

**PREPARED STATEMENT**

**OF**

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**CHAIRMAN**

**FEDERAL TRADE COMMISSION**

**ON**

**UNITED STATES POSTAL SERVICE**

**BEFORE THE**

**SUBCOMMITTEE ON ECONOMIC GOALS AND INTERGOVERNMENTAL POLICY**

**OF THE**

**JOINT ECONOMIC COMMITTEE**

**UNITED STATES CONGRESS**

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Mr. Chairman and Members of the Subcommittee: I am pleased to have this opportunity to present my views regarding the

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<sup>1</sup> The views expressed here are those of Chairman Miller and do not necessarily reflect the views of any other Commissioner.

performance of the United States Postal Service (USPS) and the need for significant relaxation in current rules affecting the delivery of first-class mail. I would like to commend the Joint Economic Committee for addressing this important topic. As you know, it is quite broad and raises a number of complex questions, some of which have been addressed by officials of the Federal Trade Commission (FTC).<sup>1</sup> A logical approach to them would be to address first the legal and institutional history of what has become known as the "postal monopoly." From there I will proceed to a discussion of the reasons why controlling costs and setting prices has been so difficult since the creation of the USPS in 1970.

Next, I will explore the inefficiencies created by the private express statutes, and explain why there is a need for

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<sup>1</sup> Prior work in this area at the FTC includes the testimony of Timothy J. Muris, Director, Bureau of Consumer Protection, on "The Provision of Telecommunications and Information Services by the Federal Government in Competition with the Private Sector," before the Government Information and Individual Rights Subcommittee of the Committee on Government Operations, U.S. House of Representatives, February 25, 1982.

My own prior involvement in this area includes testimony before the Postal Rate Commission in Docket R74-1 (1974), and co-authoring with Roger Sherman, "Has the 1970 Act Been Fair to Mailers?," in Roger Sherman (ed.), Perspectives on Postal Service Issues, American Enterprise Institute, 1980, pp. 53-69.

more competition in the provision of postal services. I will then discuss the likely ramifications of repeal of the strictures that grant USPS a monopoly on first-class mail. After that, I will address concerns about the possibility of harmful cross-subsidization, and also potential anti-competitive effects from USPS operations such as E-COM (Electronic Computer-Originated Mail). I will close with a series of recommendations on what the Congress might do in order to enhance competition in the postal area to the benefit of its customers--who are, after all, virtually every citizen of our country.

Let me emphasize at this point that I have the greatest respect for the men and women of the USPS. My personal view is that Postmaster General Bolger is doing a commendable job in addressing the myriad of challenges he has to face. My intent is not to criticize the USPS, but rather to discuss possible ways we may all join together to improve postal service in this country.

### Postal History

It would be useful to begin with a brief excursion into U.S. postal history. 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. Nevertheless, perhaps because of a desire to unify a growing nation when there were possibly no private businesses capable of delivering mail throughout the several frontier states,<sup>1</sup> or because the provision of postal services had been a monopoly in England,<sup>2</sup> Congress passed temporary laws establishing the Post Office Department as a monopoly in 1789. Shortly thereafter, it enacted more comprehensive statutes limiting the private carriage of mail. These statutes reserved to the federal government the exclusive right to carry routinely letters for hire over post roads.

Even though Congress sought to secure a postal monopoly for the government, private express businesses proliferated. These private firms used technological advances and gaps in legislation to compete directly with the government. Throughout the first half of the 19th century Congress regularly revised the

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<sup>1</sup> See, e.g., George L. Priest, "The History of the Postal Monopoly in the United States," 13 J.L. & Econ. 33, 51-68 (1973). But such justification would seem no longer applicable, if it ever was. The U.S. is a mature country with a nation-wide system of radios, television, newspapers, magazines, telephones, and other communications media.

<sup>2</sup> See, e.g., R.H. Coase, "The Postal Monopoly in Great Britain: An Historical Survey," in Economic Essays in Commemoration of the Dundee School of Economics, 1931-1955, at 25 (J.K. Eastham, ed. 1955).

postal laws in an effort to eliminate this competition. For example, an 1825 statute that prohibited anyone but the government from carrying letters in vehicles over any post routes was amended two years later to prevent private entrepreneurs from carrying letters on horseback or foot. Ironically, the Pony Express, often used as a symbol of U.S. mail service, was not an invention of the U.S. Post Office, but was introduced by private postal companies that were, in turn, put out of business by the private express statutes. In 1845, Congress directly prohibited private express companies from carrying letters for hire, except in a few specific instances.<sup>1</sup> These private express statutes were recodified in 1872 and, with a few modifications, are still law.

In 1970 Congress reorganized the Post Office by creating the United States Postal Service as an independent, quasi-governmental business, designed to make the delivery of mail more efficient and to make the Postal Service economically and politically independent. The postal monopoly for letters (first-class mail) was maintained. As before, the monopoly did not extend to newspapers and magazines (second-class mail), direct mail advertising (third-class mail) or parcels (fourth-class mail).

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<sup>1</sup> 5 Stat. 732 (March 3, 1845).

The Postal Service exercises considerable discretion in determining the extent of its monopoly over letters.<sup>1</sup> Thus, on the one hand, while it has "suspended"<sup>2</sup> its monopoly for certain letters (such as time-sensitive materials which the present system is incapable of delivering on time), on the other hand it has expanded its monopoly by defining "letters" to include bills, receipts, IBM cards, magnetic cards, magnetic tapes, and other business documents. Recently, as new service areas such as express mail have developed, the Postal Service has typically first asserted that these new service areas fall within its monopoly and then announced a suspension of its monopoly with respect to some aspects of the new service areas.

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<sup>1</sup> 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). Thus, letters include items as diverse as advertising posters, credit cards, data processing materials and computer tapes.

<sup>2</sup> The USPS has asserted that it has authority to exempt materials from the operation of the postal monopoly pursuant to 39 U.S.C. § 601(b). Thus, the USPS defines its postal monopoly broadly to include materials (such as certain data processing materials, materials mailed within a college campus, etc.) but then "suspends" its monopoly over such materials, allowing private companies to carry such mail.

As you know, the Department of Justice has already questioned the propriety and wisdom of this process.<sup>1</sup>

At the time it attempted to depoliticize postal service, Congress structured the USPS as an independent establishment within the executive branch and eliminated the Cabinet-level Post Office Department. Under the statutory scheme, the USPS, its Board of Governors<sup>2</sup> and the Postal Rate Commission (PRC)<sup>3</sup> share responsibility for the mail classification schedule and postal rates and fees. The PRC was intended by Congress to provide an independent review of changes in postal rates and classes in order to protect the public interest. However, the PRC's power of review is limited since the Board of Governors can override the PRC's recommendation by unanimous vote.

