MANAGING CHANGE IN THE POSTAL AND DELIVERY INDUSTRIES

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THE ROOTS OF DEREGULATION: Why Aviation and Telecommunications But Not the Post Office?

James I. Campbell Jr.[1]

In 1970, the airline, telecommunications, and postal systems in the United States were all large, nationally organized monopolies or shared monopolies. All three industries claimed economies of scale implying "natural monopolies." All provided a "public service" integral to the national infrastructure. All claimed that "universal service" depended upon protection from "destructive competition." In all three industries, federal laws and regulations blocked new entry and restrained price competition. In each case, the regulatory status quo was strongly supported by well-organized, politically powerful groups, while public sentiment for reform was nil.

Table 1. Relative Size of Certain Regulated Sectors in 1970

	Revenues ($ bil)	Employees (000)
Aviation	9.0	297
Telephone	19.0	839
Post Office	7.7	741

Sources: Dept. of Commerce, *Statistical Abstract of the United States 1985*, tables 919, 925, 1070, 1071. Aviation includes CAB certificated carriers only. Telephone includes telegraph.

A quarter of a century later, the airline and telecommunications systems are substantially deregulated, while the regulatory framework of the U.S. Postal Service has remained unchanged. Why? While aviation and telecommunications

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1 The author is a lawyer in private practice in Washington, D.C. He has worked on postal policy issues on behalf of private delivery services in the United States, Europe, and other countries for two decades. He also served on the staff of the Kennedy committee during the aviation deregulation activities discussed in the paper. Nonetheless, the views in this paper represent the personal views of the author only and should not be construed as those of his clients or former associates.

deregulation was proceeding, many observers argued that the intellectual case for deregulating the postal system was essentially the same.[2] Yet Congress, which enacted legislation to deregulate the national airline system in 1978 and the national telecommunications system in 1996, has yet to address seriously reform of the national postal system.

This paper considers why deregulation proceeded in the airline and telecommunications industries but has never been seriously addressed in the postal sector. It suggests that airline and telecommunications deregulation were rooted in economic analyses and judicial cases prepared well before congressional action. These necessary roots of deregulation have, so far, been missing from the postal policy debate. Nonetheless, the history of aviation and telecommunications deregulation suggests steps which might engender conditions under which Congress could consider postal deregulation in the foreseeable future.

1. Deregulation by Economic Consensus: The Aviation Industry

Airline deregulation was the result of an extensive Congressional review of the Civil Aeronautics Board that started with oversight hearings in 1974 and 1975 by the Senate Subcommittee on Administrative Practice and Procedure, chaired by Ted Kennedy of Massachusetts.[3] This congressional review culminated in the Airline Deregulation Act of 1978. The Kennedy committee investigation, in turn, was built upon economic and legal analyses undertaken during the previous decade.

The Civil Aeronautics Board was established by the Civil Aeronautics Act of 1938. The act prohibited commercial airlines from offering interstate air transportation to the public without a certificate from the CAB. By granting or denying certificates, the CAB regulated entry into the interstate airline industry route by route. It could also reject rates proposed by the airlines and exempt intercarrier agreements from the antitrust laws. The act directed the CAB to use its powers towards several public interest ends, including "encouragement and development of an air transportation system properly adapted to the present and future needs of

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2 *See, e.g.*, John Haldi, *Postal Monopoly* (1974); U.S. Department of Justice, *Changing the Private Express Laws* (1977) (principal author, Ken Robinson); Joel Fleishman, *The Future of the Postal Service* (1983); Douglas Adie, *Monopoly Mail* (1989).

3 Senate Administrative Practice Subcommittee, *Civil Aeronautics Board: Hearings* and *Civil Aeronautics Board: Report. See generally* Derthick and Quirk, *The Politics of Deregulation*, which offers an excellent description of the legislative process involved in deregulation of the aviation, trucking, and telecommunications industries. The focus of this 1985 study is Congress: why, in these cases but not others, did Congress embrace an unrepresented general public interest instead of strongly supported narrow economic interests? Viewed from the more general standpoint of how deregulation is precipitated, this study is less complete (although still enlightening) in its appreciation of the implications of work done by the Executive Branch (especially the Department of Transportation of the Ford Administration in aviation deregulation), the role of law and judicial review (especially the *Execunet* and *AT&T* cases), and changing cost structures implied by improving technology.

the foreign and domestic commerce of the United States" and "competition to the extent necessary to assure the sound development of an air transportation system properly adapted to the needs of the foreign and domestic commerce of the United States."[4]

In 1970, the airline industry consisted of ten carriers with operating authority between the major cities ("trunk routes") and several groups of smaller carriers operating on the fringe of the trunk system. All of the ten trunk carriers predated establishment of the CAB. In 1974, they collectively accounted for 92 percent of domestic revenue passenger miles; the "big four" (American, Eastern, TWA, and United) accounted for about 60 percent. Thus, despite a 269-fold increase in revenue passenger miles between 1938 and 1974, federal regulation had preserved the airline business as a shared monopoly for ten airlines in business in 1938. In addition to the trunk carriers, four groups of carriers operated in markets that had developed around the 1938 scheme. "Local service" carriers (e.g., Allegheny, North Central) provided regional service, essentially as feeders for the trunk airlines. "Supplemental" carriers provided charter service but not regularly scheduled service. "Air taxis" — companies operating very small aircraft (gross takeoff weight less than 12,500 pounds) — were exempt from CAB regulation by virtue of the act. Similarly, carriers operating wholly within California and Texas — "intrastate carriers" — were exempt from federal regulation.[5]

The market structure of the airline industry was the subject of a seminal 1962 "industry study" by Richard Caves, a professor of economics at Harvard. Caves' study was prompted by the relatively easy availability of data in the airline industry and, probably, by detailed criticism of the CAB flowing from a 1950s Congressional investigation into the CAB's failure to allow new entry or articulate objective principles for approving air fares. In the end, Caves concluded *"the air-transport industry has characteristics of market structure that would bring market performance of reasonable quality without any economic regulation."*[6]

In 1969, Congressman John Moss of California and 31 of his colleagues sued the CAB for developing price policies by means of non-public discussions with airline officials. In *Moss v. CAB*, decided in 1970, the D.C. Circuit Court of Appeals invalidated the resulting airline tariffs, declaring: "We hold that the procedure used by the Board is contrary to the statutory rate-making plan in that it fences the public out of the rate-making process and tends to frustrate judicial review."[7]

Prompted by the *Moss* case, the CAB launched a public investigation into airline costs and reasonable fares. The four-year *Domestic Passenger Fare Investigation*

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4 Civil Aeronautics Act of 1938, sec. 102.

