END THE POSTAL MONOPOLY

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Earlier this year, the cost of mailing a first-class letter went from 20 cents to 22 cents. It was the third increase in four years, the seventh since the Post Office became the independent U.S. Postal Service in 1970. As usual, politicians decried the inefficiency of postal delivery and promised to "do something." But few seemed willing to consider the one action likely to have a real effect on the efficiency of the U.S. postal system: let others compete in the delivery of first-class mail.

The Evolution of the Postal Monopoly

While the Constitution provides Congress with the power "to establish post offices and post roads," it does not require that the carriage of mail be a monopoly, much less a government monopoly. Throughout the first half of the 19th century, however, Congress enacted ever more restrictive measures limiting the private carriage of mail. For example, an 1825 statute that reserved to the federal government the exclusive right to carry letters for hire in vehicles over post roads was amended two years later to prevent private carriage on horseback or foot. This presumably made life difficult for the Pony Express, which although often used as a symbol of U.S. mail service, was a creature of private enterprise.

Finally, Congress passed the Postal Act of 1845—the so-called private express statutes—which directly prohibited private companies from carrying letters for hire.[1] These statutes (with a few modifications) remain the law today. They grant the government a monop-

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[1]5 Stat. 732 (3 March 1845).

oly in the delivery of letters (first-class mail). The monopoly does not extend to newspapers and magazines (second-class mail), direct-mail advertising (third-class mail), or parcels (fourth-class mail).

Through its ability to define a "letter," the Postal Service is in the enviable position of being able to determine the extent of its own monopoly. While the service has "suspended" its monopoly for certain letters (such as time-sensitive materials), it has also expanded its monopoly by defining letters to include bills, receipts, IBM cards, magnetic cards, magnetic tapes, and other business documents.[2] Typically, as new services such as express mail have developed, the Postal Service has first asserted that these services fall within its monopoly and then announced a suspension of the monopoly with respect to *some* aspects of the new service.[3]

Is the Postal Monopoly Economically Justified?

The standard economic rationale for production by a regulated franchise monopoly, whether privately or publicly owned, is that, under certain technical conditions, production may be accomplished at least cost by a single firm. Government may wish to impose maximum rate-of-return regulation on such "natural monopolies" in an attempt to reduce the allocative efficiency costs associated with unregulated monopolies. But even in the case of a proven natural monopoly, economists are ambivalent about the desirability of regulation because of its direct and indirect costs.[4]

There is, however, no convincing evidence that mail service is a natural monopoly. Indeed, most of the relevant studies have failed to find significant economies of scale.[5]

[2]The USPS currently defines a "letter" as any "message directed to a specific person or address and recorded in or on a tangible object." 39 C.F.R. §310.1(a).

[3]The USPS has asserted that it has authority to exempt materials from the postal monopoly pursuant to 39 U.S.C. §601(b).

[4]See, for example, Paul L. Joskow and Roger C. Noll, "Regulation in Theory and Practice: An Overview," in Gary Fromm, editor, *Studies in Public Regulation* (Cambridge: MIT Press, 1981), p. 10.

[5]For instance, an empirical study by the Post Office itself did not uncover economies of scale. See Bureau of Finance and Administration, U.S. Post Office Department, *Summary Report of Cost System Task Force on Incremental Costs* (Washington, D.C., May 1970). See also the review of studies in Leonard Merewitz, "Economies of Scale in Postal Service" (U.S. Postal Rate Commission (PRC); 30 August 1973) and the review contained in Initial Decision, PRC Docket No. R74-1, pp. 78–90. No general economies of scale were found in Rodney E. Stevenson, "Postal Pricing Problems and Production Functions" (Ph.D. dissertation, Michigan State University, 1973), and the Department of Justice found "virtually no credible evidence that this [i.e., economies of scale] is actually the case." See U.S. Department of Justice, *Changing the Private Express Laws* (1977).

Most importantly, if mail service were a natural monopoly, competitors would find it very difficult to provide the same level of service at the same or lower cost.[6] Consequently, the Postal Service's position would be secure without legal protection.

The Economic Costs of the Postal Monopoly

The Postal Service provides a classic illustration of the problems inherent in trying to determine efficient prices and hold down costs for a regulated monopoly.

The existence of large common costs in enterprises like the Postal Service makes it impossible to allocate total costs to individual services in a nonarbitrary manner.[7] This makes ratemaking very difficult. While it is conceptually possible to determine efficient prices by looking at both cost and demand conditions, the necessary information is typically not available in sufficient detail. As a result, there is no reason to believe that prices will be efficient—even before allowing for the influence of a variety of political pressures that make themselves felt during the ratemaking process.