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<sup>1</sup> Comments of the Department of Justice, Re: Amendments to 39 C.F.R. Parts 310 and 320: Proposed Revisions in the Comprehensive Standards for Permissible Private Carriage of Letters, U.S. Postal Service, March 13, 1979.

<sup>2</sup> The USPS has an eleven-person Board of Governors, nine of whom are appointed by the President and confirmed by the Senate. Those nine appoint the other two members of the Board, namely, the Postmaster General and Deputy Postmaster General. Postal Reorganization Act of 1970, P.L. 91-375, Subsection 202, August 12, 1970, pp. 2-3.

<sup>3</sup> The PRC consists of five Commissioners, all of whom are appointed by the President and confirmed by the Senate. Postal Reorganization Act of 1970, P.L. 91-375, Subsection 3601, August 12, 1970, p. 41.

## Federal Court Restrictions on PRC's Review Authority

In recent years, federal courts have sharply limited the PRC's review of USPS or Board actions. For example, there have been only five general ratemaking proceedings since the Postal Reorganization Act went into effect. The PRC attempted to require more frequent rate reviews, but the Second Circuit Court of Appeals ruled that the PRC cannot do this by arbitrarily reducing the USPS' estimates of revenue requirements. The Court stated that "the Board, and not the PRC, is responsible for making policy decisions for the Postal Service. . . [and] [s]hould the Board exceed its authority or make questionable policy choices, remedies may be pursued through Congressional amendment or judicial review."<sup>1</sup>

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<sup>1</sup> Newsweek, Inc. v. United States Postal Service, 663 F.2d 1186, 1204-5 (2nd Cir. 1981). Similarly, the Second Circuit has rejected the PRC's attempt to force the USPS to initiate Electronic-Computer Originated Mail (E-COM) as a limited-duration experiment rather than on a permanent basis. Governors of the United States Postal Service v. United States Postal Rate Commission, 654 F.2d 108, 115-17 (D.C. Cir. 1981). The court held that the PRC had both encroached on the Board's judgment and discretion as business managers and exceeded its statutory authority because only the Board and USPS may decide whether to request a decision from the PRC on rate changes. Under these court interpretations the USPS apparently has wide managerial discretion with respect to entering new fields.

Most importantly, the PRC has been unable to police USPS cost allocations or prices in some areas, while proving somewhat ineffective in others. The PRC has always been constrained by the simple fact that the USPS possesses and controls much of the data necessary to support rate and class changes and provides only limited amounts of information to the PRC. Two years ago I wrote,

...the careful, objective analyses that would permit a more scientific allocation of postal service costs have not been used by the Postal Service, although eight years have passed since a law requiring such costs as a basis for rates went into effect.<sup>1</sup>

Nothing has occurred in the last two years that would permit me to soften that assessment. Indeed, recent court interpretations of Section 3622(b), 39 U.S.C. § 3622(b), which sets forth the factors to be considered in setting rates, have imposed additional constraints on PRC review of costs. A dispute over the use of cost-of-service principles has developed in the federal appellate courts. Until the Supreme Court resolves this dispute, the PRC's attempts to question USPS' future rate

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<sup>1</sup> See Sherman and Miller, op. cit., p. 59. This is a crucial problem for a number of reasons, not the least of which is that costs that are not properly identified are not easily controlled.

proposals will be on uncertain grounds.<sup>1</sup> This is not to suggest by any means that the PRC has done everything in its power to fulfill its "watchdog" function. More action by the PRC across a broad spectrum of matters would be in keeping with its oversight mandate.

### The Postal Monopoly: Is It Economically Justified?

Another central issue is the existence of the USPS monopoly over first-class mail. Economic theory and empirical evidence

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<sup>1</sup> The Supreme Court recently agreed to hear this dispute between the D.C. and Second Circuits in granting cert on appeals of National Ass'n of Greeting Card Publishers v. United States Postal Service (81-1304) and United States v. United States Postal Service (81-1381). See Wall St. J., April 20, 1982, p. 12. The cases are scheduled for argument in the Fall Term, 1982.

Until 1981, in its ratemaking proceedings, the PRC operated under a D.C. Circuit mandate that it attribute and assign postal costs to the maximum extent possible, using cost-of-service principles. National Ass'n of Greeting Card Publishers v. United States Postal Service, 607 F.2d 392 (D.C. Cir. 1979); cert. denied, 444 U.S. 1025 (1980). Remaining costs were then allocated in a discretionary manner. The Second Circuit, however, recently rejected the D.C. Circuit's interpretation of § 3622(b). According to the Second Circuit, the PRC need only ensure that "each class or service bear as a minimum [those] direct and indirect costs attributable to that class or service," with the balance of costs allocated in a discretionary manner. Newsweek, Inc., *supra* at 1200. In other words, the Second Circuit would allow the USPS great leeway in the way it accounts for overhead expenses and those costs which could be classified as being incurred by several classes of mail.

indicate that, in the absence of market failures such as so-called "natural monopoly" situations, competition among firms in a free market most efficiently allocates resources and best encourages growth and innovation.<sup>1</sup> A private firm normally has greater flexibility and more incentive to innovate and reduce its costs than a quasi-governmental enterprise, like the USPS. Quasi-governmental enterprises tend to be less concerned about economic efficiency.

The classic justification for government enterprise is that the market cannot -- or will not -- provide a particular good or service on its own. But many private entrepreneurs have tried

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<sup>1</sup> The evidence is particularly compelling in studies of markets in which the government competes directly with private suppliers of goods and services. See, e.g., Ahlbrandt, "Efficiency in the Provision of Fire Services," 16 Pub. Choice 1 (1973) (finding private firm provides goods at lower cost than government agency); Crain & Zardkoohi, "A Test of the Property-Rights Theory of the Firm: Water Utilities in the United States," 21 J.L. & Econ. 395 (1978) (finding higher operating costs in publicly owned water utilities); Davies, "The Efficiency of Public v. Private Firms: The Case of Australia's Two Airlines," 14 J.L. & Econ. 149 (1971) (finding private company more efficient than public firm); Lindsay, "A Theory of Government Enterprise," 84 J. Political Econ. 1061, 1965 (1976) (determining government managers maximize self-interest by producing output Congress is likely to value more highly than consumers do); and Peltzman, "Pricing in Public and Private Enterprises: Electric Utilities in the United States," 14 J.L. & Econ. 109 (1977) (finding that government-owned firms adopt pricing policies that enhance their political support, not consumer welfare).

