Postal Peril: The checks aren't in the mail

BY BETTY JOYCE NASH

Everybody in Garrett Park, Md., population 1,000, has business at the town post office because they prefer to pick up mail in person while chatting with neighbors. A possible one-day cut in service, from six to five days a week, says Mayor Chris Keller, has everybody talking. Especially if Saturday gets cut since that's a big day for commuters to conduct post office business.

The U.S. Postal Service (USPS) says the change, among others, would enable it to weather not only sleet and snow but also recession and a changing mail market. Both have hammered mail streams — especially first-class mail, over which the USPS has a monopoly. It's the high-octane fuel that subsidizes the cost of carrying mail six days a week to 149 million delivery points from Honolulu to Key West. "With unemployment currently high, mail volumes are unusually low," says economist Rick Geddes of Cornell University. "It is unlikely that the USPS will be able to further cut costs to avoid losing lots of money."

Mail volume plunged by 20 billion pieces through third quarter of 2009 over the same period in 2008. The USPS' net loss: $2.4 billion. To bring in money, the USPS is rolling out initiatives in its competitive shipping business. It's gained market share in priority mail, and is still delivering plenty of advertising despite the economy. The USPS is consolidating operations and shrinking its work force, albeit incrementally. Still, the USPS will be hard-pressed to stay financially viable, especially in the short run.

Post Office-Opoly

Only the USPS can deliver letter-class mail and other contents to your mailbox, the so-called "mailbox rule." Standard mail, such as advertising circulars and magazines, is monopolized by the mailbox rule. This forbids private companies from delivering mail without postage to a mailbox.

The USPS has received no taxpayer subsidy since 1982. It gets perks, though. It's exempt from property or corporate taxes and can borrow money at Treasury rates. The USPS monopoly on letter-class mail and its exclusive access to your mailbox protects its affordable "universal service obligation" to customers everywhere at the same price. Low-cost urban routes subsidize higher-cost rural ones. Yet only about 17 percent of the U.S. population lives in rural areas any longer. Even so, the USPS has in recent years added more than a million rural delivery points.

Historically, the USPS was regarded as a natural monopoly such as transportation or telecommunications. In these industries, extensive delivery networks imply high fixed costs — the bigger the network, the cheaper the costs to provide service on average. A monopoly can achieve these economies of scale more efficiently than having multiple firms duplicate efforts. The USPS has an additional protection in the form of a legal monopoly enforced by the federal government.

Today, many observers have questioned whether postal services should be viewed as a natural monopoly anymore, especially as technology has spurred competition, with positive results, in previously high-fixed-cost industries such as airlines, trucking, natural gas, and telecommunications.

Besides, there are downsides to the restrictions that come with legal monopoly. With mail volume plummeting, the USPS can't react quickly to the market; that's why it's asking permission from the government to cut a delivery day. It must also abide by rules against when a post office can close, not to mention the political uproar when it tries. "The Postal Service faces strong political pressure to leave unneeded mail distribution centers and underutilized post offices open, and to use outdated, labor-intensive technologies," according to Geddes, in a 2005 paper in the *Journal of Economic Perspectives*.

Government Accountability Office testimony for a congressional subcommittee in May 2009 emphasized the USPS need to "right size," but recognized the problem: "USPS has often faced resistance from employees, affected communities, and members of Congress when it has attempted to consolidate its operations and networks."

The U.S. Postal Service has expanded automated services in addition to consolidating and shrinking its work force to counter declining mail volume and revenue.

Declining Demand

Mail volume peaked at 212 billion pieces in 2006. First-class mail volume fell by almost 5 percent in 2008, and revenues by 0.6 percent despite two price increases. Through the third quarter of 2009, the USPS has seen its biggest consecutive three-quarter decline since 1971. And estimates for 2010 don't look good either. That means cheaper, standard-class stuff in the mailbox and fewer first-class dollars for the USPS.

Gerald McKiernan, media manager for the USPS, attributes the falloff to the sour economy. "A lot of banking correspondence has gone away, a lot of first-class mail; the housing industry mail has gone away." And, the Internet is taking lucrative first-class mail such as bill payments.

