

IRET Congressional Advisory

INSTITUTE FOR RESEARCH ON THE ECONOMICS OF TAXATION

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THE POSTAL SERVICE'S PRODUCTIVITY PROBLEM

Executive Summary

- Current levels of productivity at the Postal Service are not high enough to justify the postal wage premium. Substantially faster increases in productivity would be hard to achieve given the constraints under which the organization now operates, but if they could be managed, they would reduce the need for reductions in compensation.
- While the Postal Service has become more productive over time, its productivity growth has been less than the average in the private sector.
- According to data from the Bureau of Labor Statistics (BLS), the Postal Service increased its labor productivity (output per hour of labor) by 40% over the period 1970 to 2000, while manufacturing and private business increased their labor productivity by 149% and 74%, respectively.
- The Postal Service emphasizes total factor productivity, which relates output to all factors of production. The Postal Service's total factor productivity rose by 12% from 1970 to 2000. For comparison, using the roughly similar measure of multifactor productivity compiled by BLS, manufacturing and private business increased their multifactor productivity by 39% and 31%, respectively, over the same period.
- A general reason why government enterprises are usually less efficient than private sector businesses is that managers in the two sectors face fundamentally different incentives. Postal productivity is further held back by constraints Congress has imposed, work rule restrictions, and adversarial labor-management relations.
- Under growing financial pressure, the Postal Service has recently tried harder to control costs. It has begun consolidating some of its operations and permitted attrition to reduce slightly its large workforce.
- Although the recent cost control efforts are commendable, the workforce reductions are modest compared to those achieved by some foreign postal services, and there is concern that Congress may block some of the agency's initiatives to lower its costs. Consequently, future postal rate increases are likely.
- The greatest boost to postal productivity would come from privatization. Short of that, substantial productivity gains could be made at the USPS as it is currently constituted by easing some of the legal and contractual restraints on the USPS and its management that now impede efficiency growth there.
- In contrast, the Postal Service should not be allowed to set its prices with less regulatory oversight or given a green light to expand into new markets because those new powers would reduce the urgency it now feels to raise efficiency by better managing costs.

THE POSTAL SERVICE'S PRODUCTIVITY PROBLEM

Several recent *IRET Congressional Advisories* have discussed the postal pay premium, and suggested ways of reducing it over time.¹ The postal pay premium refers to pay for postal workers that in most cases substantially exceeds the pay of comparable workers in the private sector.² It adds billions of dollars yearly to Postal Services expenditures.

An alternative to reducing the pay premium would be to justify the current compensation levels by raising the productivity of the USPS workforce. Conceivably, if the Postal Service were extremely efficient, it could save enough money through superior productivity to offset its high wages and benefits.

What productivity means.

Productivity indicates the rate at which inputs are converted into output. The most frequently discussed measure of productivity is labor productivity. It is defined as the output of goods and services (in real, inflation adjusted dollars) per hour of labor input. For instance, if 10 hours of work produce \$100 of output, then labor productivity is \$10 per hour. If improvements in the capital stock, technology, management, or work rules later allow 10 hours of work to produce \$200 of output, labor productivity has jumped to \$20 per hour. (In published data series, one year is usually chosen as the base year, productivity that year is expressed as 100, and productivity in other years is expressed relative to the base year.) A less common measure of productivity, but one preferred by the Postal Service, relates output to all production inputs (labor, capital, materials, etc.). The Postal Service calls this measure total factor productivity; it is

similar to what the Bureau of Labor Statistics (BLS) calls multifactor productivity.