to deliver first-class mail items such as Christmas cards and advertising posters -- and have done so at rates below those charged by the USPS. Yet most have been driven out of business by the USPS -- not by head-to-head competition, but through court enforcement of the private express statutes.<sup>1</sup> In fact, a number of firms legally deliver some of their own first-class mail themselves more cheaply than the USPS would, even though they are hampered by rules that are designed to discourage such delivery (e.g., prohibiting the firms from using part-time employees for their deliveries).<sup>2</sup> In addition, there are a number of examples of private firms providing or preparing to provide certain mail services even before the USPS entered the field.<sup>3</sup> Since private firms apparently can and want to provide a wide range of mail services, the assertion that some form of market failure fully supports government enterprise in

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<sup>1</sup> See, e.g., United States v. Black, 569 F.2d 1111 (10th Cir. 1978); cert. denied, 435 U.S. 944 (1978); United States Postal Service v. Brennan, 574 F.2d 712, 716 (2d Cir. 1978); application denied, 439 U.S. 1345 (1978); cert. denied, 439 U.S. 1115 (1978). Short of lawsuits, the USPS also sends out warning letters to mail users, notifying them of the possible unlawfulness of certain private mail services.

<sup>2</sup> See John Haldi, Postal Monopoly: An Assessment of the Private Express Statutes, American Enterprise Institute, 1974, pp.27-28.

<sup>3</sup> Express mail and electronic computer-originated mail services are two such examples.

the postal industry may be viewed with a fair measure of skepticism.

Poor performance is particularly likely from a monopoly, such as the USPS has on first-class mail. There is ample evidence, both theoretical and empirical, that monopolized markets do not normally perform as well as competitive ones.<sup>1</sup>

The lack of competition for the delivery of first-class mail specifically may reduce the USPS' incentive either to innovate or to reduce its operating costs. Perhaps the best evidence that innovation and lower prices would result from repeal of the private express statutes is the USPS's experience with its fourth-class parcel post mail. As of 1974, with about 200 years of postal experience, the USPS shipped all of its parcels in

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<sup>1</sup> See, e.g., F. M. Scherer, Industrial Market Structure and Economic Performance, 14-21 (2d ed. 1980), for a theoretical comparison of monopolist and competitive markets. A number of Federal Communications Commission (FCC) decisions that altered the monopoly 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, May 25, 1976.

bags, which resulted in high breakage rates and handling costs. However, the United Parcel Service (UPS), a private competitor, pioneered in mechanizing and containerizing the handling of parcels. This innovation reduced breakage and lowered handling costs, thereby enhancing the competitive position of the UPS vis-a-vis the USPS.<sup>1</sup> According to Haldi:

[I]n the area of containerization and mechanization, it's reasonable to conclude that free competition could not have resulted in less innovation. . . . There are reasons for believing that active competition [in first-class mail service] will simultaneously improve service and lower cost.<sup>2</sup>

Another telling example of the potential benefits of competition is the success of private express mail services. Despite the threat of suit by the USPS, numerous private carriers (called "couriers") developed in the 1960's and 1970's, specializing in the rapid and reliable transportation of

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<sup>1</sup> The USPS tried to learn from the 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 that the USPS write the investment off as a loss. See Joel L. Fleishman, "Postal Policy and Public Accountability: Is the 1970 Bargain Coming Unglued?" (Draft), Program on Information Resources Policy, Harvard University, 1981, p. 94.

<sup>2</sup> John Haldi, op. cit., pp. 47-48.

commercial documents. In 1973, the USPS responded to this innovation by establishing its own express delivery service called "Express Mail." But in 1974, the USPS attempted to expand its postal monopoly to include express mail services. Political pressures, however, ultimately forced the USPS to cease these efforts, and private express delivery services now compete openly and freely with the USPS.

The classic economic argument in favor of a (regulated) monopoly rests on the assumption that the firm in question is a "natural monopolist." A natural monopolist is "a firm which is the sole seller and producer of a set of goods whose technology makes single firm production cheaper than any other alternative."<sup>1</sup> But we have no convincing evidence that mail service has this technological characteristic despite the

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<sup>1</sup> See John C. Panzar and Robert D. Willig, "Free Entry and the Sustainability of Natural Monopoly," Bell J. of Econ., Spring, 1977, p.1.

USPS's claims that it does.<sup>1</sup> Rather, it is apparent that the USPS monopoly on first-class mail is substantially based on criteria other than economic efficiency.<sup>2</sup> If, in fact, the handling of first-class mail were a natural monopoly, the USPS should not need the private express statutes

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<sup>1</sup> The USPS's assertion that postal services are a natural monopoly because they exhibit substantial economies of scale is at variance with the available evidence. 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 U.S. Postal Rate Commission, "Economies of Scale in Postal Service" by Leonard Merewitz (August 30, 1973, processed); and the review contained in the Initial Decision, Docket 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).

See also Sherman and Miller, op. cit. The Chief Administrative Law Judge, in PRC Docket No. R74-1, Vol. 1 p. 78, also concluded that the existence of economies of scale was not proven by the evidence at hand. Similarly, the Department of Justice felt that there was "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).

<sup>2</sup> See, e.g., George L. Priest, "The History of the Postal Monopoly in the United States," 13 J.L. & Econ. 33, 33-80 (1973).

to protect its monopoly position.<sup>1</sup> By definition, competitors would not be able to provide the same quality of service at the same or lower cost.<sup>2</sup> Consequently, the USPS's position would be secure without legal protection (making the private express statutes superfluous) unless its monopoly protection enabled it to price mail significantly above its cost or it is inefficient (i.e., incurring unnecessary costs). In the latter case, removing the private express statutes would likely improve efficiency and result in lower prices.

The preceding remarks do not suggest that there are no beneficiaries of the current arrangement. Rather, economic theory and empirical evidence suggest that from society's

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<sup>1</sup> Contrast the repeated attempts by private companies to enter the market for first class mail with the lack of attempted entries in some other fields possessing demonstrated economies of scale (e.g., electric power distribution). Moreover, the mere existence of a natural monopoly does not automatically indicate a need for a government enterprise. See Demsetz, "Why Regulate Utilities?," 11 J.L. & Econ. 55 (1968).

