

**iLLUminate Blog Transcript: Jesus Salas on Privatizing the U.S. Postal Service**

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- JACK CROFT: 00:14 Welcome. I'm Jack Croft, host of the iLLUminate podcast for Lehigh University's College of Business. Today is May 7th, 2021. And we're talking with Jesus Salas about the question, should the United States Postal Service be privatized? Dr. Salas is an associate professor in the College of Business' Perella Department of Finance. He's also a co-director of the Family Business Institute within the Martindale Center at Lehigh University. His teaching and research interests include investments, corporate finance, corporate governance, and corporate risk management. Welcome, Dr. Salas.
- JESUS SALAS: 00:52 Thank you.
- CROFT: 00:53 It's been just over 50 years since the Nixon administration in 1970 passed the Postal Reorganization Act that transformed the old cabinet-level Post Office Department into a new independent government agency, the United States Postal Service. That law also, for the first time, required the Postal Service to break even. Yeah. So the issue of privatization kind of came on the table then. And here we are, more than 50 years later, and the talk around it seems to be increasing. What do you think accounts for that?
- SALAS: 01:31 Yeah. I mean, it's interesting, right? I mean, thinking back 50 years, it seems like the things that were motivating Nixon at that time were very similar to what we're seeing right now. At those times, the Postal Service really was suffering with huge deficits, partly due to an increase in mail volume, of course. And at that time, Nixon wanted to figure out how to solve that issue and get rid of having to manage the system that was also lacking in quality of service, right? So it's interesting that 50 years later, almost exactly, right-- I mean, it's 51 years later. But we're actually talking about the same issue, right? We have a USPS that is struggling to figure out how to operate, that is suffering in terms of quality of service, and it's also generating significant deficits. And so, again, we're trying to figure out, the government is trying to figure out, and maybe people are trying to figure out, and maybe we need to think of pushing forward something more extreme than what the Nixon administration did in 1970, right? So it's interesting that we're thinking of doing something to solve a problem that was very similar to what was happening in 1970.
- CROFT: 03:02 Well, let's start by looking at this broader issue of privatization, because I know you've done research on privatization in both Europe, as well as in the United States. Let's start with Europe. What have you found in the experiences of the European countries you've looked at that may help inform the discussion around potentially privatizing the U.S. Postal Service?
- SALAS: 03:28 Yeah. So let me just say that this area of research, privatization, is very large. There's plenty of studies on the topic. And they go back to World War II a little bit, and then later to Margaret Thatcher, right, who was one of the first leaders who really wanted to make an impression with the idea that privatization was beneficial. And, in general, I'll say that much of the empirical evidence suggests that privatization, obviously,

raises revenue for the country, right? It promotes economic efficiency for corporations because they'll grow faster, and then costs will fall. And they also provide an opportunity for companies to be involved in more competition, right? And as a result, it makes companies, just by themselves, become more efficient, right? So just to cite a couple of examples, a [very well-known study](#), [by] Galal, Jones, Tandon, and Vogelsang in 1994, this study was sponsored by the World Bank. And they studied 12 large companies that were privatized in Great Britain, Chile, Malaysia, and Mexico. And what they do is they try to figure out how these companies would have performed had they not been privatized. As you can imagine, this is very complex, right? It's very difficult to try to figure out how the companies would have performed had they not been privatized, right? But doing this very carefully, the authors show that, on average, performance improves by about 26% following privatization.

SALAS: 05:21

But here's the key. Here's what makes it really, really interesting. They find that workers in those companies were never made worse off, and in three companies, employers were actually better off as a result of the privatization. Okay? Now, that's only one example. After that, there's been about 20 studies, more than 20 studies that uniformly show that companies performed better after privatization. So it's not like some studies find that privatization is beneficial for companies, and some studies find that privatization is worse. Uniformly, most studies find-- all studies find, really, that privatization is beneficial for corporations. Now, me personally, I've done some work on what happens to the companies after they're privatized. Governments sometimes retain some ownership in those companies, okay? And I find that that retained ownership has negative impacts on corporate governance. Okay? So what that means is that whenever the governments retain ownership, the governance quality of those companies is actually worse off. So, in general, I would say, it's my priors and certainly, from research that's been done on this topic, which is, as I said, extensive, the results suggest that privatization is very beneficial to the country, the companies themselves, and the employees of those companies, right? And so, obviously, I would always be generally in favor of privatization. Now, I'll say that this is in Europe. Okay? And that's obviously, where a lot of the privatization happened. The U.S. is just completely different.

CROFT: 07:19

Yeah. So let's talk about that. The experience in the United States is less with privatization. But are there some examples that you've looked at that may shed some light on the potential privatization of the USPS?