5 For a brief history of the development of the Civil Aeronautics Act and its regulation of the airline industry from 1938 to 1974, see Senate Administrative Practice Subcommittee, *Civil Aeronautics Board: Report*, appendix B (principal author, J. Campbell).

6 Caves, *Air Transport* at 447 (emphasis added).

7 *Moss v. Civil Aeronautics Board*, 430 F. 2d 891, 893 (D.C. Cir. 1970).

(*DPFI*) forced administration officials to consider and declare their positions on CAB pricing policies and gave economists the data with which they could assess in detail the effects of CAB regulation of prices. In the end, the single most politically attractive argument for reform arising from the Kennedy hearings was the prospect of lower airfares that could be achieved by wringing out the excessive costs laid bare by the *DPFI*.

In the early 1970s, Caves' analysis was extended by several economists. In a 1970 book, William Jordan, an ex-airline employee turned economist, examined intrastate service in California as a "control" against which the effect of the CAB's policies could be assessed. In 1972, George Eads demonstrated that federal regulatory policies produced an exorbitant price tag for the amount of extra local service generated by federal subsidies. Like Jordan, Eads relied in part on comparison between the CAB regulated carriers and another class of unregulated carriers, in Eads' case, the air taxis. In 1974, the data and emerging rationale of the *DPFI* led to a careful analysis of airline fares and CAB fare policy by George Douglas and James C. Miller III. These studies, and others, produced a general consensus among economists that federal regulation of the aviation industry was misguided and even counter-productive.

Economic literature setting out the case for reform for aviation reform was instrumental in the Kennedy committee hearings that began in fall 1974. Although it is often cynically suggested that major congressional action depends upon the bidding of large economically interested constituencies, oversight of airline regulation was in fact opposed by all the major players in the airline business. The impetus for the hearings was primarily Kennedy's desire to improve his legislative reputation by undertaking the difficult and unpopular job of seriously and systematically reviewing the work of a major federal agency. The fact that aviation regulation had been the object of well-developed economic analyses made the CAB a more feasible subject for serious review than regulatory agencies whose merits and demerits had not been so thoroughly studied. In the beginning, Kennedy himself had no idea of deregulating the airline industry and no notion of the degree to which his hearings would attract the attention of the popular and academic press. In reality, Kennedy's general philosophical stance was not so much militantly pro-deregulation as vaguely pro-consumer.[8]

The Kennedy committee hearings focused on four fundamental defects in CAB regulation. First, the CAB had blocked entry into the trunk routes by refusing to act on applications for new entry into trunk routes, holding such applications for years, and then dismissing them as "stale". In so doing, the CAB avoided judicial review of an implicit policy excluding newcomers from the major airline markets, a procedure of highly questionable propriety. Second, the CAB's domestic fare

8 Derthick and Quirk, *The Politics of Deregulation*, 105-06. Despite his diffidence in the beginning, aviation deregulation will likely be viewed one of the most significant legislative accomplishments in Kennedy's long Senate career.

policy was criticized as leading to unnecessarily high prices. Third, the CAB's exemption of certain airline market allocation agreements from the antitrust laws was heavily criticized. Fourth, the CAB was found to have misused its enforcement powers.[9]

As the Kennedy committee hearings demonstrated, inadequacies in CAB regulation were exacerbated by changes in the cost structure of the industry brought about by new technology. In the early 1960s, the introduction of turbojet aircraft reduced airline costs substantially, especially in long distance markets, yet prices did not fall with falling costs.[10] Instead, airlines competed by means of greater flight frequency and service enhancements. The introduction of all-jet aircraft in the late 1960s and jumbo jets in the early 1970s increased this tendency towards "service competition." On the long distance routes, service became extravagant, featuring free drinks, fashion shows, and many empty seats per passenger. The high level of long distance fares prompted a charter airline, World Airways, to propose new service that would cut the coast to coast airfare in half. The CAB's failure to even consider World's application nicely illustrated the connection between fare policy and entry restrictions.

The Kennedy committee hearings prompted the CAB itself to reconsider its mission. In 1975, under the chairmanship of newly appointed John Robson, a special CAB study committee courageously confirmed the gist of the outside economic analysis and generally supported deregulation.[11] In 1977, with pro-competitive legislation looming on the congressional horizon, President Carter appointed renowned economist Alfred Kahn as chairman of the CAB. Kahn started deregulating without awaiting legislation, making legislation both more necessary and inevitable.

Despite the momentum created by the Kennedy committee hearings and the initiatives of the CAB, deregulatory legislation proved politically impossible without specifically addressing the issue of governmental assurances of service to small towns. It proved necessary to extend Eads' analysis of local air service with detailed state-by-state and carrier-by-carrier analysis carried out by the Department of Transportation and an outside consultant.[12] In the final legislation, CAB regulation over small town air service was substantially enlarged by adding a new

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9 The Kennedy committee hearings laid the intellectual basis for more summary reports by the committees with substantive jurisdiction. *See* House Committee on Public Works and Transportation, *Legislative History of the Airline Deregulation Act of 1978.*

10 George W. Douglas and James C. Miller III, *Economic Regulation of Domestic Air . Transport*, 7-9, 52.

11 CAB, *Regulatory Reform: Report of the CAB Special Staff.* A courageous long time CAB staffer, Roy Pulsifer, was the chairman of the group and principal author of the report.

