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THE POSTAL WAGE PREMIUM: NO WONDER THE POSTAL SERVICE LOSES MONEY

Executive Summary

- At the end of June, businesses and consumers had to swallow an 8.8% increase in the price of a first-class stamp, from 34¢ to 37¢, as well as increases in other postage rates. The government-owned Postal Service, which has grappled with red ink throughout most of its history, clearly has serious financial problems.

- A key element of successful reform of the Postal Service is addressing its bloated cost structure.

- Some 76% of Postal Service costs consisted of wages and fringe benefits in 2001. A number of economic studies have concluded that the Postal Service pays its workers a substantial premium above wages paid to comparable workers in the private sector of the U.S. economy.

- A cautious estimate based on the many economic studies reviewed here is that the "postal wage premium" is at least 20%, and more likely is 30% or more.

- When fringe benefits are added to cash wages, the "postal pay premium" may be in excess of 40%.

- Economic studies have used three main approaches in estimating the postal wage premium: (1) numbers of job applicants and quit rates; (2) wage changes when moving between jobs; and (3) human capital models. The different approaches have all yielded the same basic conclusion: postal employees receive substantially higher compensation than comparable private sector workers.

- The evidence has convinced a number of neutral labor arbitrators that a large postal wage premium exists.

- Suppose the postal pay premium is 30%. The Postal Service could have saved $8.1 billion in 2001 alone merely by reducing the premium from 30% to 10%. That saving would, by itself, have allowed the Postal Service in 2001 to break even ***and*** cut the price of a first-class stamp from 34¢ to 31¢. If the Postal Service required a 3¢ rate hike in 2002 to cover higher costs, the price would then have gone to 34¢. The actual rate increase to 37¢ would have been unnecessary.

- Well-crafted postal reforms are desirable, but poorly thought out "reforms" could make the problems worse.

- The Postal Service's strategy of growing itself out of a hole by expanding into more private ventures is fundamentally flawed, because it enters each venture handicapped by having to pay compensation that is 20% to 40% above market rates.

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Introduction

A previous *IRET Congressional Advisory* had explained that much of the value from the Postal Service's monopoly pricing power on non-urgent letter delivery is captured by postal unions and their members in the form of above-market wages. (Stephen J. Entin, "The Postal Service: A Monopoly That Loses Money," *IRET Congressional Advisory*, No. 130, June 3, 2002.) As that happens, the Postal Service is made weaker financially than otherwise and postal customers are forced to pay higher rates.

The amount by which postal workers' wages exceed private-sector wages of comparable workers is known as the postal wage premium. Many economists have examined whether a postal wage premium exists, and if it does, attempted to estimate its magnitude. This *Advisory* discusses their findings. Most studies have reached roughly the same conclusion: there appears to be a large postal wage premium, sustained over a long period of time. Because the Postal Service is labor intensive — 76% of its total costs were compensation related in 2001[1] — wage premiums that are anywhere close to the size of the majority of estimates will add several billion dollars every year to the organization's expenditures.[2]

The issue is timely because after several years in which costs have risen faster than revenues, the Postal Service is once again in its usual financial condition of operating in the red. The Postal Service has responded with a plan that it says would correct its financial problems, and some members of Congress are calling for new legislation to help the Postal Service financially. An awareness and understanding of the postal wage premium can tell us much about the reforms that the Postal Service needs, and about the quality of its proposed reform plan.

Empirical estimates of the postal wage premium

The Postal Reorganization Act of 1970 (PRA) and the events that followed sparked interest in whether postal workers received higher compensation than comparable workers elsewhere. There were two reasons for the heightened interest. First, the PRA made it a matter of law that postal workers' pay should be comparable to private sector pay for similar work:

> It shall be the policy of the Postal Service to maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy[3]

The comparability standard has the dual advantages that it would provide reasonable compensation to postal employees and, simultaneously, not place an undue burden on postal customers, especially those within the monopoly.