SALAS: 07:37

Yeah. So this is where the evidence becomes a little bit more ambiguous. It's more difficult to study privatization in the U.S. because the U.S. government has traditionally not really owned a lot of businesses. They've never really run businesses. The only businesses that could have been privatized in the U.S. are generally airports, prisons, and utilities. And now, there's the discussion of the USPS, right? So what makes all of these businesses unique? Most of these businesses are essentially natural monopolies. So what that means is that most of these businesses, there's no other business that can really compete with them, right? And so, therefore, when you privatize them, it's not clear that these companies are going to operate efficiently just because of competition, right? And so, therefore, because of that, because they don't have incentives to operate efficiently, I mean, they could just charge as much money as they can, right, as they really want to. Because of that, they'd have to be regulated. right? And since they have to be regulated, now, we have other negative

consequences, right? Because now, we have to develop the perfect regulation, right? And that's really, really difficult, right?

SALAS: 08:48

So what you want to do, when you regulate these businesses, if you were to privatize them, is that you'd want to promote innovation. Okay? And then, on the other hand, you'd want to restrict or limit how much they can charge for the services. Now, these attempts to regulate businesses in the U.S. is far from perfect, right? Of course, it's very difficult to do this. Firms likely bribe politicians in order to allow them to raise prices. There's few incentives for them to innovate. As much as you try to do this, it's very difficult to incentivize companies that are privatized to innovate when they're natural monopolies. And we have certainly seen failures in utilities more recently. We have the fires in California, which I think the utility company is going to go declare bankruptcy as a result. We have the storm in Texas recently, that was also-- could be partly at least attributable to some failures by the utility companies. There's also some evidence that utility companies will manipulate their accounting figures in order to appear that they're not making as much money, so that then they can push to be able to increase the prices that they charge for the services, right? I mean, if you think about it, once you regulate, and once you eliminate competition, then you're going to have incentives to try to figure out ways to get out of the regulation, or to try to charge as much as possible. Now, overall, okay, even in the U.S., the evidence suggests that privatizing, for example, prisons, okay, has led to improvements in the quality. And what I mean by this is that the people who are incarcerated, actually, the evidence suggests-- and this is not my research, but the evidence suggests that they're also treated better than those that are managed by the government. And there's also evidence that utilities also perform better because of privatization. But, of course, it's not clear completely that the benefits outweigh the costs. Because, as I said, it's costly to regulate these companies, and it's imperfect.

CROFT: 11:00

Now, is there some inherent tension between being required to serve all people, even those living in the most remote parts of the country, and operating as a business?

SALAS: 11:19

Yeah. So this is the critical part of the issue of privatizing the USPS. And, in fact, this is probably why Nixon didn't fully privatize the USPS in 1970, right? In fact, it is likely not profitable for the USPS to deliver to remote areas, right? But the mandate is for USPS to deliver and to ship from everywhere in the United States, including the most remote rural areas. And so any sale or privatization of USPS would necessitate a mandate that the company would have to continue to serve these rural remote areas. Okay? So this essentially would make the company regulated because that means that there would be some rules that the company would have to follow. And in addition, for example, you'd have to say that they can't just charge an exorbitant amount to ship to or deliver to these areas. And they probably would have to say how often you have to pick up the mail, how quickly you have to deliver mail. I mean, as you can see, it's very complicated to regulate these situations, right? You have to think of all the possible scenarios and all the possible ways that whoever buys USPS would have to figure out-- would want to figure out how to avoid these regulations. And so you'd have to figure out all the rules and all the oversight in order to make sure that the USPS is not trying to avoid the mandate, right? And so, therefore, privatizing USPS would not be simple, right? Anybody who buys USPS would be operating in a highly regulated business, which likely restricts how much money the company would make, right? And so, in the end, the restrictions could make the privatization of USPS unattractive. Maybe nobody would want to buy such a business.

CROFT: 13:11

Right. And I know that you've looked at the balance sheet for USPS, which is public record. And what does that tell us about the business model?

SALAS: 13:23

Yeah. So the USPS is also in terrible financial shape. Okay? They have unfunded pension liabilities of about \$90 billion. And then they have additional debt of about \$30 billion. Then if you look at-- on the other side, if you look at the assets of the USPS, they are about \$35 billion. Okay? So that means the company owes a lot more than it owns. Okay? So anybody who would want to purchase the USPS would probably also be acquiring those liabilities, right? And so if you think about it, any time you buy the USPS, you're also acquiring the \$90 billion liability on the pensions. And you'd also be acquiring the \$30 billion debt that the USPS has. Okay? Now, the government could take over and pay those debts for the USPS. But that would just mean that the tax holders would be on the hook for that. And I'm not sure everybody wants to do that, right? Now, it is difficult to imagine, therefore, how much the USPS is worth if we were to include the value of having to pay off these debts, right? Now, the government is, on the other hand, trying to consider getting rid of the defined benefit pension plan that they have, and turning it into some kind of Social Security. So what that would mean is that instead of paying right now for the pensions of the employees that are going to retire in the future, what you'd want to do is have the employees right now contribute to pay for the retirement of the people who retired in the past. So that's kind of more or less how Social Security works, right? The government is not saving money for you for the future. Rather, the current employees are paying for the retirement benefits of the people who retired in the past, right?