12 *See* Paul McAvoy and John Snow, *Regulation of Passenger Fares*, chapters 3-6, which reprints some of the key analyses of the Department of Transportation. At the Department of Transportation, the principal author of small community studies (and hence of the resulting essential air service program) was Peyton Wynns.

section to the law. The CAB was made directly responsible for contracting for service to small towns and determining reasonable fares and schedules.

The Airline Deregulation Act was enacted in October 1978. It phased out federal regulation over several years. Entry regulation was continued for three years. Price regulation was continued for five years. "Essential service" to all towns served by the national airline system was guaranteed for ten years.[13] A ten-year program to assist employees dislocated by deregulation was also enacted.

While prior economic and legal analyses made airline deregulation possible, they did not necessarily make it inevitable. Airline deregulation was presented to Congress and eventually enacted because of a high level of leadership from key individuals. The vital first step was contributed by Senator Ted Kennedy. In addition, the critical mass for reform depended upon the efforts of the Senate Commerce Committee, led by Howard Cannon; the Ford Administration, led by Deputy Under Secretary of Transportation John Snow; and the Civil Aeronautics Board, led by John Robson and Alfred Kahn.[14]

2. Deregulation by Judicial Adherence to a Public Interest Standard: The Telecommunications Industry

Whereas airline deregulation was prompted by Congressional oversight, deregulation of the telecommunications industry was precipitated primarily through judicial review of the decisions of the Federal Communications Commission.[15]

The Federal Communications Commission (FCC) was established by the Communications Act of 1934. The FCC regulated entry and rates in the interstate telecommunications industry. The act required the FCC to ensure that telephone service was available "upon reasonable request." The general public purpose of telecommunications regulation was expressed in the following terms: "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . . ."[16]

Like the aviation industry, the telecommunications industry was wholly owned by private companies. One company, American Telephone and Telegraph (AT&T), dominated the market to such an extent as to be a virtual monopolist. AT&T's position derived from skillful use of patents and mergers, a process which raised its market share from 50 percent in 1907 to 80 percent in 1934. In 1970, AT&T still controlled 80 percent of the greatly enlarged market for telephone service and virtually all of the long distance telecommunications market.[17]

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13 *Airline Deregulation Act of 1978*, secs. 33, 40, 43.

14 *See*, Derthick and Quirk, *The Politics of Deregulation*, 239-42.

15 In this paper, only the "common carrier" aspects of telecommunications regulation are considered.

16 47 USC 151.

As in the aviation industry, improving technology lowered the cost of long distance service while prices remained high. Unlike in the aviation industry, high prices in long distance markets did not result in service competition since AT&T was the sole carrier. Instead, high prices generated high profits which were used to underwrite some of the costs incurred in serving local telephone markets. Although the amounts of cross-subsidy could not be determined with accuracy, AT&T suggested that they were substantial.

In the 1960s, microwave technology both reduced the cost of bulk long distance telecommunications services and created opportunities for new entry. In 1963, Microwave Communications, Inc. (MCI) applied to the FCC for authority to offer long distance telecommunications for large business customers by means of a microwave system between St. Louis and Chicago. After reviewing extensive objections from AT&T, the FCC ultimately approved the MCI application in 1971. MCI opened for business in 1972. In the same year, the FCC announced a general policy in favor of new entry in the "specialized communications" field. The *Specialized Common Carrier Decision*, however, did not deregulate the long distance telecommunications market. It allowed competition only for bulk business users, in a manner roughly equivalent to charter aviation service provided by "supplemental" air carriers.

The main event was deregulation of retail or "switched," long distance telecommunications markets. This was effected in 1978 over the objections of the FCC and AT&T. In September 1974, MCI filed a tariff for a long distance telecommunications service called "Execunet." Execunet allowed retail customers to share a bulk business line. In 1976, the FCC ordered MCI to stop Execunet service because it crossed the boundary from bulk business service to retail service. MCI appealed to the courts, arguing that the FCC had failed to exercise its discretion according to the public interest standards set out in the statute. In 1977, in the *Execunet I* case,[18] the D.C. Circuit Court of Appeals agreed with MCI and reversed the FCC decision. The court ruled that the FCC could not stop MCI's retail service unless it made an "affirmative determination of public interest need for restrictions," which it had not done.[19] More generally, the court warned:

> the Commission must be ever mindful that, just as it is not free to create competition for competition's sake, it is not free to propagate monopoly for monopoly's sake. *The ultimate test of industry structure in the communications common carrier field must be the public interest, not the private financial interests of those who have until now enjoyed the fruits of de facto monopoly.* [561 F.2d at 380 (footnotes omitted, emphasis added)]

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17 The regulatory history of the telecommunications industry until 1980 may be found in the excellent study by Gerald Brock, *The Telecommunications Industry.*

18 *MCI Telecommunications Corporation v. Federal Communications Commission*, 561 F. 2d 365 (D.C. Cir. 1977), *cert. denied* 434 U.S. 1040 (1977).

19 561 F. 2d at 379.

AT&T then refused to allow MCI to connect its long distance lines with AT&T's local lines, creating an insurmountable practical barrier to new entry. The FCC quickly acquiesced, and MCI returned to the courts. In *Execunet II*, an exasperated D.C. Court of Appeals again reversed the FCC, holding that a right of interconnection was implied by its earlier judgment.[20] Although practical difficulties remained, the legal walls protecting AT&T's monopoly in the long distance telephone market had crumbled.