Second, postal wages rose rapidly in the early 1970s, both to buy labor support for the reorganization act and in response to actual and threatened mail strikes. Economist Sam Peltzman later calculated that during the period 1960-1970, postal wages grew, on average, 1.1% a year faster than did U.S. manufacturing wages.[4] During the years 1970-1980, the differential almost doubled, with postal wages growing, on average, 2.0% a year faster than U.S. manufacturing wages. In another study Rick Geddes concluded, using data for 1930-1996, that the "reorganization significantly increased the wages of postal workers relative to other government workers."[5] These wage hikes fueled the suspicion that postal workers may have become overpaid relative to other workers by the mid 1970s, whether or not a wage premium had existed earlier.

In trying to determine whether a postal wage premium exists and estimating its magnitude, economists have followed several approaches. One technique is to compare the number of people seeking postal jobs and the quit rate from postal jobs with job seekers and quit rates for other employment. If postal employment offers an unusually attractive combination of wages, fringe benefits, and job security, a long line of people should be seeking every postal job and very few people with postal jobs should be quitting before retirement, compared to queues and quit rates elsewhere. In fact, the Postal Service is noted for having a long job applicant queue and a low quit rate. In an early study, Douglas Adie estimated the optimal wage at the Postal Service and in a number of industries over the period 1958-1972 by comparing the industry quit rate to the cost of training replacement workers. Adie concluded that the postal wage premium was large and sustained.[6] "[W]orkers in the Postal Service were overpaid by 32.6 percent in 1972, which was more than for any two-digit industry considered... Over the years 1958-1972, the mean excess postal wage was 27.4 percent, which ranked third highest among two-digit industries considered."[7]

Another approach is to examine how an individual's wages change when moving from the private sector to the Postal Service or vice versa. For example, if someone joining the Postal Service scores a much larger wage gain than is typical for workers switching between other jobs, that would be evidence of a postal wage premium. Alan Krueger used this method and found evidence of a postal wage premium, as part of a more general study of wage differentials between the government and private sectors.[8] Based on data for 1974-75, 1978-79, and 1979-80, Krueger estimated that the postal wage premium exceeded 30%. He also examined 1984 and 1986 displaced worker surveys and estimated a postal wage premium of about 13% from that information. While the estimates were imprecise because of a limited number of postal workers in the sample, Krueger said, "Nevertheless, these results support ... [the] claim that postal workers are paid more than comparable private sector workers."[9]

The approach most frequently seen in economic studies is to use a "human capital" model that estimates econometrically (using regression analysis) how much a worker will be paid based on the worker's human capital and labor market and socioeconomic characteristics (education, experience, occupation, location, part- or full-time status, sex, etc.). If postal workers make more (less) than would be expected based on their personal and labor market characteristics, they are judged to have a wage premium (deficit).

In one of the first studies to estimate compensation by means of a human capital model, Sharon Smith, using 1973 data, reported, "On average, federal workers, both postal and nonpostal, of both sexes, receive wages which are superior to the wages of nonunionized private sector workers of similar socioeconomic characteristics and at least comparable to unionized private sector workers."[10] In a follow-up study with 1975 data, Smith found, "[T]he federal wage advantage was estimated to be at least 13 percent and as much as 20 percent in 1975... Postal workers appear to enjoy the largest relative wage advantage [among federal workers], especially in recent years."[11] In another early study, Joseph Quinn estimated that in 1969 postal workers received relative wages 11% or 12% higher than those received by comparable workers in the private sector.[12] Smith and Quinn both noted that the compensation premium for postal workers would probably have been larger if the estimates had included fringe benefits, which tend to be better for postal workers than private-sector workers. Joseph Gyourko and Joseph Tracy, using 1977 data, estimated the postal wage premium at 23% or 48%, depending on what assumptions are made about unobserved worker characteristics.[13] They said that "Federal wages appear to be high relative to private-sector wages" and that "Postal workers consistently have the highest estimated differentials."[14]

