

Postal Reform: An Investment in Jobs and the Economy

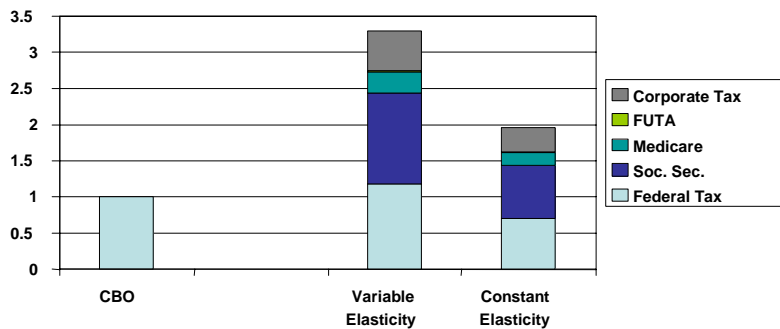
A new study from the Institute for Postal Studies shows that job losses and tax revenue forgone resulting from the failure to pass postal reform legislation would exceed other budget impacts three to one.

In contrast with the critics of postal reform who have charged that the proposed postal reform legislation would increase the deficit by as much as \$1 billion per year, this new analysis shows that **not** passing postal reform could result in a loss of tax revenues in the \$2 billion to \$3 billion range.

This analysis calculates the tax revenues that will be lost when jobs are impacted by raising postal prices. Jobs and companies in the \$900 billion mailing industry are increasingly price sensitive. Nine times as many jobs are private sector jobs than are postal jobs. Electronic services are only one example of the way in which this once staid industry built around a government monopoly is increasingly competitive and therefore will react to sharp price increases.

Without postal reform industry experts calculate that the postal price increase to be requested later this year will be 5.2 percent higher than otherwise necessary. The USPS will have to raise extra revenue to fill a postal pension escrow fund that the Congress, OMB, Treasury and OPM agree is not needed for postal pensions. The following figure summarizes the lost tax revenues using two different assumptions about price elasticity, one from Dr. Michael Bradley of GWU and the traditional USPS assumption.

Budget Impacts from Cost Increase vs. Revenue Losses



In short, as opposed to the CBO analysis of the **increased costs** associated with postal pension reform that impacts the cost side of the federal budget, the deficit problem is actually made worse by the impact that higher postal prices will have on the **revenue** side of the federal budget.

The Fight for Postal Reform

Postal reform is close at hand after nine years of debate. Postal reform bills have passed committees in both the House and the Senate. This legislation offers the opportunity to mitigate future USPS rate increases, sustain mail volume and save jobs.

The proposed postal reform would address the postal retirement issues that were left unfinished when Congress passed postal retirement legislation last year (the Postal Civil Service Retirement System Reform Act of 2003). The 2003 retirement reform law created an escrow fund to contain the scheduled post-year 3 pension payments by the USPS that Congress and the Administration agreed would no longer be needed to fund retirees. The retirement reform legislation stated that Congress would have to “revisit” the escrow provision before it could be eliminated.

If Congress does not revisit the postal retirement legislation, the USPS will be required to raise rates to its customers higher than would otherwise be necessary. On Monday September 20, 2004, Postmaster General John E. "Jack" Potter stated that he would keep his promise not to raise rates until 2006. But he also indicated that if there is no postal reform, the rate increase that will soon be proposed to the Postal Rate Commission by the USPS will have to be in the double digits.

During the past three years since the USPS published its Transformation Plan at the request of Congress, the leadership of the USPS has made unprecedented progress in cutting costs. Productivity at the USPS has increased for five consecutive years. At the same time, service has improved and on-time delivery of First-Class Mail exceeds 96 percent. Nonetheless, postal experts believe that these have been short-term achievements. The successful financial performance of this past year has not been forecast to be repeated next year. Future years are likely to be even tougher as customers now have competitive alternatives to traditional mail services.