In 1976, while the MCI cases were under study at the FCC, Congress began to consider legislative reform of telecommunications regulation. Its starting point was a bill proposed by AT&T that would have created a legal monopoly in favor of AT&T. The basic argument in support of this bill was that a monopoly over long distance telecommunications was necessary to allow cross-subsidization of local, especially residential, telephone service. Competition in the long distance market, argued AT&T, threatened to raise everyone's local telephone rates, a political nightmare. Almost two hundred congressmen and senators cosponsored the "Bell bill." In congressional hearings, however, economists uniformly deplored the prospect of a legal monopoly for AT&T even though they could not, in the absence of detailed data about the costs of telephone service, quantitatively refute AT&T's cross-subsidy arguments. Their criticism was enough to doom the Bell bill; it was abandoned after a year of hearings.[21]

With the demise of the Bell bill, pro-competitive forces tried to make the case for reform legislation based upon deregulation. Congressmen Lionel van Deerlin and, later, Tim Wirth, successive chairmen of the House Subcommittee on Communications, held extensive pro-reform hearings in the late 1970s and early 1980s. The hearings included many of the same witnesses who had made the case for aviation deregulation. Nonetheless, the pro-competitive forces were unable to gain Congressional support in the face of AT&T's opposition. Van Deerlin and Wirth failed where Kennedy had succeeded.

AT&T's assorted tactics to hinder its competitors — including predatory pricing of competitive services, withholding cost information from the FCC, contesting FCC jurisdiction over interconnection issues, and technical excuses to deny interconnection with AT&T facilities — raised legal questions under the antitrust laws.

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20 *MCI Telecommunications Corporation v. Federal Communications Commission*, 580 F. 2d 590 (D.C. Cir. 1977), *cert. denied* 439 U.S. 980 (1978).

21 The story of the rise and fall of the AT&T bill is retold in Derthick and Quirk, *The Politics of Deregulation*, 136-40, 174-88. Writing in 1981, the staff of the House telecommunications subcommittee noted that the levels of cross-subsidy between long distance and local telephone services remained a mystery: "It is unclear to what extent local exchange has benefited from past shifts in revenue requirements .... It has not been shown which offerings benefited from the balance of total separations charges. This residual could have been used to lower local residential services revenue requirements and provide rate relief. But it could also have been used for reducing businesses' local rates, or other intrastate expenditures, such as local private lines or terminal equipment." *Telecommunications in Transition*, 78.

In 1974, the Department of Justice filed suit against AT&T. In 1982, facing almost certain defeat, AT&T agreed to settle the case by breaking up its operations into a long distance company and a series of local operating companies as of January 1, 1984.[22]

After the *Execunet* cases, the FCC was required to reconcile competitive entry in the long distance markets with its statutory obligation to maintain universal service. In response, the FCC innovated.[23] It required AT&T to keep separate accounts for local exchange services and long distance services. Access to local services were charged to all long distance service providers, whether AT&T or its competitors. The "access charge" was sufficiently above cost to underwrite losses incurred in maintaining universal telephone service at the local level. In short, all long distance services were "taxed" to pay for universal local service. The breakup of AT&T facilitated this taxing mechanism by providing structural separation between the long distance and local operations previously provided by AT&T.

Deregulation of federal entry controls did not immediately result in effective competition in the long distance telephone market. In this respect, as well, the long distance telephone market differed fundamentally from the aviation sector. Starting from a monopoly position, AT&T had the resources to strangle small new entrants unless restrained. Therefore, after the *Execunet* cases, the FCC adopted a strategy of phased transition towards a competitive market. A study of policy options, the *Competitive Carrier* investigation, proceeded through numerous reports and appeals between 1979 and 1985. In the end, the FCC divided the long distance telephone market into two types of carriers: dominant and non-dominant. A dominant carrier was one "able to engage in conduct that may be anti-competitive or otherwise inconsistent with the public interest."[24] Dominant carriers were subject to the traditional rate of return regulation; non-dominant to a more streamlined regulation. The only carrier found to be "dominant" was AT&T.

After the breakup of AT&T in 1984, the FCC looked for ways to loosen the strict rate-of-regulation to which AT&T was subject as the "dominant" carrier. In 1989, the FCC replaced rate-of-return regulation with price cap regulation. Price caps allowed AT&T to adjust rates within limits intended to prevent gouging or predatory tactics. Furthermore, to prevent AT&T from cutting business rates by raising the rates of the general public, price caps applied separately to three "baskets" of services: individual customers, 800 number service (WATS), and large businesses. In 1991, the FCC concluded that "basket 3" services (large business

22 *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001 (1983).

23 For an account of the evolution of FCC regulation in the 1980s, see Howard Griboff, "New Freedom for AT&T."

24 The FCC continued, "This may entail setting prices above competitive costs in order to earn supra normal profits, or setting prices below competitive costs to forestall entry by new competitors or to eliminate existing competitors." FCC, Competitive Common Carrier Services and Facilities Therefor, First Report and Order, 85 FCC 2d 1, 21 (1980).

customers) had become effectively competitive and reduced regulatory requirements accordingly. This decision allowed AT&T to negotiate individual contract rates. In 1993, the FCC came to a similar conclusion with respect to "basket 2" services (800 number services). In 1995, the FCC granted AT&T's petition to effectively deregulate "basket 1" services (individuals) and reclassified AT&T as "non-dominant".[25]

Thus, there was an 18-year period from the *Execunet I* decision opening the long distance telephone market to new entry in 1978 to the elimination of "dominant" classification of AT&T in 1995. During this transition, the FCC managed the transition from a monopoly to an effectively competitive and deregulated long distance telephone market.