Moreover, with restricted entry, an inefficient rate structure is easy to maintain, because new firms cannot enter in response to a price that is set too high. Thus, cross-subsidization, which is virtually impossible under competitive conditions, occurs with some frequency in regulated industries. It is, in fact, a major source of the economic inefficiency associated with the Postal Service. In addition, postal costs are generally higher because the Postal Service faces only limited incentives to produce in the least-cost manner.

[6]Under special circumstances, it is theoretically possible for an entrant to provide one of a natural monopolist's services at a price lower than the most efficient price, in which case the natural monoply is said to be "unsustainable." See John C. Panzar and Robert D. Willig, "Free Entry and the Sustainability of Natural Monopoly," *Bell Journal of Economics* (1977), pp. 1–22. But we have no evidence that the postal monopoly is unsustainable. In fact, "there is no evidence that the cost conditions for that are present in postal services." See Bruce M. Owen and Robert D. Willig, "Economics and Postal Pricing Policy," in Joel L. Fleishman, ed., *The Future of the Postal Service* (New York: Praeger Publishers, 1983), p. 231. More generally, the sustainability literature is "too specialized and insufficiently operational" to support entry restrictions as a policy prescription. See Joskow and Noll, p. 17.

[7]See Melvyn A. Fuss, "Cost Allocation: How Can the Costs of Postal Services Be Determined," in Roger Sherman, ed., *Perspectives on Postal Service Issues* (Washington: American Enterprise Institute, 1980), pp. 30–46; Owen and Willig, pp. 227–45; and Rodney E. Stevenson, "The Pricing of Postal Services," in Harry M. Trebing, ed., *New Dimensions in Public Utility Pricing* (East Lansing: Michigan State University, 1976), pp. 427–52.

Inefficient Rate Structure

Because of the problems involved in allocating costs, precise quantitative estimates of cross-subsidies within the postal system are difficult to obtain. It is generally conceded, however, that high-density urban service subsidizes low-density rural service. It is also alleged that first-class mail in general subsidizes some or all of the other classes.

The subsidy from urban to rural users arises primarily because the Postal Service charges the same rate for all first-class mail, regardless of the distance the mail travels and the costs of delivering it. Some first-class mail is therefore overpriced and some is underpriced. Consequently, as the Postal Service itself has stated, "if the Private Express Statutes were repealed, private enterprise . . . would be free to move into the most economically attractive markets. . . ."[8]

One of those areas would undoubtedly be transaction mail—bills, bank statements, and so forth. This mail, which tends to be generated by a few, high-volume local business mailers (for example, banks, utilities, and department stores) and tends to be destined for high-density areas, is relatively inexpensive to deliver.[9] If entry were permitted, the price for delivering transaction mail (which constitutes a significant portion of first-class mail) would fall. This is what the competitive process is all about, notwithstanding the fact that the Postal Service refers to it as "cream-skimming."[10] Such cream-skimming opportunities only occur when prices exceed costs. The existence of such opportunities is therefore evidence that current pricing misallocates resources.[11]

Whether there is an additional subsidy going from first-class mail to other classes is an issue of some contention. However, the Postal Rate Commission's chief administrative law judge concluded that such a subsidy did exist, and that "the Postal Service has become a tax-collecting agency collecting money from first-class mailers to

[8]U.S. Postal Service, Statutes Restricting Private Carriage of Mail and their Administration (House Committee on Post Office and Civil Service, 93d Cong., 1st Sess., Committee Print 1973), p. 6.

[9]The Postal Service offers discounts for presorted first-class mail of 500 or more pieces. It also offers discounts for first-class mail addressed with machine-readable "Zip + four" address labels. However, these discounts do not take into account the number of separate places to which the mail is addressed, nor the population density of those locations.

[10]Ibid., p. 5.

[11]See, for example, Alfred E. Kahn, *The Economics of Regulation: Principles and Institutions, Volume II: Institutional Issues* (New York: John Wiley and Sons, 1971), pp. 220–46.

distribute to other favored classes."[12] If this is the case, entering firms would be able to lower the average price charged for first-class mail.

Higher Overall Costs

The postal system is a particularly good source (in the event that one is needed) for evidence that private enterprise performs better than government enterprise and that competitive markets perform better than monopolies.[13]

The costs of the Postal Service are significantly higher than they should be because the incentive to hold down costs—most notably, labor costs—is limited. Postal workers are paid far more than is necessary to retain their services.[14] Because entry into postal markets is restricted, the Postal Service is able to pass those higher costs along to its customers.

Higher costs also result from failure to innovate. For example, as of 1974, the Postal Service still shipped all of its parcels in bags, which resulted in high breakage rates and handling costs. When the United Parcel Service (UPS)—a private competitor—introduced mechanization and containerization, breakage was reduced and han-

[12]See James C. Miller III and Roger Sherman, "Has the 1970 Act Been Fair to Mailers?" in Sherman, *Perspectives*, pp. 64–65.

