

**Remarks of  
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Before I talk about the subject of this panel, "Where do we go from here?", I'd like to take a moment to review where we are now. The Postal Service is a government agency. It is one of the very few government agencies that provides a commercial service. It really doesn't go much beyond its basic mandate and involve itself extensively in the private economy. It is neither buying up private firms here and abroad nor is it using monopoly revenue to embark on ambitious assaults on its competitors. It is trying to enter new markets very tentatively. By many measures the United States postal system is a great success. It has been successful in breaking even with less than \$4 billion in net losses out of nearly a trillion dollars in revenue over the last 30 years. While service may not be terrific, it is adequate to stimulate far more mail per capita than any other industrial country.

As you know, the German Postal Service is being privatized and just a few days ago it had its IPO. Last week, the chief postal economist for the German Regulator visited the Postal Rate Commission. During a discussion about our two Postal Services, I found myself pointing out what a relative success the U.S. Postal Service is. The German Regulator said, "But you are just defending socialism. America leads Europe in all aspects of the market economy, but not in the postal sector."

***The views expressed here are the author's and do not necessarily reflect the opinions of the Postal Rate Commission.***

What she said was true; the U.S. along with Japan has the least commercialized Postal Service in the industrialized world and the strongest monopoly.

As we all know, neither Government agencies nor monopolies are known for efficiency and innovation. Unlike a private enterprise, the U.S. government postal corporation doesn't have a clear mandate or an incentive structure to promote efficiency. Instead, the Postal Services engages in what economists call satisficing. Satisficing occurs when an organization attempts to do just well enough in meeting its goals and is not driven to maximize the attainment of any particular goal.

Thus, the Postal Service tries to satisfy its unions, mailers of all stripes, its own management, the Postal Rate Commission and the Congress. Satisficing does not lead to great efficiency, low labor costs, innovation, or to being a lean mean competitor.

Frequently I hear postal observers blame the failings of the Postal Service on particular individuals in postal management, or on the Board of Governors, or in union leadership positions, or on the Postal Rate Commission or in Congress. The problem does not lie with particular individuals; it lies with the whole organizational structure of the Postal Service as determined by the Postal Reorganization Act and with the incentive system it provides. I will call this the "governance structure." It includes the Board of Governors, the Rate Commission, the Congress, and the many statutory constraints on the Service.

The governance structure has performed adequately over the last thirty years, but let me just cite one fact that is quite frustrating. Total factor productivity has grown at 0.4 percent a year over the last decade; half the rate of the private non-farm economy. This is in spite of \$26 billion in capital commitments during this period, including more than \$7 billion for mail processing equipment and over \$4 billion for postal support. Postal support includes such things as computers and communication gear – the stuff that has brought about the explosion of productivity throughout the private economy. Thus, all aspects of the Service, mail processing, delivery and administrative, have seen large investments but not a commensurate payoff. Frankly, with all the productivity enhancing capital investment

and the substantial amount of costs that are fixed with respect to volume, total costs per unit of workload should have grown substantially less than inflation over the last decade. But it did not.

Now, I do not know when, or even if, First Class volume will begin a secular decline. But the nagging question arises, how will the governance structure of the Postal Service work if and when First Class volume does start to decline? Will it be possible to improve productivity enough to prevent what could become a death spiral of rising prices and failing volume? The current governance structure was adequate when times were good and volume was growing. How will it cope when times are bad and volume is decreasing?

The latest attempt at legislative reform has failed largely due to the opposition of competitors. It does not look as if that opposition is going to go away. Recall that H.R. 22 only had an indirect effect on labor. If new legislative proposals were to adversely affect labor, then, as they say “forget-about-it.” I am not the first to say that United Parcel Service, the unions, and postal management each has a veto over legislation that affects them.

Any legislation that would materially strengthen the Postal Service’s ability to compete will be strongly opposed by its competitors. This will continue, even if a Presidential Commission makes recommendations along those lines; even if First Class volume begins a secular decline.

I believe the legislative stalemate will continue for the foreseeable future and only the Postal Service can help itself to make the important changes it needs. The Service holds very few cards and I think it should play its monopoly card. Because the Postal Service can unilaterally suspend its monopoly, it should experiment by suspending the monopoly for advertising mail. As a corollary, it must also stop enforcing the mail box law.

