreasing the Postal Service's monopoly over time as well as removing legal obstacles to the closing of underutilized post offices. They also would subject priority mail, expedited mail, parcel post, and international mail to federal income taxation, antitrust laws, and truth-in-advertising laws, thus nudging them toward conventional business activities. However, letter mail would continue to be protected by the delivery monopoly, and the Postal Service would not be completely privatized (Kosar 2005). Yet these recommendations have not been enacted. As for the Postal Accountability and Enhancement of 2006, it may provide the Postal Service some additional flexibility to compete with private-sector firms. However, it is not clear that this legislation will be able to offset the challenges of decreasing volume of first-class mail.

Indeed, implementing any reform of the Postal System is difficult. Numerous groups, including unions, prefer the status quo, and Congress has found substantial postal reform to be too controversial. Yet other industrialized countries have started serious efforts to allow competition into their postal systems. Perhaps with the Internet breathing down the postman's back, Congress will be forced to implement stronger reforms, and the Postal Service will have to follow a different path.

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