Michael Wachter and colleagues have provided the most detailed estimates in a series of studies stretching from the early 1980s to the present.[15] In a recent paper, using 1998 data from the Census Bureau's Current Population Survey (CPS), Wachter, Hirsch, and Gillula reported, "The estimate of the bargaining unit postal wage premium ... [is] a 23.7% wage advantage for postal relative to private sector non-postal workers with similar characteristics... The wage premium calculated for *all* postal workers (78.5% coded union and the remainder nonunion) is ... 20.0%."[16] When the researchers supplemented this with Dictionary of Occupational Title (DOT) data to better adjust for "job skill and working conditions", the wage premium for bargaining unit postal employees jumped to 36.2%.[17] In earlier years, Wachter and various colleagues had obtained generally similar results, although they did find a slight narrowing of the postal wage premium due to less generous arbitration awards in the second half of the 1980s and the early 1990s.

These estimates, like those of Smith and Quinn, ignore benefits. Wachter, Hirsch, and Gillula found that adding benefits to their estimates "yields a postal total compensation premium about 8 percentage points higher than the wage premium," which implies that the total postal compensation premium for bargaining unit postal employees exceeds 40%.[18] They also cite as evidence for a substantial postal wage premium 1997 and 1998 data from the Postal Service New Hire Survey (NHS) showing an average wage gain of 35.8% for new postal hires[19], compared to an average wage gain of only a few points for people switching from one non-postal job to another. For further corroboration, they point to the long waiting list for postal jobs and the low postal quit rate.

A few researchers using human capital models have concluded that postal pay is comparable to private sector pay, but those results hinge on restricting the comparison to subgroups of private sector workers. For example, Martin Asher and Joel Popkin reported finding no postal wage premium when they compared postal workers' wages to those of white male workers at large companies, with heavy weight given to workers in highly unionized industries.[20] Although Asher and Popkin found that postal wages exceeded those for the general population of private sector workers, they claimed the difference was solely due to job bias against women and non-whites in the private sector. Dale Belman and Paula Voos also concluded there is not a postal wage premium but specified their model in a way that compared postal workers to the relatively small percentage of private sector workers in unions.[21]

Perloff and Wachter replied that Asher and Popkin were exaggerating the effect of private sector job bias and added that they found a 10% postal wage premium even if they looked at just white males.[22] In addition, Wachter and colleagues have raised repeatedly a more fundamental criticism. That is, whether one approaches the wage issue with the efficiency objective of paying enough to attract qualified workers to the Postal Service but not overpaying, or with the equity objective of paying postal workers about the same as comparable workers in the private sector, it makes sense to compare postal workers' pay to that of all comparable private sector workers, not just to a subset of private sector workers with above-average pay. In addition, as a legal matter, the textual language of the 1970 legislation seems to require using the broader comparison. What this means, for example, is that the pay of private-sector union workers should be included in the standard against which postal pay is compared, but because union membership has dropped to 9% of private sector workers, they should be given a corresponding (small) weight.[23]

The evidence convinces neutral arbitrators

The issue of whether a postal wage premium exists has arisen frequently before the arbitrators who set labor compensation when the Postal Service and one of its unions cannot agree. The evidence has persuaded numerous arbitrators — among them Clark Kerr in 1984, Richard Mittenthal in 1991, Arthur Stark in 1995, David Vaughn in 1996, Stephen Goldberg in 2001, and John Wells in 2002 — that a postal wage premium exists.[24] For instance, while Goldberg was reluctant in his arbitration award to evaluate the competing econometric models of the Postal Service and the union, he was convinced by the Postal Service's large queue of job applicants, low quit rate, high benefits, and exceptional job security that the postal wage premium is real.