With AT&T broken up and entry into long distance telephone service permitted by court decree, Congress slowly returned to consideration of a telecommunications deregulation bill. As in the aviation deregulation, legislative assurance of universal service become a primary goal. Indeed, universal service assumed even greater importance in the telecommunications debate because of a general feeling that, after aviation deregulation, the Civil Aeronautics Board (later, the Department of Transportation) had not used its new regulatory powers over small town air service to assure the level of service expected by Congress. As Ernest Hollings, chairman of the Senate Commerce Committee put it, "we still have got to do better with universal service . . . . . I admire all of these [telephone companies] but somebody has to look after the public. [W]e saw what happened with deregulation of the airlines, and we do not want that to happen with this one."[26]

The Telecommunications Act of 1996 largely confirmed the phased deregulation of long distance telephone service overseen by the FCC since 1978 and authorized the FCC to continue to manage the process, particularly in respect to the expansion of the local telephone companies into the long distance market (forbidden by the 1982 AT&T case) and development of an evolving program to define and guarantee universal service. The law confirmed the FCC's policy of "forbearance," that is, exempting carriers from regulatory controls where there is effective competition.[27] As intimated by Senator Hollings, the universal service provisions in the telecommunications act are more detailed than the corresponding provisions in the aviation deregulation act. The FCC was authorized to develop, in conjunction with state authorities, a definition of universal service that reflects "an evolving level of telecommunications." Geographic rate averaging was endorsed. Special protection was afforded particular groups of users such as rural health care providers, schools, libraries, and the poor. The FCC was also authorized to require carriers to provide necessary service and to pay subsidies for the services so required.[28]

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25 FCC, Motion of AT&T Corp to be Reclassified as a Non-dominant Carrier, Order 95-427 (Oct. 23, 1995).

26 Senate Commerce Committee, *S. 1822: Hearings*, 84.

27 *Telecommunications Act of 1996*, sec. 401 adding new secs. 10 and 11 to the 1934 act.

In retrospect, it seems likely that telecommunications deregulation, like aviation deregulation, might not have occurred but for the extraordinary work of certain individuals. In telecommunications, however, the exceptional contributions were legal rather than legislative: the work of MCI lawyers in planning and executing the legal strategy that led to the *Execunet* decisions and the work of the Department of Justice and Judge Harold Greene that culminated in the breakup of AT&T by application of the antitrust laws.

3. Absence of Deregulatory Roots: The Postal Sector

The regulatory framework for the delivery services industry differs markedly from that in the aviation and telecommunications industries. In the postal sector, unlike in aviation and telecommunications, there is no unified regulatory framework which embraces all market participants and regulates activities according to neutral public interest criteria. The regulatory framework for the postal sector, such as it is, was established by the monopoly provisions of the Postal Code of 1872[29] and the Postal Reorganization Act of 1970. Regulatory authority is divided and asymmetric. An independent agency, the Postal Rate Commission, regulates the *structure* of USPS's rates according to public interest criteria regarding unjust or unreasonable discrimination among mailers.[30] The Postal Service itself determines the overall *level* of postage rates and, since 1974, purports to set criteria and conditions for entry into the most important segments of the industry.[31]

Factors which led to deregulation of the aviation and telecommunications industries in the last 25 years have been conspicuously absent from the postal sector. The key to aviation deregulation was the availability of careful economic studies showing that the CAB had failed to achieve the public policy goals set by Congress in 1938. These studies, in turn, derived in part from the courts' insistence that the CAB give reasons for decisions with reference to evidence gathered in public hearings and in part from facts available from certain unregulated sectors which provided benchmarks for the effectiveness of federal regulation. In the telecommunications industry, deregulation was unlocked by court cases that required the FCC to base entry decisions on demonstrated public interest considerations, not on the commercial interests of AT&T, and by application of the antitrust laws to AT&T. In both industries, deregulation was furthered by actions of federal agencies after they were externally forced to exercise their powers according to objective public interest criteria.

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28 *Telecommunications Act of 1996*, secs. 101, 102 adding new secs. 254 and 214(e) to the 1934 act, respectively.

29 Act of June 8, 1872, ch 335, secs. 222-239, 299, 17 Stat 283, 310-12, 322, *codified* 18 USC 1693-99; 39 USC 601-06.

30 39 USC 3601-3662.

31 39 CFR parts 310, 320 (1995).

In the postal sector, economic analyses to date have not been sufficiently detailed and consistent to offer a reasonably clear picture of how competition would affect the Nation's universal postal service. There is no postal equivalent of Caves' industry study.[32] Although, as in the airline industry, there are fringe markets — parcel, express, and local messenger — there are no detailed studies of these markets and the lessons they may hold for the central, regulated market, due in part to an absence of uniform data from the private sector. In particular, there are no studies of markets which might be considered as reasonably equivalent to USPS's markets in the same way that the intrastate markets were taken by Jordan to be sufficiently equivalent to regulated aviation markets to allow comparisons and conclusions. Finally, a central feature of the current regulatory scheme is the uniform national postage rate for letters, yet there is no generally accepted analysis of the means or cost of maintaining a uniform tariff (at least for personal letters) in a deregulated environment. In short, unlike in the aviation industry in the mid-1970s, there has not developed a well-documented consensus among economists as to what deregulation would bring.[33]

On the other hand, economic analysis of the postal sector is perhaps not so barren as in the telecommunications sector in the mid-1970s. In important areas, economic analysis has achieved a considerable degree of consensus. Most importantly, there seems to be general agreement over estimates of excess wages induced by the postal monopoly.[34] The resulting estimates of possible savings from deregulation are very high: on the order of $8 billion annually. Such analysis roughly parallels the work of Douglas and Miller in the aviation field. Similarly, since the pioneering work of Robert Cohen and others, there seems considerable acceptance of the view that the cost of universal service is relatively small compared to total postal revenues.[35] Such studies could play a role in postal policy discussions similar to that of Eads in aviation policy discussions.

The relative poverty of postal economic studies is due in some measure to the Postal Service's ability to suppress much of the data that could be useful in assessing reform proposals. Like AT&T in the 1970s, the Postal Service has chilled the possibility of legislative deregulation by arguing that deregulation would result in disruption of massive cross-subsidies which sustain postal service to substantial

32 Books which provide extended descriptions of the Postal Service but fall short of the standard set by Caves include: Alan L. Sorkin, *The Economics of the Postal System* (1980) and John T. Tierney, *Postal Reorganization* (1981).

33 In Appendix D of *The Postal Crisis* issued in 1977, the Department of Commerce considered deregulation "the single most important postal issue" and listed a number of economic studies which it judged "must be conducted in the search for a solution to current postal and communications industry problems" including studies related to low density service, labor costs, new technology, and a more quantitative approach to the value of the Postal Service contribution to the national life.