<sup>2</sup> 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 monopoly is said to be "unsustainable." See, e.g., Panzar and Willig, pp. 1-22. But we have no evidence that the postal monopoly is unsustainable. In fact, Willig, who has contributed significantly to this new research, indicates his belief that "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," Program on Information Resources Policy, Harvard University, 1981, p. 10.

perspective the losses associated with a statutory government monopoly over first-class mail may exceed the benefits derived from it. Just such a judgment that the costs exceed the benefits led the Justice Department and the Council on Wage and Price Stability, independently, to suggest that the private express statutes be repealed in order to allow the entry of private competitors into the market for first class mail.<sup>1</sup>

### Need for a Study of the Postal Monopoly

Considering the strong presumption against the economic efficiency of a government monopoly, it seems to me that the burden of proof that the postal monopoly's benefits outweigh its costs should be on those who support maintaining the private express statutes. It should not be assumed that the USPS is a natural monopoly, in need of government action prohibiting competitive entry, as the private express statutes effectively do.<sup>2</sup> It would seem illogical to allow the USPS, with both the data (or the capacity to generate it) and the most to gain

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<sup>1</sup> See U.S. Department of Justice, Changing the Private Express Laws (1977) and "Comments of the Council on Wage and Price Stability Concerning the Private Express Statutes," Docket No. R76-4, 1976.

<sup>2</sup> Government protection would be necessary if and only if the Postal Service is an unsustainable natural monopoly.

by demonstrating the existence of such a natural monopoly, to simultaneously avoid independent review of much of its data while claiming the benefit of any doubt.

Where do we proceed from here? I think we obviously need more information, and I think the USPS itself is the logical candidate for providing it for two reasons. First, the USPS should have the incentive to prove that it is a natural monopoly since it has already taken that position publicly. Second, the USPS has easy access to and familiarity with the data that would be needed for such a study.<sup>1</sup>

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<sup>1</sup> Data that would be needed to test an "unsustainability" theory include the extent of complementarities in production between the USPS' outputs, the substitution relationships among its products' demands, and how the USPS' costs (including its joint and common costs) vary with changes in its output. If some of this data does not currently exist, serious consideration should be given to generating it. I testified to that effect in Docket No. R74-1. More recently, Clyde S. DuPont, former Chairman of the PRC, has indicated that existing postal data is inadequate. See Clyde S. DuPont, "The Postal Rate Commission," in Sherman (ed.), Perspectives, op. cit., pp. 114-116.

The USPS's unwillingness to make its data available to others has prevented other parties from examining the efficiency of its operations. According to the Department of Justice (in 1977), "there is no credible and reliable evidence at hand that would permit public policy makers to reach an informed judgment regarding the need, if any, to retain the private express statutes." See U. S. Department of Justice, op. cit., p. 27. In fact, even the Postal Rate Commission (PRC) which is required by law to review the USPS's rates, has sometimes had difficulty

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I believe that the USPS should be required to produce a detailed empirical study of whether a strong economic justification exists for continuing its statutory monopoly over first-class mail.<sup>1</sup> All data used in this study should be made public, and the report should be reviewed widely by various experts.<sup>2</sup> Should such an investigation fail to provide strong economic justification for a continuation of the postal

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(FOOTNOTE CONTINUED)

getting relevant data from the USPS. See, e.g., pp. 1-5 of Appendix E to United States of American Postal Rate Commission, Docket No. R80-1, Appendices to Opinion and Recommended Decision, Volume 2, February 19, 1981. This unavailability of vital data regarding USPS functions has not been limited to pricing matters alone. In December of 1981 the PRC even suspended its ECOM docket because "[t]he USPS had clearly and consistently refused to provide the Commission any information on any substantive issue in the remanded ECOM docket." See United States of America v. United States Postal Service, Dec. 30, 1981, p. 9.

<sup>1</sup> This conclusion is consistent with the recommendations of the Department of Justice and the Council on Wage and Price Stability. See U.S. Department of Justice, op. cit., and Comments of the Council on Wage and Price Stability, op. cit. The need for such an investigation is particularly compelling considering that the USPS is the second largest U.S. utility after AT&T and the largest commercial undertaking in which the federal government is currently engaged.

<sup>2</sup> I would suggest, as a matter of fact, that the USPS enlist the aid of numerous experts in the field in setting up its study methodology -- including those in the private commercial sector, those at universities and at public policy centers, and even those at other government agencies.

monopoly, I would urge Congress to repeal the private express statutes.

### Effects of Repealing the Private Express Statutes

Let me now address, in a preliminary way, the likely effects of repealing the private express statutes. Such a repeal could have a dramatic effect on the market for first-class mail. As new firms enter the market, the existing uniform rate structure would tumble. Although the Postal Reorganization Act of 1970 prohibits cross-subsidization of mail across classes, it does not prohibit it within a class. For example, because the USPS charges different first-class mail customers the same rate, even though the costs of serving those customers differ, some first-class mail is overpriced and thus subsidizes other first-class mail. In fact, the USPS has stated 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.<sup>1</sup>

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<sup>1</sup> U.S. Postal Service, Statutes Restricting Private Carriage of Mail and their Administration (H. Comm. on Post Office & Civil Serv., 93d Cong., 1st Sess., Comm. Print 1973) p.6.

The USPS refers to this form of competition as "cream-skimming."<sup>1</sup> But despite its pejorative connotation, "cream skimming" is generally beneficial. The ability of a new market entrant to provide a service at a price lower than the current charge generally indicates that the current price exceeds the cost of providing the service. Since economic efficiency normally requires that a product's price be equal to the marginal cost incurred in producing it,<sup>2</sup> the existence of "cream-skimming" opportunities suggests that current USPS pricing misallocates resources. Repeal of the private express statutes could help end this inefficiency.<sup>3</sup>

A category of first-class mail that could arguably be charged a lower rate of postage is transaction mail, which constitutes a significant portion of first-class mail. This mail, which consists mostly of bills, bank statements and so forth, tends to be generated by a few, high-volume local

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<sup>1</sup> Ibid., p. 5.

<sup>2</sup> See F.M. Scherer, op. cit., pp. 12-21.

<sup>3</sup> Variation of first class postal rates, as would be expected if the private express statutes are repealed, is not without precedent in this country. A uniform rate was not introduced until 1863. See Leonard Waverman, "Pricing Principles: How Should Postal Rates Be Set?" in Sherman (ed.), Perspectives, op. cit., pp. 9-10.

business mailers (e.g., banks, utilities, and department stores) and their customers and to be delivered in high-density areas. The delivery of this mail, which bears typed addresses, is less expensive than delivering a letter addressed by hand (of equal weight) over long distances between non-urban points. Yet, both types of mail currently are charged the same postage. In a competitive market for first-class mail, consumers who use lower-cost mail services would benefit from lower rates for those services.<sup>1</sup> Such differential rates would allow resources to flow to their optimal use.<sup>2</sup>

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<sup>1</sup> An efficient allocation of resources does not necessarily require each item of mail to have a different rate. The cost of the pricing system itself--both to suppliers and customers -- must be considered when determining the set of prices that will maximize welfare. Yet, because there appear to be significant cost differences related to delivering some mail, and a slight variation from the present uniform rate structure would not be expected to be too complex or costly to maintain, it is possible that repeal of the private express statutes would lead to some variation.