> [W]hat stands out clearly ... is that Postal Service jobs are highly sought after, and once obtained, are held onto. Applicant queues are long, and the quit rate is all but non-existent... Employees represented by APWU [American Postal Workers Union] have total job security, an extraordinary benefit package, and wages that have fully kept up with inflation. These data, which show how much Postal Service jobs are valued, both by those who want them and by those who have them, provide powerful support for the Postal Service argument that the Postal Service provides a wage and

> benefit package ... better than that available for comparable work in the private sector.[25]

Wells relied on similar facts and wrote in his award that based "on external comparability evidence in this case ... rural carriers [the postal-worker group before his arbitration panel] enjoy a wage and benefit premium compared to the private sector...."[26]

A huge financial burden

If the postal pay premium is anywhere close to what the evidence suggests, it imposes staggering extra costs on the Postal Service. As a back-of-the-envelope calculation, suppose the compensation premium is 30%. A premium of that size would have added *$12.2 billion* to Postal Service costs in 2001 alone.[27] That is, bringing postal pay into line with market pay would have saved the Postal Service $12.2 billion just in 2001.

As another illustration, suppose the postal compensation premium had been reduced from 30% to 10% in 2001. Although postal pay would still exceed the pay of comparable workers in the private sector by 10%, merely reducing the premium to 10% would have saved the Postal Service $8.1 billlion in 2001 and enabled it to break even with a first-class postage rate of 31¢, instead of 34¢.[28] Even if one accepts the Postal Service's claim that it needs a 3¢ rate hike to cover higher costs over the next few years, that would only have brought the first-class stamp rate to 34¢. The actual rate hike on June 30, 2002 from 34¢ to 37¢ would have been unnecessary. Although many reforms are desirable at the Postal Service, aligning postal compensation with private sector compensation is the single reform that would probably have the biggest positive financial impact.

The financial drain that the postal wage premium places on the Postal Service is magnified by the organization's relatively slow pace of productivity improvements. Because productivity at the Postal Service had grown as less than it has in the private sector, the agency needs thousands of workers above what it would require if its productivity gains equalled those in the private sector. That means thousands of additional workers draw pay from the Postal Service, as a result of which thousands more workers receive a postal wage premium than would be the case if the Postal Service's productivity were better. A future paper in this series will discuss the Postal Service's productivity problem.

The postal wage premium and the Postal Service's "Transformation Plan"

In April, the Postal Service proposed a "Transformation Plan" that it claimed would put it on a sound financial footing.[29] The plan calls for three main changes in how the agency operates and says the result would be a "Commercialized Government Enterprise". First, the Postal Service offers many suggestions for cutting costs. Second, the organization wants a freer hand to move into competitive markets. Third, it wants to be able to set product prices with less regulatory oversight. The plan says explicitly that the Postal Service would retain its monopoly on non-urgent letter delivery, and it apparently would also retain its exemption from most taxes (income, sales, and property), its special credit line at the U.S. Treasury, and assorted other governmental powers. Much of the plan would require congressional approval through new legislation.

Given the presence of the postal wage premium, does the Transformation Plan make sense? The answer is that a better handle on costs is highly desirable, but the other proposals — expansion and less regulation of its prices — would be terrible public policy.

Cost cutting makes excellent sense because the Postal Service's financial woes are primarily due to its high costs. With the postal wage premium running billions of dollars annually, modestly reducing the premium's size would be sufficient, by itself, to shift the Postal Service from a money losing operation into one that breaks even or earns net income. Costs should also be cut by curbing excessive spending in other areas and improving the Postal Service's productivity, which has grown slowly compared to productivity in the private sector, but the postal wage premium is so enormous that it would be logical to make it one of the pillars of postal reform. As the Transformation Plan says, "Labor agreements are, by far, the largest single element of the Postal Service's costs and therefore the primary determinant of prices and *the key factor in the Postal Service's overall financial viability*. [Emphasis added.]"[30]

Further expansion into competitive markets is a recipe for financial disaster, however, given how much more the Postal Service's spends on labor than do private-sector businesses for comparable work. The problem is that if the Postal Service sets prices on competitive-market products low enough to successfully attract customers from private-sector rivals, its very high labor costs are likely to saddle it with losses on those products, despite its tax exemptions and other government-based advantages. The agency could compensate for high labor costs if it were unusually productive or could command premium prices by tailoring its services to customers' needs, but it has historically lagged in those areas, which further diminishes the odds that it would avoid losses on new ventures in competitive markets. Hence, instead of helping the Postal Service financially and holding down prices in its core business, expansion into competitive markets would tend to worsen the agency's finances, require higher cross-subsidies from customers within the postal monopoly, and place taxpayers at greater risk.