To cope, the USPS wants to defer its obligation to prepay a chunk of its retiree health fund as required by law; last year's payment was $5.4 billion. Not a trivial expense, given that the USPS has the biggest work force in the nation outside of the U.S. Department of Defense and Wal-Mart.

Second, the Postal Service wants to cut a delivery day, maybe temporarily. A study group at the USPS is meeting with unions, management associations, and consumer groups to see how it would affect their industries, McKiernan says. A curtailed schedule could save $3.5 billion annually, according to the USPS; a George Mason University study for the Postal Regulatory Commission estimated $1.9 billion. As of press time, Congress had not acted on the request to cut a day of delivery, but a committee in the U.S. House of Representatives had approved a partial reduction in payments to the health fund, according to McKiernan.

The USPS' role and the mail market have changed since the era of the first Postmaster General, Ben Franklin. Back then, the postal service delivered newspapers (for a penny within 100 miles) to far-flung cities and towns to inform the electorate. And pioneers depended on the service as their only conduit for personal letters to friends and family back east.

The postal monopoly was codified in 1845; the mailbox rule dates from 1934. The most recent overhaul to the USPS came in 2006 with the Postal Accountability and Enhancement Act (PAEA). With the act came some flexibility to adjust postal rates. (First-class, standard, periodical, and package service are all monopoly services while express, priority, bulk parcel, and international are competitive.) The PAEA allows annual price changes, but holds average increases for the monopoly mail to the consumer price index. That's making it hard for the USPS to raise rates right now because inflation is low, McKiernan notes.

Competitive shipping services in 2008 represented about 11 percent of USPS mail revenue and 1 percent of volume. The competition (firms like UPS and FedEx) dominates express and parcel markets, and that includes foreign postal services doing business in the United States. (However, they are feeling the economic strain too. DHL, owned by the German postal service DeutschePost, in 2008 cut its U.S. work force by 14,500 employees and reduced domestic services.)

Lack of innovation is another problem for the regulated monopoly. "We try to do things but we get pulled back," McKiernan notes. For instance, UPS will pack and ship for a customer, but "we can't do that."

But the USPS is discounting and promoting its expedited service like Express and Priority mail for large users, hoping to pick up some DHL business. The USPS also has arranged with shippers to take goods that "last mile," in some cases, and is piloting a partnership that would enable customers to return UPS-shipped goods via postal carrier. UPS drivers then collect those parcels at the post office.

Labor and Real Estate

A local post office is a sacred cow, especially in small towns. Even though the USPS needs to consolidate its real estate, it's tough. McKiernan notes: "You can't close a post office for economic reasons only." He says once when the USPS announced a particular closure, the town's mayor protested and vowed to send an e-mail about it to the postal service. "There was an irony in that."

But the USPS desperately needs to reduce capacity and is considering closures. About 413 stations are under review. Already, some 53,196 alternate locations sell stamps, among other services, and the USPS also contracts for service at 4,510 locations. About 1,914 independent firms, like shipping stores, offer USPS services as well as competitor products.

Mayor Keller of Garrett Park says the town's post office has been targeted for closure at least once, back in the 1950s. "The town undertook a fairly big effort to keep it," he said. "That was viewed as potentially unfortunate for the community spirit of the town."

Likewise, it's hard for the USPS to cut employees, and it is labor — not capital — intensive. Compensation and benefits comprise about 80 percent of USPS costs. And postal workers make about 28 percent more than others in comparable jobs, according to Barry Hirsch, Michael Wachter, and James Gillula, in a 1999 article in *Research in Labor Economics*, updated in 2003. That wage premium rises to 34 percent when occupational skill requirements and working conditions are included, and even more when total benefits are considered.

Even with automation and commercial work-sharing agreements, the percentage of cost attributable to labor has remained the same for some years. Nevertheless, the work force has shrunk through attrition and retirement, from a peak of about 798,000 to 663,000 workers. And more are likely to go — about 160,000 will be eligible to retire in fiscal 2009, and 130,000 more in 2010 through 2013. Some workers also will be offered early retirement.

While labor and operations may be straightforward to quantify, there may be security concerns. For the same reason it's hard to close a post office, it may be hard to see the mailbox rule relaxed — what if just anyone could use your mailbox?