<sup>2</sup> Any premium currently paid by some first class mailers above the cost of that service is of concern not only because of the direct effect such rates have on these users, but also because business mailers can be expected to pass excessive postal costs on to their customers in the form of higher prices for their products. Thus, there may also be a significant indirect effect. In addition, just as underpriced mail will be overused, overpriced mail will be underused and will (inefficiently) divert resources to competing information transfer systems.

Repeal of the private express statutes is also likely to reduce the transfer of income that is an implicit part of the current uniform rate structure. For example, when rates are uniform, non-urban long-distance first-class users seem to benefit at the expense of intra-city first-class users. Under a competitive regime, however, one group of users would not be forced to subsidize another group of users. Nor, for that matter, could businesses be subsidized by any relatively underpriced second-, third-, or fourth-class mail. Instead, each type of mail would be expected to pay its own way.<sup>1</sup>

Repeal of the private express statutes could result in relatively higher rates and/or reduced service for some postal users just as it would likely result in lower rates and/or improved service for others. But any shifting of relative rates and service would simply ensure that postal service prices reflect the costs of providing them. For society as a whole, such changes would bring about a more efficient allocation of resources. If it were felt that a particular type of mail, such as rural delivery, should have its price discounted or its service raised, then Congress could grant an explicit subsidy to the users of that type of mail. An explicit subsidy of that

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<sup>1</sup> It should be stressed that lower rates for business mailers would redound to the benefit of consumers of those businesses, as the savings in costs would be passed along.

sort would likely fully maintain current services at less cost than the present structure entails. The decision to allocate such a subsidy properly belongs to Congress.<sup>1</sup>

Fears of significant reductions in rural service as a result of repealing the private express statutes are largely unfounded. When regulation of the interstate trucking industry was relaxed, for instance, service to small rural communities was not abandoned, despite similar fears. The Interstate Commerce Commission found that during the first six months following passage of the Motor Carrier Act of 1980 (MCA) both motor carrier service availability and quality were, for the most part, unchanged in small rural communities.<sup>2</sup> Moreover, even if repeal of the private express statutes did lead to the

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<sup>1</sup> In the mid-1970's it was estimated that if there were no charge at all for rural mail delivery, the out-of-pocket cost to the USPS would be less than \$600 million a year, or about 5% of the USPS's total costs. See generally Hearings Before the House Postal Facilities Subcom. on New Criteria for Small Post Office Closings, 94th Cong., 1st Sess. 17 (1975); Briefing by the Postmaster General for the House Post Office and Civil Service Committee, 94th Cong., 1st Sess. 11 (1975). Since this figure was less than one half of the excess revenue that was thought to be generated by first class mail at that time, the current pricing system would appear to subsidize some non-rural mail users as well. See U.S. Department of Justice, op. cit., p. 15.

<sup>2</sup> Interstate Commerce Commission, Office of Policy and Analysis, Interim Report: Small Community Service Study, June 1981.

closing of some rural postal offices, it is extremely unlikely that postal services would ever be ended in those areas. More likely, mail delivery in rural areas would continue but residents would have to travel farther to purchase stamps and to undertake other transactions at a post office.<sup>1</sup>

Repeal of the private express statutes might also reduce first-class postage relative to other classes if revenue from first-class mail is in fact presently used to subsidize other mail classes -- an issue of some contention among the experts.<sup>2</sup> If so, and if the private express laws were repealed, entering firms would likely compete away most or all of any excess revenue that first-class mail earns, eliminating (or at least reducing) USPS' potential to use those earnings to subsidize other classes of mail. Thus, if such cross-subsidization does presently occur, repeal of the private express statutes would likely lead to lower rates for first-class mail relative to other classes of mail. Such a reduction

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<sup>1</sup> See Waverman, op. cit., p. 17. If this were considered contrary to the public interest, it would seem more efficient and equitable for Congress to provide a direct subsidy to address the problem.

<sup>2</sup> The relatively inelastic demand for first-class mail and the postal monopoly may give the USPS the ability to use this mail to subsidize other classes.

in first-class rates, and an increase in other rates, would bring postal prices more in line with the marginal costs of providing each service, thus leading to enhanced consumer welfare via a more efficient allocation of resources.

### Cross-Subsidization and Its Effects

Although the Postal Reorganization Act of 1970 prohibits subsidization across classes of mail, it has been alleged that the USPS' approach to costing and pricing leads to such cross-subsidization (perhaps unintentionally) and the concomitant inefficiencies associated with it. For example, the chief administrative law judge in U.S. Postal Rate Commission Docket R74-1 (vol. 1, p. 13) concluded that

the Postal Service has become a tax-collecting agency collecting money from first-class mailers to distribute to other favored classes. Every time a person pays 10 cents to mail a first-class letter he is paying his appropriate attributable cost plus his proportionate share of residual cost, and in addition, he is contributing almost 2 cents to pay the costs of other services.<sup>1</sup>

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<sup>1</sup> The USPS' recent decision to raise first-class letter rates from 15 cents to 20 cents, rather than to 18 cents as the PRC recommended, does little to dispel this criticism. This 33 1/3 percent increase, which only came about because the USPS Board of Governors unanimously voted to overturn the PRC's recommendation, far exceeded other rate increases. In fact, the USPS actually reduced some other rates at the same time that it was increasing the rate on first-class letters.

Those who allege the existence of such cross-subsidization typically argue that it results from the PRC's effort to "attribute" and "assign" USPS costs to the various classes of mail and from the discretionary manner in which the remaining USPS costs are allocated. The USPS and PRC themselves have disagreed over how the USPS' costs should be allocated, with the former favoring a larger discretionary percentage than the latter. For example, in the most recent rate case the PRC felt that 73.6 percent of USPS' costs were attributable or assignable, while the USPS felt that only 59.3 percent of its costs should be so allocated.<sup>1</sup> This disagreement has reached the courts. An appeals court in Washington, D.C., believes that the PRC should allocate costs to the maximum extent possible based upon actual expenses, while an appeals court in New York has stated that the PRC could determine its rates half through allocation and half through other factors (i.e., by discretion).<sup>2</sup> As you know, the U.S. Supreme Court recently

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<sup>1</sup> See U.S. PRC Opinion and Recommended Decision, Docket No. R80-1, vol. 1, pp.5-7.