Letting the Postal Service adjust product prices with diminished regulatory oversight would also be a serious policy mistake. First, it does not tackle the agency's fundamental problem, which is high costs, especially for labor. Second, it would increase the danger to monopoly-market postal customers of being forced to cross-subsidize losses on competitive-market products. As long as the Postal Service retains its monopoly, customers within the monopoly need at least the present level of regulatory protection.

In addition to being bad policy in their own right, the expansion and product pricing proposals are harmful because they divert attention from costs. Until labor and other costs are better controlled, the Postal Service will always be in financial difficulty.

Conclusion

There is abundant evidence that postal workers receive substantially higher wages than comparable private sector workers. In addition to being contrary to the explicit language of the Postal Reorganization Act of 1970, the postal wage premium imposes a massive, continuous financial strain on the Postal Service. Although politically difficult, narrowing or eliminating the postal wage premium is the single action that would most improve the Postal Service's bottom line.

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Endnotes

1. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. 4, accessed on the Internet at www.usps.com/strategicdirection/transform.htm.

2. This paper does not investigate compensation at the very top of the Postal Service. The agency's leaders are paid much less than top executives at large private sector companies. Some observers fear that this difference often prevents the Postal Service from obtaining the executives most capable of managing and directing the organization.

3. 39 U.S.C. 1003(a). A similar directive is contained in 39 U.S.C. 101(c).

4. Sam Peltzman, "The Control And Performance Of State-Owned Enterprises: Comment," in Paul A. MacAvoy, W. T. Stanbury, George Yarrow, and Richard J. Zeckhauser, eds., *Privatization And State-Owned Enterprises: Lessons From The United States, Great Britain and Canada* (Boston: Kluwer Academic Publishers, 1989), pp. 69-75.

5. Rick Geddes, "The Economic Effects Of Postal Reorganization," *Journal Of Regulatory Economics*, 1998, pp. 139-156.

6. Douglas K. Adie, *An Evaluation Of Postal Wage Rates* (Washington, DC: American Enterprise Institute, 1977).

7. *Ibid.*, p. 92. "Two-digit" refers to broad industry groups as specified by the government's Standard Industrial Code (SIC) classification system.

8. Alan B. Krueger, "Are Public Sector Workers Paid More Than Their Alternative Wage? Evidence From Longitudinal Data And Job Queues," in Richard B. Freeman and Casey Ichniowski, eds., *When Public Sector Workers Unionize*, a National Bureau Of Economic Research Project Report (Chicago: University Of Chicago Press and National Bureau Of Economic Research, 1988), pp. 217-240.

9. *Ibid.*, p. 229.

10. Sharon P. Smith, "Are Postal Workers Over- Or Underpaid?" *Industrial Relations*, May 1976, pp. 168-176, quote from pp. 175-176.

11. Sharon P. Smith, *Equal Pay In The Public Sector: Fact Or Fantasy?* (Princeton, NJ: Industrial Relations Section, Princeton University, 1977), p. 132.

12. Joseph F. Quinn, "Postal Sector Wages," *Industrial Relations*, Winter 1979, pp. 92-96.

13. Joseph Gyourko and Joseph Tracy, "An Analysis Of Public- And Private-Sector Wages Allowing For Endogenous Choices Of Both Government And Union Status," *Journal Of Labor Economics*, April 1988, pp. 229-253.

14. *Ibid.*, p. 248.