[13]There are, of course, many other sources. See Roger Ahlbrandt, "Efficiency in the Provision of Fire Services," *Public Choice* 16 (1973): 1–15 (finding private firm provides goods at lower cost than government agency); W. Mark Crain and Asghar Zardkoohi, "A Test of the Property-Rights Theory of the Firm: Water Utilities in the United States," *Journal of Law and Economics* 21 (1978): 395–408 (finding higher operating costs in publicly owned water utilities); David G. Davies, "The Efficiency of Public v. Private Firms: The Case of Australia's Two Airlines," *Journal of Law and Economics* 14 (1971): 149–65 (finding private company more efficient than public firm); Cotton M. Lindsay, "A Theory of Government Enterprise," *Journal of Political Economy* 84 (1976): 1061–77 (determining government managers maximize self-interest by producing output Congress is likely to value more highly than consumers do); and Sam Peltzman, "Pricing in Public and Private Enterprises: Electric Utilities in the United States," *Journal of Law and Economics* 14 (1977): 109–47 (finding that government-owned firms adopt pricing policies that enhance their political support, not consumer welfare).

A number of Federal Communications Commission (FCC) decisions that altered the monoply conditions formerly prevailing in the common carrier communications field provide empirical evidence that competitive markets perform better than monopolized ones. The Chairman of AT&T, for example, testified that as a direct result of the FCC's rulings, the Bell System companies were forced to become more innovative and to deploy the results of that innovation more rapidly. In addition, the prices Bell charged were generally reduced and new policies reflecting more cost-related pricing were adopted. See generally letter from FCC Chairman R. E. Wiley to All Members of Congress on H.R. 12323, 25 May 1976; and FCC, Second Report in Docket 20003, FCC 80-5, released 29 January 1980.

[14]See Douglas K. Adie, "How Have Postal Workers Faired Since the 1970 Act?" in Sherman, *Perspectives*, pp. 74–93.

dling costs lowered. As a result, the Postal Service has steadily lost business to UPS.[15]

The success of private express mail service is also indicative of the benefits of competition. Despite the threat of suit by the Postal Service, numerous private carriers developed in the 1960s and 1970s, specializing in the rapid and reliable transportation of commercial documents. In 1973 the Postal Service responded and established its own express delivery service called "Express Mail." Despite attempts to expand the postal monopoly to include express mail services, private services now compete openly and freely. Indeed, private companies such as Federal Express and Purolator deliver overnight to more cities than does the Postal Service.

Fears of Higher Prices and Reduced Service

If repeal of the private express statutes will reduce rates for some postal services, will it also raise rates for others? This is a major fear, particularly for residents of rural areas. There are, however, two reasons for believing that such fears are exaggerated.

First, if competition reduces the overall level costs, this will benefit everyone, including consumers of high-cost services. Second, our experience with the deregulation of trucking and airlines suggests that fears of significant reductions in rural service due to postal deregulation are probably unfounded. Some small cities are no longer served by large jets, but commuter airlines have used smaller planes to serve small communities at far lower costs. Thousands of new companies have gone into trucking, and as a result trucking service to rural areas has improved.

If we can obtain airline and trucking service throughout the country without a government monopoly, competition can also work for letter delivery. The configuration of service may change somewhat, but surely everyone would have access to affordable mail delivery.

If a subsidy is deemed necessary, it might be patterned after the small-community air service program implemented along with airline deregulation. This program now subsidizes air service to 145 communities at an annual cost of $51 million. This cost has declined significantly since the program began in 1978, and the program is

[15]The USPS tried to learn from UPS's success by building a one billion dollar bulk mail system to improve its handling of parcel post mail. But that effort has been such a failure that the General Accounting Office has suggested USPS write the investment off as a loss. See, for example, Joel L. Fleishman, "Postal Policy and Public Accountability: Is the 1970 Bargain Coming Unglued?" Manuscript, Harvard University, Program on Information Resources Policy, 1981, p. 94.

scheduled to be phased out. Yet, on the whole air service to small communities has improved since deregulation.

The cost of the small-community air service program has been running at about 0.2 percent of total domestic airline revenues. The analogous figure for the Postal Service would be $26 million—a paltry sum for ensuring that there will be universal mail delivery, and for enabling the benefits that competition would bring to this industry.

Conclusion

The burden of showing that the postal monopoly is necessary or desirable has not been met. All the available evidence suggests that competition in the market for first-class letter delivery would create substantial benefits.

If the private-express statutes were repealed, existing mail firms would expand and new ones would enter the market. Probably just as important, the spur of competition would mean improvements in the Postal Service itself. Private enterprise will get the mail delivered—just as it did in the Old West.