<sup>2</sup> While less than 50 percent of costs were so allocated in the first rate case, by the 1976 case the percentage had risen to about 60 percent and in the 1977 case it exceeded 70 percent. See Sherman and Miller, op. cit., pp. 59-60.

agreed to settle this dispute.<sup>1</sup>

One possible cause of the wide disagreement over correct pricing of USPS services is the difficulty inherent in determining appropriate prices when the same enterprise provides a variety of services, as with the USPS. The presence of common and joint costs (i.e. costs relating to the provision of two or more classes of mail service), which account for a large percentage of total USPS costs, greatly complicates the setting of rates. Any attempt to separate or allocate common or joint costs must be somewhat arbitrary and may not lead to optimal pricing of the various classes of mail service.<sup>2</sup>

The validity of allegations that costs are or are not correctly allocated would be clearer if the USPS were to make more of its data available for public scrutiny, as I recommended earlier. Since the issue of pricing is very complex and there is such a lack of agreement as to how it should be performed in the postal area, there is need for additional study. However,

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<sup>1</sup> See Wall St. J., op. cit., April 20, 1982, p. 12.

<sup>2</sup> See Melvyn A. Fuss, "Cost Allocation: How Can the Costs of Postal Services Be Determined," in Sherman (ed.), Perspectives, op. cit., pp. 30-46.

the current dearth of good, publicly-available data poses serious obstacles to any such endeavors.

### E-Com and Its Effect on Private Electronic Message Services

Finally, I would like to make a few comments about the Postal Service's provision of electronic message services. As you are aware, Postal Service involvement in electronic message services, particularly its recently-operational E-COM system, has been quite controversial and the subject of numerous administrative and judicial proceedings. The fundamental issue is whether there is a need for the USPS to provide such services.

Once again, our basic presumption is that goods and services are best and most efficiently provided by independent firms operating in open and competitive markets. Government intervention generally is justified only by market failure. It is against this principle that USPS activities should be measured.

The Postal Service's present service, E-COM, is a blend of modern telecommunications and the traditional hand delivery of

mail. As a so-called "Generation II" service,<sup>1</sup> E-COM involves the use of common carrier telecommunications to send messages in electronic form to a receiving post office where they are printed, stuffed into envelopes, and placed into the first-class mail stream. While Postal Service delivery of the stuffed envelopes seems clearly within its traditional role, telecommunications and data processing are not. This new role is especially difficult to justify in view of the desire and ability of private firms to provide such services.

The telecommunications and data processing service sectors today are characterized by rapid growth and innovation. Other changes in industry structure apparently on the way as a result of legislative and judicial actions are intended to increase still further the opportunity for competition and innovation. A wide range of information services are already being competitively offered. For example, Generation I and II services are being sold by Western Union, Tymnet, Graphnet, Southern Pacific, and Telepost among others.<sup>2</sup>

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<sup>1</sup> The so-called "Generation I" service involves a similar system, except the message input is originally in hard copy form and is converted to electronic form prior to transmission.

<sup>2</sup> Further, the early indication is that E-COM is not attracting usage at anywhere near projected levels. According  
(CONTINUED)

A short step away from the present service is the so-called "Generation III" service, which involves direct electronic messages from sender to recipient. This service is already being sold by a large number of firms, including AT&T, GTE-Telenet, General Electric, Tymnet, and a host of computer services firms. Since it does not involve physical delivery of hard copy, it cannot reasonably be argued that a Generation III service is simply the traditional postal mission by more modern means. Nonetheless, private businesses perceive the Postal Service as ready to offer this type of service<sup>1</sup> Since the Postal Service has no apparent justification for such activities, I support the recommendations contained in the 1979 Presidential Review Memorandum on Postal Service Involvement in Electronic Mail Offerings that the Postal Service be prevented

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(FOOTNOTE CONTINUED)

to one source, the reason is that the system is poorly designed to meet user needs. "The Post Office's Electronic Turkey," Business Week, March 29, 1982, p. 35.

<sup>1</sup> See, e.g., "Government Provision of Electronic Message Services," Position Paper of the Association of Data Processing Service Organizations, Inc., (ADAPSO), February 16, 1982, at 16.

from offering end-to-end links or from building its own transmission network.<sup>1</sup>

A related, albeit secondary, issue is the manner in which the Postal Service prices its electronic services. Although cross-subsidization is ostensibly prohibited, there is a concern that the Postal Service will, nonetheless, cross-subsidize its electronic services.<sup>2</sup> These concerns are fueled by the fact that E-COM fees are set at the level recommended over two years ago when the system's capital costs were estimated to be \$7.4 million, although its subsequent contract with RCA calls for USPS expenditures of at least \$38.6 million, a sum more than five times greater. Moreover, since the government stands behind it, it may not be reasonable to view the Postal Service as just another competitor in a competitive market, even if it does price to cover its costs. Congress has required, for example, that the Federal Reserve not only charge fees for its commercial services to fully cover costs but also that it add an adjustment to cover imputed taxes, profits, cost of capital, and the like.<sup>3</sup> If the Postal Service continues to offer

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<sup>1</sup> 44 Fed. Reg. 438929-30.

<sup>2</sup> See, e.g., ADAPSO, supra, n. 3, at 19-22.

<sup>3</sup> Monetary Control Act of 1980, Title I, Public Law 96-221, March 21, 1980.

electronic services, such a requirement for E-COM might at least make competition with the private sector more equal.

### Conclusion

Allow me to sum up now by stating a few recommendations regarding the Postal Service issues previously touched upon, and to provide a "blueprint" of further options that the Congress may want to consider. I would like to make it clear that these proposals, and this discussion, are by no means anti-USPS. I fully realize that the men and women of the Postal Service perform valuable jobs. My theme, instead, is that opposing change and ignoring economic realities in the postal realm would not serve consumers nor the long-range interests of the USPS itself.

First of all, it's absolutely clear that even if nothing else is done, the USPS should bear the burden of demonstrating -- if it can -- that first-class mail service is indeed a natural monopoly in need of legal protection prohibiting competitive entry. In order to go about this task, Congress could require the USPS to conduct a thorough analysis of this matter subject to full outside review of the study plan, data, and analysis. The mandate for this empirical study should be broad, covering

not only the concerns mentioned earlier, but others, such as why first-class mail is presumed to be a natural monopoly even though second-, third-, and fourth-class are not. Moreover, alternative ways of restructuring mail service (such as devising more appropriate mail categories as the result of a functional analysis of the mail) should not be overlooked.

Even if such a study affirms the existence of a natural monopoly in first-class mail, Congress could consider other actions to increase the accountability of the USPS and to protect the interests of consumers. I have three specific ideas in mind here, although there may well be other possibilities. First, Congress could restrict the ability of the USPS to set the bounds of its own monopoly by either statutorily defining "letter," or by providing increased oversight of USPS decisions concerning their definitions.