34 *See* Michael. L. Wachter and Jeffrey M. Perloff. "A Comparative Analysis of Wage Premiums"; Douglas Adie, "How Have Postal Workers Fared Since the 1970 Act?"

35 Robert Cohen et al, "Rural Delivery and the Universal Service Obligation."

portions of the citizenry. Despite the central importance of this claim, the Postal Service has never provided quantitative support. The Postal Service has also strongly criticized the nature of regulatory oversight by the Postal Rate Commission while, at the same time, refusing requests by the Senate and the Postal Rate Commission to provide information on international mail services, an unregulated postal service which could serve as a benchmark for gauging the failings or successes of current regulation.[36]

The other path to deregulation emerging from experience in other industries is judicial review. However, in postal cases, unlike in cases involving aviation and telecommunications regulation, the courts have not held key regulatory decisions to a standard of demonstrable consistency with the public interest.

In 1974, the Postal Service adopted regulations which defined the postal monopoly in such a way that they asserted broad new USPS authority to regulate entry into the delivery services industry. These regulations expanded USPS's claim of monopoly to include carriage of all types of commercial papers and printed matter in addition to first class correspondence. According to the 1974 regulations, entry into this market depended upon issuance of a general administrative license by the Postal Service "suspending" the postal monopoly as to particular types of service or classes of mailers. The Postal Service also claimed the right to attach conditions to such licenses, applicable to both private carriers and their customers.[37] The most important effect of these regulations was to block entry into the burgeoning market for delivery of "direct mail" (printed advertisements). Just as MCI's entrance into the bulk long distance telecommunications market cast doubt on the efficiency of AT&T's monopoly over long distance telecommunications, so new delivery services for direct mail might have challenged assumptions about the postal monopoly.

The only important challenge to the 1974 regulations to date has been a 1979 case, *ACTMU v. Postal Service*.[38] In this case, the direct mail industry questioned the Postal Service's administrative extension of the monopoly to direct mail. The D.C. Circuit Court of Appeals, by a divided vote, upheld the regulations without, as in *Execunet I*, requiring that regulations blocking new entry be consistent with the public interest, as distinct from the interest of the incumbent carrier. Instead, the court required only that the new regulations "further the objectives of Title 39 [i.e., the Postal Service]." Rather than requiring the factual premises of the regulations be supported by evidence gathered in public hearings, the court was satisfied that, in defining the scope of its "letter" monopoly, "the Postal Service has settled

36 Letter from Marvin Runyon, Postmaster General, to David Pryor, Chairman, Subcommittee on Federal Services, Post Office, and Civil Service of the Senate Committee on Governmental Affairs, dated April 22, 1993.

37 38 FR 17512 (1973) (first notice); 39 FR 3968 (1974) (second notice); 39 FR 33209 (1974) (final rule). In these regulations, the Postal Service also asserted previously unheard-of powers to investigate and fine persons who violated the Postal Service's postal monopoly regulations.

38 *Associated Third Class Mail Users v. U.S. Postal Service*, 600 F.2d 824 , *cert. den.* 444 U.S. 837 (1979).

upon a reasonable criterion — the presence or absence of an address — and that its definition suffers from no more than the level of arbitrariness which is inevitable."[39] In effect, the legal test in *ACTMU* is the mirror image of the test employed in *Execunet I.* The standard for legal validity was held to be consistent with the good of the Postal Service, not the good of the general public, and the standard of proof was held to be not objective evidence but absence of arbitrariness.

In telecommunications deregulation, the other legal coup was application of the antitrust laws. This approach has never been tried in the postal sector since the Postal Service is apparently immune from U.S. antitrust law. By way of contrast, it may be noted that European post offices are subject to European competition laws, and cases brought under these laws have been a major factor in bringing about a wide-ranging reconsideration of postal policy by the European Commission.[40]

Similarly, a notable stop on the road to aviation deregulation was the court's demand, in *Moss v. CAB*, that the level of airline rates be publicly justified. In a 1981 rate case, the Postal Rate Commission modified the overall level of new rates proposed by the Postal Service by disallowing about 4 percent of costs which the Postal Service claimed to justify its proposed rates. Later in that year, in *Newsweek v. CAB*, the Second Circuit Court of Appeals reversed the Postal Rate Commission's action and held that the Commission decision "had the effect of undermining the [Postal Service's] exclusive authority in timing changes in postal rates and fees."[41] The effect of this decision was to give the Postal Service unfettered discretion regarding the overall level of rates to be charged for monopoly services.

More generally, a consideration of these cases suggests that differences between the aviation and telecommunications industries, on the one hand, and the postal sector, on the other, are intimately related to differences in their organic statutes. The organic statute of the Postal Service, the Postal Reorganization Act of 1970 — unlike the Communications Act of 1934 and the Civil Aeronautics Act of 1938 — does not separate commercial and regulatory functions. The Postal Service itself decides when its commercial interest requires it to withhold disclosure of information which may be useful to regulatory reform. And the Postal Service itself decides, within broad bounds, the details of its legal monopoly and the level of monopoly rents which should be extracted from mailers in order to further the public interest.

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39 600 F. 2d at 825 n. 5, 830. Remarkably, the opinions in the *Execunet*, *Moss*, and *ACTMU* cases were written by the same judge, J. Skelly Wright; Judge Malcolm Wilkey, who joined Judge Wright in both *Execunet* cases, dissented in the *ACTMU* case.

40 European Commission, Case IV/32.791 - Remail. In 1988, the International Express Carriers Conference complained that agreements among post offices relating to terminal dues and market allocation were inconsistent with the competition rules of the EC Treaty (USPS was a party to the agreements in question). The European Commission agreed but, in 1995, dismissed the IECC's complaints based on the conclusion that the post offices promised to mend their ways. An appeal of this dismissal is now pending before the European Court of First Instance; a decision is expected in early 1997.