SALAS: 15:23

Now, if the government were to do this, if the government were to convert the pension plan of the USPS into some kind of Social Security, then if you really want to sell the USPS, you have to think about what you do with that. Does that become part of the government? So is the pension always going to be a government debt? Or is that something that the company will be able to change? And so it becomes a really big problem because there's actually some money in those pensions. And so who owns that money, right? Now, let me also say that this defined benefit pension plan, okay, was very common, okay, in the U.S. for many, many, many decades, right? And little by little, many companies have been getting rid of those defined benefit pension plans. In fact, the competitors to the USPS, FedEx-- or two of the competitors, FedEx and UPS, they already got rid of their defined benefit pension plans. What that means, they didn't just say like, "You no longer have a defined benefit pension plan." What they did is anybody-- starting a few years ago, anybody who was hired to FedEx and UPS, they don't get a defined benefit plan anymore. Okay? So that also reflects what's been happening at USPS. Generally speaking, USPS is a step behind in making necessary changes. The reality is that it's not surprising. It makes sense that companies cannot sustain defined benefit plans. It's just not possible. Okay? It's not because companies don't want to. It's because of the demographics, right? It's because there's many-- people live longer. Okay? And people are retiring younger, right? And the retirement age has not changed that much, right? And so as a result, you just don't have enough money to pay for the pension benefits. And so we know clearly that defined benefit plans are just very difficult to manage. But the USPS is still not wanting to make the necessary changes. And that's a big problem. And that's a big reason why we're discussing the issue of what to do with the USPS.

CROFT: 17:39

Now, to complicate things even a little more, I think most people probably think of Amazon and FedEx and UPS as strictly competitors with the Postal Service, when it's also true that there's a somewhat symbiotic relationship between them. They rely on the Postal Service, to a degree. And if you could talk about that.

SALAS: 18:04

Yeah. I mean, it's really interesting because, as I mentioned earlier, there are other businesses that the U.S. has privatized in the past, like the prisons and the utilities. And in those cases, those are kind of natural monopolies, right? Well, in the case of the USPS, it's not exactly a natural monopoly, right? I mean, it is partly a natural monopoly because they still have to deliver mail to the mailboxes, right? Nobody else does that. FedEx doesn't do that. UPS doesn't do that, right? But a lot of the business is packages, right? And that is really competing with UPS and FedEx. Now, here's where it gets really funny, right? Because UPS and FedEx actually pay the USPS to deliver what they call the last-mile service. So whenever the UPS and FedEx don't want to do it, or because it's unprofitable for them to do it, to deliver to these rural remote areas, they'll just go and pay the USPS to do it, right? And so this is really important, right? Because the USPS is mandated to deliver to every rural remote area, right?

SALAS: 19:10

Now, FedEx and UPS, they know it's unprofitable to operate in many remote areas in the U.S. Therefore, FedEx and UPS actually use USPS to provide what they call the last-mile service. And so that means that FedEx and UPS pay the USPS rate to deliver to the remote areas. And so it is more profitable-- think about this. It is more profitable for the UPS and FedEx to pay USPS than to ship by themselves. Okay? So what that means, okay, is that these companies likely would lose money shipping to and from rural remote areas, right? Now, whoever buys the USPS would probably be mandated to ship to and deliver from these rural remote areas. And so that means that whatever company takes over the USPS would automatically be at a disadvantage economically compared to UPS and FedEx. Because they would be forced to deliver and operate in these areas at a loss, right? FedEx and UPS are not required to operate in these areas. As I said, FedEx and UPS would rather just pay the USPS to deliver in those areas. And so essentially, whoever buys the USPS would have to operate with a government-induced limp, right? And it can't overcome that limp, right? And so if you think about it, it's almost a little unfair, right? I mean, who would want to do that? I'd rather just operate my own business instead of having to take over the USPS and operate at a limp.

CROFT: 20:42

Let's start breaking it down then. What do you see as the main pros and cons of privatizing Postal Service in the U.S.? And let's start with the pros, the advantages that we would be most likely to see from it.

SALAS: 20:56

Yeah. So I clearly believe that a privatized USPS would be more efficient. Operating costs would probably fall. The pension problem would probably be resolved. There would probably be no more defined benefit plan. Yes, the employees would probably get a worse pension. However, let's be clear, a pension that promises lower payments is probably still better than a pension that now has low prospects of paying anything at all, right? I mean, right now, the pension that the USPS workers have, it's unlikely to pay off. I mean, it's just not sustainable, right? Now, innovation probably would also go up. Okay? Maybe Sunday delivery could become standard. Most importantly, the U.S. would never have to have the burden of figuring out what to do with the USPS again. So that's clearly a benefit for the government.