The comptroller general stated in 2001 that the Postal Service's business model was broken. The President's Commission on the Postal Service stated that tough choices would be needed to sustain universal postal services (2003). Looking to the future, postal experts agree that price increases will be needed to sustain current operations. The question is how high must they be and what impact will they have?

Postmaster General Potter told the National Postal Forum audience that the USPS would soon initiate the process of raising rates for 2006. Without postal reform, experts believe proposed increases will be nearly 15 percent because of the need to fund the escrow. In recent years, price stability has effectively resulted in real term decreases in postal prices. Even so, there have been volume declines. Without reform, a proposed rate increase will not only restore the rate increase trend to the level of inflation but will take it higher.

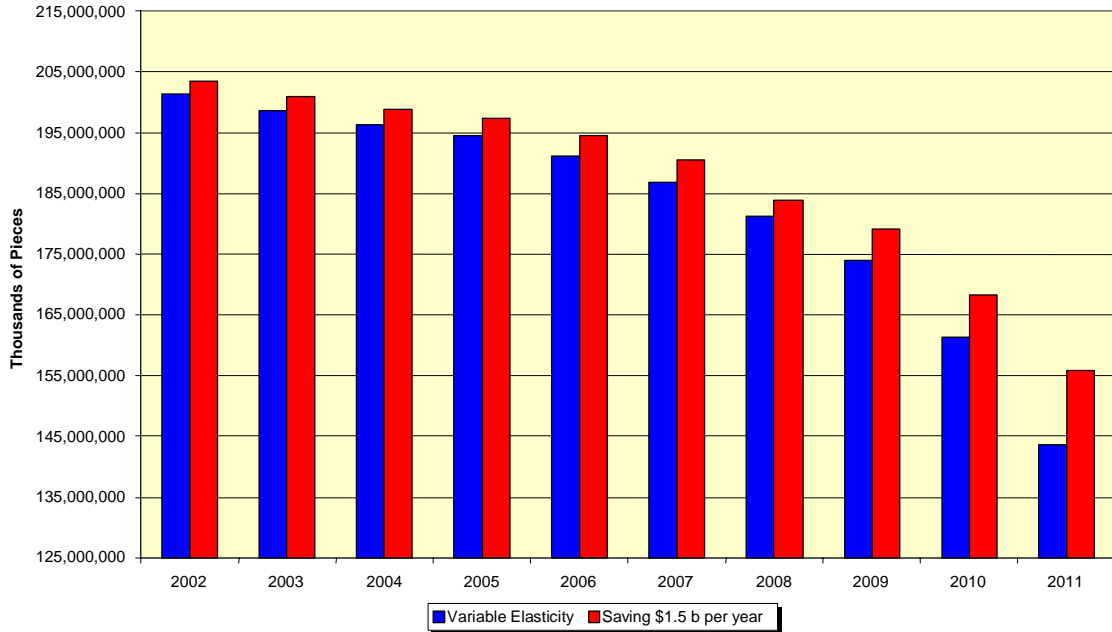
The Congressional Budget Office estimated in June 2004 that postal reform would have a budget implication. While there would be on-budget savings of \$25.7 billion, there would be an estimated off-budget cost of \$34.5 billion in the years 2005-2014. The way in which postal reform addresses issues of future pension payments, healthcare liabilities and military retirement results in this estimate of nearly \$1 billion per year in budget impacts.

The failure to pass postal reform, however, will also have a negative budget impact stemming from lost tax revenues associated with lost jobs. This summary reviews a new analysis sponsored by the Institute for Postal Studies of the Envelope Manufacturers Association's Foundation that estimates the potential negative consequences measured in lost tax revenue and shows that tax losses would be likely to exceed other budget impacts.

In a recent study published by the Institute for Postal Studies, Professor Michael Bradley of George Washington University examined the implications of raising prices for postal services. Figure 1 shows the forecasts that were contained in Dr. Bradley's work. He projected a significant volume decline in the event that price increases were introduced in an increasingly price sensitive mailing marketplace. His analysis shown in Figure 1 also shows that the need for future price increases and the resulting volume decline could be mitigated by significant cost decreases. In either event, these forecasts will result in job losses.