41 *Newsweek v. United States Postal Service*, 663 F. 2d 1186, 1204 (2d Cir. 1981).

Differences in the organic statutes of the sectors reflect differences in the manner in which they were drafted. The Civil Aeronautics Act was prepared under the direction of a subcommittee of the Senate Commerce Committee chaired by Senator Harry Truman. The temper of the committee was revealed when officials of the Post Office (of all people) complained that the proposed regulatory scheme would throttle competition. Truman retorted, "Show me that provision. If that is true, it ought to be changed."[42] If the Civil Aeronautics Act proved anti-competitive in practice, its authors nonetheless established a public interest standard against which administrative deficiencies could finally be measured. Once the public interest in competition became evident, the Civil Aeronautics Board was independent enough to promote competition. In contrast, the Postal Reorganization Act of 1970 resulted from recommendations of a ten-member committee chaired by Frederick Kappel, former chairman of AT&T. The driving force behind enactment of the act was the desire of postal management to gain greater control over the Postal Service so that it could operate in a "business-like" manner.[43] However unlikely deregulation by administrative reform was at the CAB, it appears still less likely at the Postal Service because of the influence of the Postal Service's short-term commercial interests.

Finally, as noted above, deregulation of the aviation and telecommunications industries proceeded in part because of extraordinary leadership exerted by certain individuals, such as Senator Ted Kennedy in the aviation field and MCI's lawyers in the telecommunications field. In contrast, postal policy has generally not benefitted from such leadership. No congressional committee has so far (early 1996) stepped forward to conduct an analysis of the postal sector similar to that undertaken by the Kennedy committee in the airline industry or by the House Communications Subcommittee in the telecommunications industry. Nor has anyone mounted a skilled and innovative legal challenge to the fundamental regulatory structure comparable to that mounted by MCI.[44] The Executive Branch (outside the Postal Rate Commission) has put little effort into postal policy.

There is, it should be noted, one significant exception to absence of deregulatory movement in the postal sector: the exemption from the postal monopoly for urgent letters, adopted in 1979.[45] The urgent letter exception to the postal monopoly

42 Senate Committee on Interstate and Foreign Commerce, *Hearings on S. 2 and S. 1760* at 75.

43 *See* J. Tierney, *Postal Reorganization* (1981) at 1-27.

44 In the critical *ACTMU* case, ACTMU's lawyer was a former Postmaster General, J. Edward Day, who was ill prepared to conduct a proper exposition of the case. The completeness of ACTMU's presentation may be surmised from the fact that the circuit court's opinion is directed more towards the arguments of an *amicus curiae* than to those of the plaintiff.

45 In addition to the exemption for urgent letters, a second, but less significant, deregulatory development was exemption of international remail in 1986. 51 FR 29636-38 (Aug. 20, 1986). Postal unions fought this exemption in the courts until finally losing in the Supreme Court on procedural grounds. *Air Courier Conference of America v. American Postal Workers Union*, 498 U.S. 517 (1991). This exemption was essentially the result of leadership from a group of small private remail companies and the Antitrust Division of the Department of Justice.

permitted development of the most important new fringe market in the postal sector, the express market. This exception serves to highlight the importance, and possibilities, of leadership in postal deregulation.

The urgent letter exception was primarily the result of political leadership by Senator Tom Eagleton, a member of the subcommittee on postal affairs but not its chairman. In the mid 1970s, the Postal Service was determined to suppress the rise of fledgling private express companies such as DHL, Federal Express, and Purolator. Although political novices, the private express companies responded to USPS's threats with a grass roots campaign designed to demonstrate, through customer statements, the economic value of their services. The Postal Service and postal unions fiercely opposed an exemption from the postal monopoly that would permit private express companies to carry high priority mail. The Postmaster General estimated that an exemption for urgent letters could cost the Postal Service up to $2 billion, 13 percent of USPS's revenues.[46] Despite unfamiliarity with the express industry, Eagleton became convinced of the merits of its case. He succeeded in amending the Senate postal bill to provide an exemption for urgent letters.[47] The Senate postal bill died with expiration of the 95th Congress in 1978, but the Eagleton amendment led to House hearings the next year[48] which prompted the Postal Service to issue regulations "suspending" the postal monopoly for urgent letters in September 1979 in order to forestall legislative reform.[49] Thus, in at least one significant area of postal policy, sound economic arguments and political leadership carried the day against the opposition of incumbents with far greater political clout, as had occurred on a grander scale in the aviation and telecommunications sectors.

In summary, aside from the limited debate over permitting express services, the question of postal deregulation has never been seriously considered by Congress because the postal sector has not been subject to either the careful economic analysis that underlay aviation deregulation nor a sustained and innovative legal challenge to entry restrictions such as pressed by MCI in the telecommunications industry. In both cases, the absence of deregulatory stimuli can be traced, in part, to differences in the organic statutes which establish the regulatory framework for the Postal Service. Further, the high quality legal and political leadership evident in the deregulation of the aviation and telecommunications debates has so far been largely missing from the postal policy debates. Nonetheless, the last quarter century of

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46 Letter from William F. Bolger, Postmaster General, to Edmund S. Muskie, chairman, Senate Committee on Governmental Affairs, dated September 26, 1978.

47 The Senate committee firmly endorsed the Eagleton amendment. Senate Committee on Governmental Affairs, *Postal Service Amendments Act of 1978*, 17-21.

48 House Subcommittee on Postal Operations and Services, *Private Express Statutes*.

49 44 FR 61178-82 (Oct. 24, 1979), *codified* 39 CFR 320.6. Although these regulations purport to suspend the postal monopoly for urgent letters, the Postal Service has no statutory authority to suspend any portion of the postal monopoly. See footnote 51, below.

postal policy is not wholly barren of the sorts of influences which could ultimately lead to postal deregulation.