What would be the impact on Postal Service volume? Well, not a lot, and I base this conclusion on a series of studies I have done with my colleagues at the Postal Rate Commission. We have found that the Postal Service’s low delivery costs are due to two factors. First, much of the costs of delivery are fixed; second it has very large volumes. These factors give rise to significant economies of scale. The resulting cost of delivery is

so low that it would be almost impossible for a competitor to compete based on price alone. Both Sweden and New Zealand have eliminated their Postal monopolies and neither Postal Service has lost much market share.

The Postal Service should experiment with advertising mail because it pays a relatively small portion of Postal overhead cost. In the short run, any lost overhead could be made up from other mail. If the experiment were successful with advertising mail, surely the Postal Service would be able to eliminate the monopoly for First Class mail. The economics of advertising mail make it much more subject to diversion than First Class. It should be noted that periodicals have never been subject to the monopoly.

Once the Postal Service was fully competitive, the *raison d'être* for the current regulatory system would be gone. It would be logical to have a new regulatory system which would only involve a loose price cap on single-piece First Class and an attributable cost floor for other products.

Now, let me explain why I believe eliminating the monopoly would have little effect on Postal volume. As I said, this conclusion stems from studies we have done at the Rate Commission. The first showed that there is no cross-subsidy between rural and urban delivery.<sup>1</sup> Thus, we don't need a monopoly to pay for universal service. The second study showed that the incremental or avoidable cost of delivering advertising mail is about 7 cents a piece.<sup>2</sup> The avoidable cost is important because economic theory says that a competitor's cost should be below it for there to be what is called, efficient entry. Economic theory says that the Postal Service should be allowed to lower its rates towards its avoidable cost in order to forstall inefficient entry. I believe that the Postal Rate Commission could work out procedures to allow the Postal Service to lower its rates in the

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<sup>1</sup> Cohen, Robert H., William W. Ferguson, and Spyros S. Xenakis. 1993. "Rural Delivery and the Universal Service Obligation: A Quantitative Investigation." In *Regulation and the Nature of Postal and Delivery Services*, edited by Michael A. Crew and Paul R. Kleindorfer. Boston, MA: Kluwer Academic Publishers.

<sup>2</sup> Cohen, Robert H., William W. Ferguson, John D. Waller, and Spyros S. Xenakis. 1999. "An Analysis of the Potential for Cream Skimming in the United States Residential Delivery Market." In *Emerging Competition in Postal and Delivery Services*, edited by Michael A. Crew and Paul R. Kleindorfer, Boston, MA: Kulwer Academic Publishers.

limited geographical areas where competition would emerge. This second paper goes on to show that it would be very difficult for a competitor to get its combined in-office and out-office costs below the Postal Service's avoidable costs.

The third paper points out that because of work sharing discounts, we have a competitive private system for sorting and transportation.<sup>3</sup> Work sharing mailers and consolidators are, in effect, private competitors of the Postal Service. Their discounts are based on the Service's avoided cost. The data show that under 30 percent of advertising plus periodical mail is presorted to the carrier route and drop-shipped at the local area offices (SCF or DDU) at costs lower than the Postal Service's cost. This is an upper bound on the contestable volume.

Faced with potential and actual competition, the Postal Service would respond like an ordinary business and lower its costs, improve its productivity and service, and even provide "innovative new products." Competition will make for a better Postal Service.

Even without a monopoly, the Postal Service should be required to maintain universal service. The Swedish and New Zealand Posts have been required to provide universal service after their monopolies were eliminated.

Once the Postal Service were fully competitive, I don't think that it would make a great deal of sense to maintain the Postal Service as a government agency.

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<sup>3</sup> Cohen, Robert H., William W. Ferguson, John D. Waller and Spyros S. Xenakis. 2000. "Universal Service Without a Monopoly," in *Current Directors in Postal Reform*, edited by Michael A. Crew and Paul R. Kleindorfer, Boston, MA: Kluwer Academic Publishers.

These studies are available at the Postal Rate Commission's Web Site: [www.prc.gov](http://www.prc.gov)