Worries about added risks of nuisance mail and identity theft crop up. Residents in Garrett Park, Md., have avoided home delivery for two reasons. Certainly the biggest may be social, "because going to the post office afforded an opportunity to run into people," Keller says. But should that preference be considered too "touchy-feely," people also say they like the security of the postal box. They worry about identity theft. While postal customers, by and large, don't go to that extreme to retrieve mail, identity theft looms as a threat. And the USPS is widely trusted. It came out on top in the 2007 and 2008 Ponemon Institute privacy trust rankings of U.S. government agencies. (The nonprofit institute researches privacy management.)

The USPS' 1,600 postal inspectors in FY 2008 made 8,919 arrests for various fraud and drug offenses. The USPS hired the RAND Corp. to analyze effects on the postal inspection service of changing the mailbox rule. RAND found that relaxing the rule would add to cost and complexity of the USPS inspection service. However, Jim Campbell, who consults on postal reform for the European Commission, says that the issue "has not been significant in the reforms around the world that are much further down the road." In many countries, the incumbent service retains much of the mail business, even if privatized, corporatized, or both.

All Around the (Developed) World

Whether relaxing the mailbox rule or the monopoly over letter-class mail or both would drive the USPS to thrive would depend on implementation. If the service were privatized, investors would have incentive to make sure it cut costs and brought in new revenue.

With a continued monopoly, those incentives are dulled. "If, however, a privatized USPS were also de-monopolized, and thus subject to competition from other delivery companies, it need not be subject to price regulation of any kind," Geddes says. "In the latter case, its operation would likely be very efficient and innovative."

Outside North America, postal markets are opening to competition, using various approaches. (All except Japan, says Campbell, which is "getting cold feet.") The European Union wants harmonized practices so quality and delivery among countries stays efficient and transparent.

Reform started with Sweden. In 1994, the Sweden Post became a state-owned joint stock company, obliged to provide universal service. By 2007, according to Campbell, about 90 percent of total mail was delivered by Sweden Post. Its biggest rival, CityMail, specializes in delivering presorted bulk mail in cities twice a week. Sweden Post replaced more than 80 percent of post offices with contract agencies, to customers' initial chagrin. However, customer satisfaction revived as postal services got better. And service price and quality to urban areas, where they compete with CityMail, have improved. Sweden Post has reported 5 percent profit margins in recent years, according to a 2008 report by Campbell and co-authors Alex Dieke and Antonia Niederpruem.

Reform is always resisted, says Campbell, who is compiling a survey for the European Commission of postal reform in the 30 European Union and European Economic Area countries. "I've been involved in postal reform in many parts of the world. There is no place you can go where they don't say, 'Yes, but this is different.' But the truth is the postal office is mainly a buildup of a lot of rather simple operations. It doesn't change drastically."

Yet ongoing European reform often takes one step forward and two steps back. Deutsche Post, for instance, well on its way to reform, ditched remnants of its monopoly at the start of 2008, but the German government passed a minimum postal wage requirement that has stymied competition.

The postal service in the Netherlands, TNT, was the first in Europe to privatize, after combining with an Australian express package firm. The Dutch government sold its last stake in the firm in 2006. (As a competitor to Deutsche Post, TNT is fighting the German labor law.) In the Netherlands, competition has flourished in the direct-mail market, and the Dutch government has commissioned TNT for the universal delivery of correspondence. The EU Postal Directive requires mail markets to be opened to competition by the end of 2010; the date is 2013 for 12 of the EU's 27 states, including Greece, Luxembourg, and Eastern Europe.

Postal networks worldwide will likely continue to re-form so they can respond to the shifting revenue streams that emerge from a changing mail mix and recession. Delivery services like FedEx and UPS also have had to manage costs to offset declines.

The question for the USPS — any postal service — remains how to manage market conditions when hamstrung by a monopoly's accompanying regulations. For now, the USPS hopes consolidation, its proposed five-day per week delivery schedule, and relief from prefunding retiree health benefits will keep the service viable. The GAO has listed the USPS as "high risk" because of its infrastructure and personnel costs as mail volume and revenue decline.

In the long haul, even without a monopoly, the USPS would more than likely dominate delivery because it would be tough for competitors to duplicate the network already in place. Still, Campbell notes, "There is no question that getting rid of the monopoly pushes the company to do a better job." **RF**

Readings

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