4. Possible Steps Towards Presenting Postal Deregulation for Decision

Experience in the aviation and telecommunications industries suggests that deregulation has increased use of these industries and thus served the general public interest. At least, it is clear that Americans have substantially increased their use of the airlines and telephones relative to their use of the post office. If, in fact, deregulation of the postal sector would similarly serve the public interest, then it seems plausible that a way can be found to bring about such reforms, however politically daunting the prospect may now appear. Possible steps to this end are illuminated by an appreciation of the roots of deregulation in other industries.

Table 2. Relative Growth in Certain Sectors, 1970-1993

	1970	1993	Growth
Aviation, revenue passengers (mil)	153	487	318%
Telephone, average daily calls (mil)	484	2370	490%
Post, items (tril)	85	171	202%

Sources: U.S. Dept. of Commerce, *Statistical Abstract 1995* and *Historical Statistics of the United States: Colonial Times to 1970* (1975). Telephone calls in 1993 assumes average time per is 4.5 minutes (estimate by P. Wynns, FCC).

One step, plainly suggested by the history of aviation deregulation, would be to encourage more and better economic analysis of the postal industry, especially in several areas. For example, an economic profile of the delivery services sector obviously needs to be drawn. It would also be helpful to have an economic analysis of the implications of deregulated delivery services—U.S. messenger services, delivery services in Sweden, Finland, New Zealand—and their implications for the U.S. delivery services market. Still another useful study would be a comparison of the costs and revenues of international postal services with the costs and revenues of domestic postal service to shed light on the costs and benefits of current regulation by the Postal Rate Commission.[50] More generally, in both the aviation and telecommunications deregulation debates, pro-competition forces underestimated Congressional concern for assurances of universal service. It seems clear that economic studies of the postal industry should, in particular, focus on the costs and mechanisms of assuring universal service at a uniform rate for individual letters. Finally, the history of deregulation in other industries suggests the importance of changing technology in undermining the rationale for regulation. In the

50 Such a study, however, will apparently require Congressional assistance in obtaining the necessary historical data from the Postal Service.

postal sector, it would seem useful to examine carefully the implications of telecommunications and personal computers for the future of regulation.

Both aviation and telecommunications deregulation also show that great policy changes can flow from judicial review which requires reasoned justification for policies critical to the regulatory scheme. While such postal litigation has been fruitless so far, a close examination of cases suggests that future prospects are not necessarily hopeless. In particular, the *ACTMU* case was poorly argued and the decision weakly reasoned; it may be subject to challenge in subsequent litigation. Indeed, the 1974 postal monopoly regulations as a whole appear vulnerable to judicial review. The rationale underlying these regulations—the proposition that the Postal Service is authorized to "suspend" the postal monopoly[51]—is a legal myth which has so far escaped serious legal challenge.

A third possible approach may be indicated by the failure of the organic regulatory acts in the postal sector to provide a clear separation between commercial and regulatory authority. As a matter of administrative law, the Postal Reorganization Act of 1970 represents a far less effective means of controlling abuse of public authority than either the Communications Act of 1934 or the Civil Aeronautics Act of 1938. The latter two employed public authority to create pockets of economic privilege and oversight mechanisms that, eventually, became captured by the economic forces they were called upon to regulate. Nonetheless, these acts also incorporated objective standards of the public interest and the means of judicial review. The Postal Reorganization Act of 1970, on the other, established a large area of economic privilege with no means to measure the level of monopoly rents or administration of the monopoly law against objective standards of the public interest. The scope of independent regulation is essentially confined to the single issue (albeit an important issue) of preventing unjust and unreasonable discrimination among mailers.

As a preliminary step, it may be possible to encourage Congress to address the definition of the public interest in postal affairs in a manner that is independent of the commercial interests of the Postal Service. For example, the Postal Rate Commission could be given greater independence from the Postal Service and more objective public interest standards on which to base its decisions. Similarly, administration of the postal monopoly law could (as in the European Union) be legally linked to evidence relating the scope of monopoly to support for universal service, rather than support for the commercial well-being of the Postal Service. Such fundamental changes in the organic law of Postal Service could allow the courts and Congress more objective bases against which to judge the appropriateness of substantive deregulation.

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51 As several observers have noted, the statute cited by the Postal Service as authority to *suspend* the postal monopoly, 39 USC 601(b), in fact only authorizes the Postal Service to *extend* the scope of the postal monopoly in certain limited circumstances. *See, e.g.,* George L. Priest, "The History of the Postal Monopoly," 60.

Deregulation of the aviation and telecommunications industries also highlights the need to consider carefully the transition from a regulated to a deregulated industry. In the telecommunications industry, regulation of long distance telephone service was phased out over an 18-year period as effective competition gradually replaced the monopoly. In the aviation industry, regulation was phased out over 5 years even though the starting point was an environment of reasonably aggressive oligopolistic competition. In both industries, Congress insisted upon the introduction of increased regulatory protections for universal service.

Finally, experience in the deregulation of aviation and telecommunications suggests that a half-hearted effort will not suffice to deregulate a major industry like the postal sector. Sustained, competent leadership from a political leader, an Executive department, or a company appears to be a necessary ingredient.

5. Conclusions

Consideration of the deregulation of the aviation and telecommunications sectors suggests that deregulation of a major industry is not primarily a thunderbolt of legislative intelligence. Nor is deregulation an exercise in political muscle. Deregulation is the culmination of a long process of intelligent, and intelligible, interaction between regulatory mechanisms, judicial oversight, and scholarly analysis. In the end, deregulation in the aviation and telecommunications industries proceeded because the courts and independent scholars were able to measure the existing regulatory framework against the legal, economic, and social principles of society, and the regulatory framework was found wanting. Once the public interest was thus clarified beyond reasonable doubt, Congress was able to act even when opposed by powerful incumbent interests.

Those who would encourage deregulation of the postal system must appreciate the deep intellectual roots of a major deregulation. If proponents can use scholarly and judicial analysis to make a clear and convincing case for postal deregulation then there is reason to hope, and believe, that Congress or the courts will embrace the public interest and act accordingly.

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