- CROFT: 21:51                      And the cons, what would be the main disadvantages that might come with privatization?
- SALAS: 21:56                      Yeah. I mean, I think it's clear that we'd probably have to pay more. The cost of shipping mail and packages would probably go up, right? There would probably need to be some panel to regulate the USPS. And that's costly, right? You have to hire the panel. You have to oversee the company. It would be costly to regulate the USPS. The USPS would probably try to bribe the panel. These bribing costs, these oversight costs, all of these things would be costly. And, ultimately, we'd all be paying for that, right? The USPS would likely be pushed to be allowed to charge a lot more to deliver to and from rural or remote areas. And maybe, eventually, they could get away with doing that, right? And also, in these rural and remote areas, the company would probably do whatever they can to slow down the delivery of packages and/or mail to these rural remote areas. So for sure, the rural remote areas would be the ones that are most likely to suffer the most from a privatization of the USPS.
- CROFT: 23:05                      So the bottom-line question is, is privatization a realistic option for USPS at this point?
- SALAS: 23:12                      Yeah. So right now, I just don't even think it's possible to privatize the USPS. The pension system, the problem with the pension system, that has to be resolved. Then the U.S. probably also needs to think about and discuss how a regulated USPS would operate, right? I mean, we'd have to really think carefully about these things. There's economic theory on how you can regulate companies in order to maximize whatever the ultimate goal of the government would be. And so you really have to think about those things before you just start thinking about who are you going to sell it for, and how much money you're going to get. So there are just too many things that need to happen in order to prepare for a potential USPS privatization. I don't see right now any will by the government or by anybody to do any of these things at this point. So, therefore, I don't think it's anywhere in the neighborhood of time before the government is going to be doing that.
- CROFT: 24:13                      So does that mean it will always require the federal government to cover deficits?
- SALAS: 24:18                      Yeah. And so let's be clear about this. The USPS doesn't actually receive any direct money from the U.S. There are some indirect benefits because the federal government gives the USPS some preferred terms on their debt? Okay? Honestly, the U.S. government needs to put their foot down and clean up the USPS liability situation. Yes, this will probably cost money to taxpayers. Okay? However, the USPS cannot be sold. It cannot be improved until they solve these issues, right? And so, first of all, I'll say it first. I think that the USPS defined benefit program needs to be terminated, like today. Yes, the shipping rates will need to be raised. The first-class mail shipping, the stamps, they will need to go up. And we need to start funding some of the gap in the pension liabilities because that's not going to just go away, right? Finally, there probably will be a need for the U.S. government to cover some of those pension fund liabilities. If it were me, I would only consider this option after the U.S. terminates the defined benefit pension plan. I guess I'm saying that the future does not look great for the USPS. But I think there are ways to fix the USPS. I just hope there's enough will from the government to actually do it.
- CROFT: 25:36                      So going back to how we started this discussion, 50 years from now, do you think other people will still be talking about a lot of these same issues regarding postal service in the United States?



SALAS: 25:48

Yeah. I mean, I guess it all comes back to-- the question you're really asking me is, how much faith do I have in government, right? And I guess that's a really, really big question, right? I think, right now, I would predict that-- based on what we're seeing right now from government, I would have to say that my prediction is that 50 years down the line, we're probably still going to be trying to figure out what to do with the USPS. Now, I hope that I'll change my mind, right? I'm not saying that it's impossible for the government to change the way that they're managing the USPS. But given the deadlock that exists in government right now, and given the unwillingness by government to address big problems, I just feel like it's very unlikely that in 50 years, we won't be talking about the problems with the USPS.

CROFT: 26:47

All right. I think we can end on that optimistic note. And I'd like to thank Dr. Salas for being with us on iLLUminate today. It's been most enlightening.

SALAS: 26:57

Oh. It's my pleasure. I love talking about this stuff. I mean, privatization is a really, really big and fun topic.

CROFT: 27:02

Okay. Dr. Salas' research has been published in the Journal of Financial Economics, the Journal of Financial and Quantitative Analysis, Organization Science, the Journal of Banking and Finance, the Journal of Corporate Finance, the Journal of Real Estate, Finance, and Economics, and others. This podcast is brought to you by iLLUminate, the Lehigh Business Blog. To hear more podcasts featuring Lehigh business thought leaders, please visit us at [business.lehigh.edu/news](http://business.lehigh.edu/news). And don't forget to follow us on Twitter @lehighbusiness. I'm Jack Croft, host of the iLLUminate podcast. Thanks for listening. [music]