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REAL TRANSFORMATION NEEDED AT POSTAL SERVICE

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Faced with shrinking business and massive deficits, the U.S. Postal Service (USPS) is in trouble. Steadily advancing technologies and the rise of electronic alternatives mean that the Postal Service, as currently structured and operated, may not long be viable. Although postal management recently announced a welcome set of policy reforms, more fundamental changes are necessary—including elimination of the USPS monopoly on letter mail, and even privatization.

Yet Congress has considered only smaller reforms and, last week, rejected even that approach. Attention now turns to the White House, which may appoint a blue-ribbon commission to recommend changes. Meanwhile, America's postal consumers continue to wait—or move in line.

Financial Woes. On June 30, 2002, the price of a first-class stamp will rise from 34 cents to 37 cents, the second increase in 17 months. This increase, however, is only the most visible sign of a looming postal meltdown.

The numbers are not encouraging. Mail volume, which used to increase reliably each year, is stagnant or worse. In fiscal 2001, advertising mail decreased for the first time in 10 years. The contraction of total volume during the first half of fiscal 2002 was the largest since the Great Depression. As business drops off, costs to the Postal Service continue to grow, resulting in mammoth deficits for the

system. Even with June's postage increase, the USPS projects losses of some \$1.5 billion for fiscal 2002. This follows losses of \$1.7 billion in fiscal 2001 and \$200 million in 2000.

While there are many factors at work, the fundamental cause of the system's problems is the Internet. Increasingly, communication is taking place on-line rather than via letter carrier. In the past couple of years alone, it has become commonplace to send even greeting cards electronically. Bill payment (which accounts for approximately one-fifth of first-class mail volume) may be the next to go as on-line bill payment becomes increasingly common.

Last year's anthrax attack may have accelerated this trend. In addition to imposing large new security costs, fear of terrorism drove large numbers of Americans away from the mail, forcing them to find alternative ways to communicate. Having found them, they may never come back. In Washington, large portions of Capitol Hill and the execu-

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tive branch have been without normal mail delivery for months, yet life has gone on much as before.

Systemic Inefficiency. Prospects for the USPS are further dimmed by its notorious inefficiency. Despite a huge investment in automation, the system's productivity growth has been abysmal—approximately just 11 percent over the past three decades. Rate increases may only make things worse, driving away even more customers.

Prospects for the Future. Because of these factors, the future of the Postal Service is uncertain. In a decade or so, paper mail could be a quaint hold-over from the past, akin to sending a telegram or renting a phone from AT&T. More likely, mail delivery will continue, but on a smaller scale. One thing is certain: The business of delivering mail will face substantial challenges. In the words of a U.S. General Accounting Office report released earlier this year, "A transformation [is needed] if USPS is to remain viable in the 21st century."

In response to this critical situation, in April 2002, the USPS released a detailed "transformation plan" proposing reforms such as closing unneeded post offices and reforming labor rules. Although the Postal Service has announced it has begun to make changes in many of these areas, whether it will achieve substantial improvements remains to be seen.

Perhaps the most controversial portion of the plan is the proposal that the USPS be given increased flexibility in its operations, including wider powers to raise capital and set rates. The plan also calls for more freedom to enter related businesses, such as e-commerce, transportation, and printing.

Introducing Market Competition to Generate Reform. The case for increased flexibility is sound. So is the case for diversifying lines of business, especially for a firm in a declining industry. Yet the

Postal Service is no ordinary business. It enjoys a wide range of perquisites and protections tied to its government status, from exemption from taxation to implied guarantees from the U.S. Treasury. Foremost among these is its legal monopoly on letter mail: Competition with the Post Office in this arena is a criminal offense. This protectionism creates very real concerns that, despite increasing use of Internet communication, the Postal Service could distort markets to the detriment of competitors and consumers alike.

Moreover, eliminating such special privileges and recreating the service as a private, competitive corporation may be good for the Postal Service itself. After all, an insulated and protected status fostered much of the USPS's notorious inefficiency in the first place. The fundamental culture of the Postal Service needs to change, and such change will be spurred by more, rather than less, competition.

Congress so far has been reluctant take on this challenge. Last week, the House Government Reform Committee voted down reform legislation (H.R. 4970). However, even this legislation would not have brought sufficient reform to the system, since the USPS would have continued to enjoy protections and perks, including its status as a legal monopoly.

The focus of reform efforts has now turned to the White House, which may soon appoint a blue-ribbon panel to develop recommendations. Bold proposals from such a panel could spark the real transformation that the Postal Service so desperately needs. America's long-patient postal consumers—now waiting in line to buy their new 37 cent stamps—deserve no less.

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