Figure 1

Total Volume

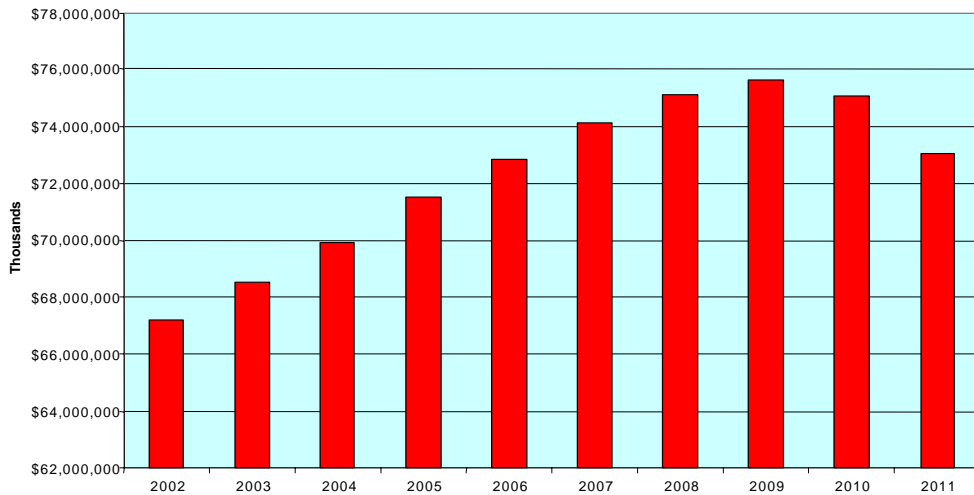


The small economic model developed by Professor Bradley showed significant revenue decline that would be associated with this volume decline. Figure 2 shows the results of this analysis. Price increases produce volume declines. Volume declines result in declining postal and mail revenues.

Figure 2

The declining revenue eventually erodes the Postal Service's revenue flow:

Total Revenue



In this scenario, after 2011, the Postal Service can no longer raise enough revenue to break even.

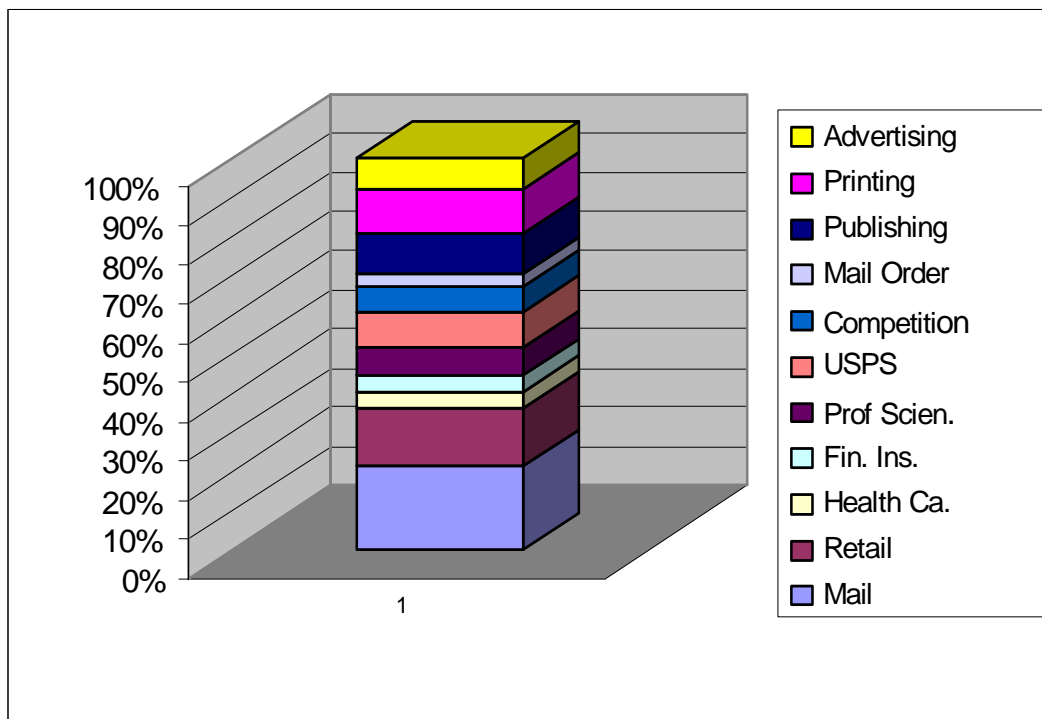
Traditional analysis by the USPS has assumed that demand for postal services would be constant in the future. Historically, there has been an extremely strong connection between economic growth and the growth in mail volume. The small economic model, however, examined the implications of a market in which there were substitutes and alternatives that made demand for postal services more sensitive to prices.