15. For example, see Jeffrey M. Perloff and Michael L. Wachter, "Wage Comparability In The U.S. Postal Service," *Industrial And Labor Relations Review*, October 1984, pp. 26-35, 37; Barry T. Hirsch, Michael L. Wachter, and James W. Gillula, "Postal Service Compensation And The Comparability Standard," *Research In Labor Economics*, 1999, pp. 243-277; and Michael L. Wachter, Barry T. Hirsch, and James W. Gillula, "Difficulties Of Regulation When Wage Costs Are The Major Cost," in Michael A. Crew and Paul Kleindorfer, eds., *Future Directions In Postal Reform* (Boston: Kluwer Academic Publishers, 2001). Wachter and his colleagues have produced some of their work under contract with the Postal Service. The Postal Service has frequently called Wachter as a witness.

16. Wachter, Hirsch, and Gillula, *op. cit.*.

17. *Ibid.* The job skill adjustment substantially raises the premium, reflecting "the DOT's assessment that postal crafts require lower levels of skill than the average private sector occupation", while the working condition adjustment slightly lowers the premium.

18. *Ibid.*

19. *Ibid.*

20. Martin Asher and Joel Popkin, "The Effect Of Gender And Race Differentials On Public-Private Wage Comparisons: A Study Of Postal Workers," *Industrial And Labor Relations Review*, October 1984, pp. 16-25, 36. Asher and Popkin did some of their work under contract with postal unions.

21. Dale Bellman and Paula Voos, "Postal Service Comparability: Issues Of Definition And Measurement," *Proceedings Of The Forty-Ninth Annual Meeting*, Industrial Relations Research Association, 1997, pp. 38-47. Bellman and Voos did some of their work under contract with postal unions and have testified on their behalf.

22. Perloff and Wachter, *op. cit.*

23. The decline in the union share of private sector workers combined with union members' relatively high pay suggest that unions have frequently secured above-market wages for their members, but, as a result, are often pricing them out of jobs. (Hirsch, Wachter, and Gillula, *op. cit.*, specifically examine whether union workers tend to receive higher pay because of superior productivity, and conclude that is not the case.) Union members have declined as a share of private sector wage and salary workers from 17% in 1983 to 9% in 2000. In the government sector, where political forces are relatively more important than in the private sector, a larger share of workers belong to unions, 37% in 2000, and that share has held steady. (For data, see U.S. Census Bureau, *Statistical Abstract Of The United States, 2001* (Washington, DC: Government Printing Office, 2002), p. 411.)

24. Arbitration panels consist of one arbitrator selected by the Postal Service, one selected by the union, and a third ("neutral") arbitrator who serves as chair and, in effect, makes the decision. The arbitrators mentioned in the text are the neutral arbitrators.

25. Stephen B. Goldberg, Neutral Chair, Interest Arbitration Proceedings, United States Postal Service and American Postal Workers Union, AFL-CIO, "Supplemental Opinion Dealing With Economic Issues," entered January 11, 2002 for the December 18, 2001 award, accessed on the Internet at www.apwu.org/departments/ir/cba/2001suppaward.pdf.

26. John C. Wells, Neutral Chair, Interest Arbitration Proceedings, United States Postal Service and National Rural Letter Carriers' Association, "Opinion And Award," February 3, 2002, accessed on the Internet at www.postallinks.com/pdf_files/arbitrationproceedings.pdf.

27. The Postal Service reported $53 billion of total labor costs in 2001. (U.S. Postal Service, *Annual Report, 2001*, p. 23.) This is divided by 1.3 to find what wages costs would have been under the comparability standard, on the assumption that postal wages were 130% of the wages needed for comparability with private sector wages.

28. Total labor costs of $53 billion in 2001 are multiplied by 1.1/1.3 to find what labor costs would have been if the postal compensation premium had been reduced to 10%. It is assumed the cost savings are used to close the Postal Service's 2001 deficit of $1.7 billion and finance an across-the-board cut in postal rates.

29. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, accessed on the Internet at http://www.usps.com/strategicdirection/transform.htm.

30. *Transformation Plan*, p. 52.