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Window Glaziers and Letter Carriers

While condolences pour out to those hurt by Hurricane Sandy, it is estimated that $30-$50 billion of recovery funds may be requested to help New Englanders rebuild. Federal support is typical with natural disasters but rekindles the debate of whether rebuilding from a storm is "stimulative" to growth and therefore – despite the extreme personal tragedy – an event with a silver economic lining. The same arguments can be made for fighting wars or keeping certain jobs afloat because, as they say, "it causes money to be spent and keeps people working." This is something for investors to ponder as we face both natural and man-made disasters such as the so-called fiscal cliff.

Franc-ly Speaking

In the 1850s French economist Frederic Bastiat wrote "Ce qu'on voit et ce qu'on ne voit pas," which translates to "what one sees, and what one does not." In the "Parable of the Broken Window" told therein, a shopkeeper's son accidentally breaks a shop window. The disappointed father is consoled by onlookers who remark, "What would become of the glaziers if panes of glass were never broken?"

The story continues with Bastiat agreeing that the six francs it costs to repair the window creates economic benefit as the "…glazier performs his task, receives his six francs, rubs his hands, and, in his heart, blesses the careless child." This is the part that Bastiat says is "*seen*" by all, but he argues that what is "*unseen*" is that the shopkeeper would have spent the six francs on something else like shoes or books had the child not misbehaved. He argues cynically that if the breaking and repair of windows is a "good thing" for the sake of a strong economy, all windows should be broken soon after they are repaired. Taken to the extreme, the glazier could start "hiring" children to break windows for one franc each and still come out ahead.

Let's dispense for the moment the debatable economic merits of wars and natural disasters and, instead, talk about a current enterprise—the US Postal Service (USPS)—that struggles in the face of changing technology. In its day, the USPS was the greatest facilitator of free speech in America. With Benjamin Franklin its first Postmaster General in 1775, few other organizations had such an impact on our country's commerce and communication. This self-supporting government agency is granted monopoly powers and access to Federal credit. However, the quadruple whammy of the facsimile machine, the internet, and growth of UPS and Federal Express has altered the landscape. Only someone hiding beneath piles of snow and sleet would argue that the postal service's role in America should not change. To be fair, the leadership of the USPS has made restructuring recommendations on which Congress has failed to act.

The USPS numbers are indeed numbing. Over the last five years, postal volume has fallen 20%, and losses in fiscal year 2012 alone were $15.9 billion[1]. Their unfunded pension obligation now stands at over $45 billion[2], and on October 1st they defaulted on a $5.6 billion pension obligation — the second such default in as many months. They have also borrowed all of their $15 billion line of credit with the government.

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1) New York Times, "Postal Service Reports Loss of $15 Billion." November 16, 2012.
2) U.S. Congressional Research Service. The U.S. Postal Service's Financial Condition (R41024; Jan. 27, 2012), by Kevin R. Kosar.

Turn up the Volume

Now we come to the window-breaking part of this story. In an effort to survive the downward spiral of first-class mail volume, the postal service has cut 110,000 employees, but has also offered special deals to junk mail issuers in order to generate revenue to keep their current 560,000 workers busy and 32,000 postal offices open (sounds a bit like the glaziers offering children money to break windows to us).

Aside from the fact that most citizens, whom the postal service is supposedly serving, despise the amount of junk mail they get, it is also putting tremendous pressure on municipalities charged with landfill management issues. According to the *New York Times,* cities faced with the costs of disposing of some 84 billion pieces of unwanted mail, annually, are now providing online registries that allow residents to opt out of receiving junk mail[3].

So here is how the process really works:

1) Trees cut down and sold to paper plants
2) Shredded lumber is treated with chemicals, water and heat to yield paper.
3) Paper shipped to printers
4) USPS delivers billions of items that are typically thrown straight in the trash
5) Waste management companies pick up the trash for expensive recycling and or the dump
6) Municipalities help citizens tell junk mailers to stop.

While jobs and economic activity are technically created at every step, when viewed as a whole, the process is neither productive, nor value-added. Instead of government guarantees, coupled with legislative inaction enabling a destructive process to continue, consider the following alternative: a right-sized USPS lets the market price of postage that retailers pay for catalogues rise to reflect the true cost of delivering them. Retailers would then think twice about sending a 5-pound catalog to the broadest mailing list they can find. Few consumers would complain and municipalities would save money.

This restructuring of the system would undoubtedly mean layoffs of postal workers and others whose jobs are dependent on this "old" way of doing business—something easily "seen" in Bastiat's parable; however, the country would also have unseen benefits in the form of more landfill space, more trees, less pollution and more energy. Fewer government-guaranteed USPS liabilities would only improve the fiscal health of the country and decreases in the price of lumber, paper and energy, would effectively put money in the pockets of businesses and citizens, alike, to stimulate economic activity and hiring elsewhere — hopefully in productive, value-added systems. Add in a reduction in greenhouse gases—leading, some would say, to fewer Super Storm Sandys—and it makes us wonder why citizens wouldn't demand a change in the USPS's model.

3) New York Times, Times Topics. October 2, 2012.

Look Beyond the Pane

So what does this story of window glaziers and letter carriers mean in terms of Hamilton Point's investment philosophy? The answer is that case studies like this lead us to optimism that the fiscal cliff and other seemingly painful restructurings can be addressed without destroying the republic.

As we come off the election cycle and the related intense debate, we believe the country is now prepared to come to a great compromise where some taxes go up, some government spending (if it is wasteful) goes down, and all deficits narrow. The hard part will not be to increase taxes because all Washington needs to do is change some percentage rates and deductions on the tax forms. However, the difficult task of right-sizing the USPS and military programs, for example, will result in immediate unemployment that is "seen," but will likely lead to much larger benefits that our leaders should not ignore. With the elections behind us, we are confident and hopeful that both the seen and unseen can now be accounted for, debated, and negotiated by our leaders in Washington.

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