A second study (“The Jobs Study”) published by the Institute for Postal Studies in the spring of 2004 showed the potential job impacts of these forecasts of volume decline. In recent years the USPS and the Mailing Industry Task Force have estimated that there are nine million jobs associated with the mailing industry. The Jobs Study examined the industries in which these jobs reside and located the jobs geographically. The mailing industry has nine times more jobs than the USPS itself, which represents one third of the civilian workforce of the government. Not surprisingly, job impacts would be spread through nearly every congressional district.

The pessimistic scenario of the small economic model was used to estimate the potential job impacts of nearly 1.8 million jobs shown in the Jobs Study. Figure 3 illustrates the reason the potential job impacts would appear to be alarming. The mailing industry and intensive mail users touch virtually every part of the economy.

Figure 3

The diverse mailing industry is spread through the entire economy



The new Institute for Postal Studies white paper on economic impacts takes the Jobs Study one step further. Analyzing the potential lost tax revenue associated with impacted jobs, this study concludes that even traditional postal assumptions would yield significant tax losses. Using the small economic model’s assumption of a more price sensitive marketplace, future tax losses would exceed CBO estimates of other budget impacts by a significant margin.

Figure 4

**Sharp price increases produce steep volume decline,
job impacts and potential lost tax revenue.**

	Variable Elasticity (Bradley Model– 2007)	Constant Elasticity (Traditional USPS Assumption)
Total	\$3.300 billion	\$1.954 billion
Federal Income Tax	1.186	.702
Social Security	1.252	,741
Medicare	.293	.174
Federal Unemployment Tax	.014	.009
Corporate Income Tax	.555	.328

Figure 4 summarizes the appendices to the new white paper prepared by Transformation Strategy Inc. and SLS Consulting working with Professor Colin Blaydon of the Amos Tuck School of Business Administration at Dartmouth College.

Will price increases produce significant volume declines as forecast by Professor Bradley's small economic model? Will volume declines force job cutbacks? Will job losses be permanent? None of these questions can be answered with certainty. On the other hand, the secondary impacts and macro effects of raising prices higher than necessary are also not taken into account in this analysis. Because such dynamic scoring of budget impacts is widely debated, this analysis focused on potential job impacts and the federal tax revenues that would be foregone. The white paper concludes that the potential tax revenue impacts are several times the size of other potential budget impacts. Not passing postal reform is likely to impact the federal budget by reducing tax revenues by as much as \$3.3 billion in comparison with the CBO estimate of approximately \$1 billion per year.

This summary is a white paper on the economic impact of postal reform and its appendices has been prepared by Transformation Strategy Inc. and SLS Consulting Inc. of Washington, D. C. working with Professor Colin Blaydon of the Tuck School of Dartmouth College.

Professor Colin Blaydon is the former dean of the Tuck School of Business where he has taught for twenty-five years and is a former official at the Office of Management and Budget.

These back-up papers, as well as the Jobs Study and the Small Economic Model, are available from the Institute for Postal Studies of the Envelope Manufacturers Association's Foundation.