Second, Congress could strengthen the power of the PRC to provide a truly vigorous and independent check on decisions by the USPS and its Board of Governors. I should tell you, frankly, that I have doubts about the ability of any regulator to do a perfect job. But if the PRC were given very direct guidelines as well as requisite authority (e.g., powers to initiate rate cases and to subpoena information), I think the

situation could be improved. In sum, consideration could be given to whether the PRC has enough power, the right tools, and the proper enthusiasm for overseeing the vast operations of the USPS.<sup>1</sup>

Third, Congress could limit the USPS' ability to enter new fields of service (such as the E-COM program) without PRC approval and/or Congressional authorization. The expansion of USPS activities in direct competition with the private sector when there is no compelling need for such expansion should not be countenanced. Moreover, in the interests of promoting competition and protecting the consumer, I see little reason for ever granting USPS a legal monopoly in such new types of service unless it is able to provide compelling evidence why such a monopoly would be in the public interest.

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<sup>1</sup> Two especially striking anomalies about the PRC's current status are worth mentioning. First, as Roger Sherman testified, although many of the relevant issues confronting the postal domain need sophisticated economic analysis, "...there is no Chief Economist at the Postal Rate Commission, and no extensive capacity to conduct economic analysis." (Sherman Statement Before the Postal Operations and Service Subcommittee and the Postal Personnel and Modernization Subcommittee of the Committee on Post Office and Civil Service, United States House of Representatives, March 18, 1982, p.6). Second, as the U.S. Justice Department study, op. cit., pointed out at p. 23: "The PRC is the only regulatory body whose annual budget derives from and is reviewed by the entity that it regulates (with the exception of the Ohio State Utilities Commission)."

There are, of course, more extensive changes that the Congress could consider. Although I think any decision on these further measures should be deferred pending completion of the study mentioned earlier, the most obvious possibility would be to repeal the private express statutes.

As described above, this move would likely have several effects. First, it would eliminate the problem of interclass cross-subsidies (i.e., from first-class to other classes), since the USPS would no longer have the capability of charging well above costs without losing first-class mail business to the new competitors. Second, the new competition would likely drive the cost of first-class mail down relative to other classes of mail, to the benefit of consumers. Third, rural users might have to pay somewhat more for somewhat less service relative to other users of first-class mail, unless Congress chose to subsidize rural mail service directly. A direct subsidy would likely cost less than the present hidden one. Finally, repealing the private express statutes would essentially force

the USPS to reform its rate structure and improve its operations or go out of business.<sup>1</sup>

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Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be happy to respond to any questions you might have.

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<sup>1</sup> An even more extensive change would be to deregulate postal service totally by spinning the USPS off into the private sector, with no government link and no statutory barriers to competition. Such a move would have the advantages of ending all governmentally-induced inefficiencies in costs and in pricing. Of course, such an action should not be adopted precipitously.

## EXECUTIVE SUMMARY OF USPS TESTIMONY BY CHAIRMAN MILLER

Mr. Chairman and Members of the Subcommittee: I am pleased to have this opportunity to present my views regarding the performance of the United States Postal Service (USPS) and the need for significant relaxation in current rules affecting first-class mail.<sup>1</sup> I would like to commend the Joint Economic Committee for addressing this important topic.

Let me emphasize that I have the greatest respect for the men and women of the USPS. My personal view is that Postmaster General Bolger is doing a commendable job in addressing the myriad of challenges he has to face.

With your permission, Mr. Chairman, I would like to submit more detailed comments for the record and proceed now to address some of the most important postal issues.

### Postal History

It would be useful to begin with a brief look at the history of the U.S. Postal System. 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. Nevertheless, Congress in 1789 established a

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<sup>1</sup> The views expressed here are those of the Chairman and do not necessarily reflect the opinions of the Commission or any other Commissioner.

Post Office Department as a monopoly, giving it the exclusive right to routinely carry letters for hire over all post roads.

Congress regularly revised the postal laws in an effort to eliminate remaining competition during the first half of the 19th century. Ironically, the Pony Express, often used as a symbol of U.S. mail service, was not an invention of the U.S. Post Office but was introduced by private postal companies that were, in turn, put out of business by the private express statutes. Finally, in 1845, Congress directly prohibited private express companies from carrying letters for hire, except in a few specific instances. Those private express statutes, with a few modifications, are still law.

In 1970, Congress reorganized the Post Office by creating the United States Postal Service as an independent, quasi-governmental business, intended to make the delivery of mail more efficient and to be economically and politically independent.

The Postal Service exercises considerable discretion in determining the extent of its monopoly over letters. It has defined them to include bills, receipts, IBM cards, magnetic cards, magnetic tapes, and so forth. In the past several years the Postal Service has typically moved into new service areas by first claiming that they fall within its monopoly and later announcing a suspension of some aspects of the monopoly. The Department of Justice has questioned the propriety and wisdom of this process.

#### Federal Court Restrictions on PRC's Review Authority

Under Congress' reorganization, the USPS, its Board of Governors

and the Postal Rate Commission (PRC) share responsibility for the mail classification schedule and postal rates and fees. However, in recent years the relative balance of authority appears to have shifted considerably toward the USPS and its Board of Governors. Some federal courts have limited the PRC's review of USPS actions. More importantly, the PRC's authority to police USPS costs and prices has also been diminished. This ability has always been constrained because the USPS possesses and controls much of the data necessary to support rate and class changes. This data has never been subjected to a careful analysis by outside reviewers that would permit a more scientific allocation of Postal Service costs. This is not to suggest by any means that the PRC has done everything in its power to fulfill its "watchdog" function.

#### The Postal Monopoly: Is It Economically Justified?

The USPS monopoly over first-class mail is of concern because private firms normally perform better than government enterprises. Competition among firms in a free market most efficiently allocates scarce resources. A private firm normally has greater flexibility and more incentive to innovate and reduce its costs than does a quasi-governmental enterprise such as the USPS.

The classic justification for government enterprise is that the marketplace has failed and the private sector cannot -- or will not -- provide a particular good or service on its own. But this does not appear to apply to the provision of first-class mail services. After

all, there is a long list of private entrepreneurs who have tried to deliver low-cost first-class mail but who were driven out of business by the USPS -- not by head-to-head competition, but through repeated USPS court actions to enforce its monopoly.

There is also ample evidence that monopolized markets do not normally perform as well as competitive ones. A telling example of the potential benefits of private competitors in the absence of the postal monopoly is the success of private express mail services. Despite the threat of suit by the USPS, numerous private carriers developed in the 1960's and 1970's, specializing in the rapid and reliable transportation of commercial documents. Private express delivery services now compete openly and freely with the USPS for that portion of the first-class mail market.

The basic argument in favor of a (regulated) monopoly rests on the assumption that the firm in question is a "natural monopolist," or a provider of services more cheaply provided by a single firm than by many firms. But there is no solid evidence that first-class mail service has this characteristic. Indeed, if the handling of first-class mail were a natural monopoly, the USPS should not need the private express statutes. By definition, competitors would not be able to provide the same quality of service at an equal or lower price. The USPS would need legal protection for its monopoly, however, if it prices mail significantly above its cost or if it is inefficient.

The preceding remarks do not suggest that there are no beneficiaries of the current arrangement. Rather, from society's

perspective the losses associated with the statutory government monopoly over first-class mail may exceed the benefits derived from it. The Justice Department and the Council on Wage and Price Stability have independently reached that conclusion.

#### Need for a Study of the Postal Monopoly

Considering the strong presumption against the economic efficiency of a government monopoly, it seems to me that the burden of proof should be on those who support maintaining the private express statutes. It would seem illogical to allow the USPS, which has the data and the most to gain by demonstrating the existence of a natural monopoly, to simultaneously withhold its data from independent review and claim the benefit of any doubt.

It is my belief that the USPS should be required to produce a detailed empirical study of whether an economic justification exists for continuing its statutory monopoly over first-class mail. All data used in this study should be made public, and the report should be reviewed widely by various experts. Should such an investigation fail to provide strong economic justification for a continuation of the postal monopoly, I would urge Congress to repeal the private express statutes.

#### Effects of Repealing the Private Express Statutes

My preliminary view is that repeal of the private express statutes would likely have a dramatic effect on the market for first-

class mail. For example, a category of first-class mail that arguably could be charged a lower rate of postage is transaction mail. Transaction mail, which makes up a significant portion of first-class mail, tends to be generated by a few, high-volume local business mailers and their customers and to be delivered in high-density areas. Delivery of that mail bearing typed addresses is less expensive than delivering a letter addressed by hand of the same weight over long distances between non-urban points. Yet both types of mail currently are charged the same postage. In a competitive market for first-class mail, consumers who use lower-cost mail services would benefit from lower rates for those services.

Repeal of the private express statutes could result in higher rates and/or reduced service for some postal users, just as it would likely result in lower rates or improved service for others. But any shifting of relative rates and service would ensure that postal service prices reflect the costs of providing them and could generate significant savings for society. If it were felt that a particular type of mail, such as rural delivery, should have its price discounted or its service increased, then Congress could grant an explicit subsidy to the users of that type of mail for less than the USPS' current costs.

#### Cross-Subsidization and Its Effects

Although the Postal Reorganization Act of 1970 prohibits subsidization across classes of mail, it has been alleged that the

USPS' approach to costing and pricing leads to such cross-subsidization (perhaps unintentionally) and the inefficiencies associated with it. The validity of allegations that costs are or are not correctly allocated would be clearer if the USPS were to make more of its data available for public scrutiny, as I recommended earlier.

#### E-COM and Its Effect on Private Electronic Message Services

Finally, I would like to make a few comments about the Postal Service's provision of electronic message services. The fundamental issue is whether there is a need for the USPS to provide such services.

The Postal Service's present service, known as E-COM (electronic computer originated mail), is a blend of telecommunications and the traditional hand delivery of mail. While Postal Service delivery of stuffed envelopes seems clearly within its traditional role, telecommunications and data processing are not. This new role is especially difficult to justify in view of the desire and ability of private firms to provide such services.

A short step away from the present service is the so-called "Generation III" service, which involves end-to-end electronic messages from sender to recipient. Since it does not involve physical delivery of mail, Generation III service cannot be characterized as simply the traditional postal mission by a more

modern means. In the absence of an apparent justification for such activities, I support the recommendations contained in the 1979 Presidential Review Memorandum on Postal Service Involvement in Electronic Mail Offerings that the Postal Service be prevented from offering end-to-end links or from building its own transmission network.

A related concern is that the Postal Service will cross-subsidize its electronic services. In a similar context, Congress has required that the Federal Reserve not only charge fees for its commercial services to fully cover costs but also that it add an adjustment to cover imputed taxes, profits, cost of capital and the like. If the Postal Service continues to offer electronic services, such a requirement for E-COM might at least make competition with the private sector more equal.

### Conclusion

Allow me to sum up now by offering a few recommendations and providing a "blueprint" of further options that Congress may want to consider.

First of all, the USPS should bear the burden of demonstrating -- if it can -- that first-class mail service is indeed a natural monopoly in need of legal protection by producing an empirical study of the issue.

Even if such a study affirmed the existence of a natural monopoly in first-class mail, Congress could consider other actions to

increase the accountability of the USPS and to protect the interests of consumers. As a start, Congress could restrict the ability of the USPS to set the bounds of its own monopoly by either statutorily defining "letter," or by providing increased oversight of USPS decisions concerning their definitions.

Congress could also strengthen the power of the PRC to provide a truly vigorous and independent check on the USPS and its Board of Governors. I should tell you, frankly, that I have doubts about the ability of any regulator to do a perfect job. But if the PRC were given very direct guidelines as well as requisite authority (e.g., the powers to initiate rate cases and to subpoena information), I think the situation could be improved.

In addition, Congress could limit the USPS's ability to enter new fields of service (such as E-COM) without PRC approval and/or Congressional authorization. Such expansion in direct competition with the private sector need a compelling justification.

There are, of course, more extensive changes that Congress could consider. Although I think any decision on those further measures should be deferred pending completion of the study mentioned earlier, the most obvious possibility would be to repeal the private express statutes.

As described earlier, this move would likely have several effects. First, it would eliminate the problem of inter-class cross-subsidies: the USPS would no longer have the capability of charging well above first-class costs without losing business to its new

competitors. Second, the new competition would likely drive the cost of first-class mail down relative to other classes of mail, to the benefit of consumers. Third, rural users might have to pay somewhat more for somewhat less service relative to other users of first-class mail, unless Congress chose to subsidize rural mail service directly, which would likely cost less than the present hidden subsidy.

I would like to conclude by reemphasizing that these proposals, and this discussion, are by no means anti-USPS. My theme, instead, is that opposing change and ignoring economic realities in the postal realm would serve neither consumers nor the long-range interests of the USPS itself.

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Mr. Chairman and Members of the Committee, this concludes my prepared statement. I would be happy to respond to any questions you might have.