Why productivity matters. Productivity is vitally important both for the overall economy and at the level of the firm. For the nation, greater productivity means that a given quantity of scarce production inputs can generate more output. Because productivity increases output, people can enjoy more goods and services and earn higher incomes. That is why the average person in a nation with relatively low productivity tends to be poor, while the typical person in a more productive economy usually has a much higher standard of

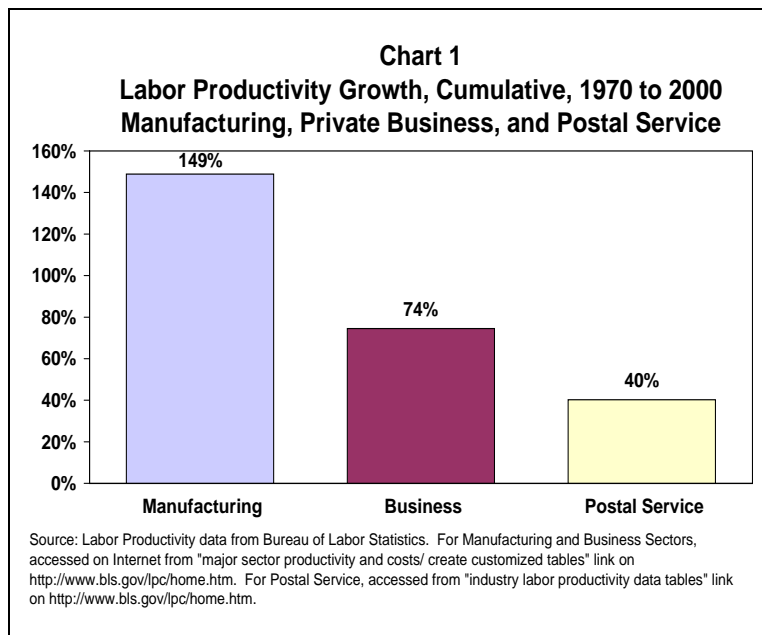
living. The rate at which productivity grows has an enormous impact on prosperity over time. For instance, if productivity increases 3% annually, wages and living standards will double in 24 years. But if productivity rises 1% annually, the same doubling of wages and living standards would require 70 years.

At the level of the individual business, the attraction of enhanced factor productivity is

that it reduces costs by allowing fewer inputs to produce a unit of output. The cost savings may go to owners as higher profits, to employees as higher wages, to customers as lower prices, or, most likely, a combination of these impacts. In this way the productivity of a business benefits its owners, employees, and customers.

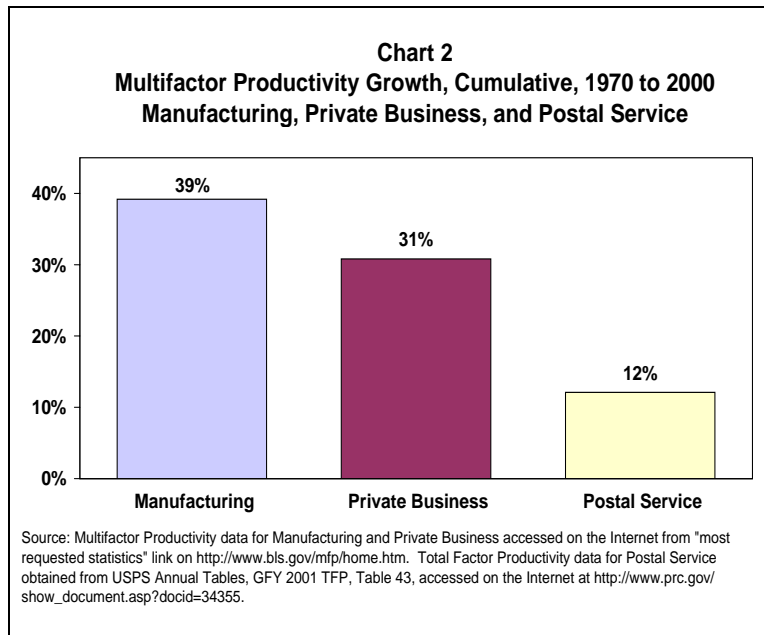
Productivity at the U.S. Postal Service

According to data from the Bureau of Labor Statistics, the Postal Service increased its labor productivity by 40% over the period 1970 to 2000



2000.^{3,4} (See Chart 1.) For comparison, manufacturing increased its labor productivity by 149% over the same period, and private business lifted its labor productivity by 69%. The message from these numbers is that the Postal Service has improved its productivity over time, but has not moved as quickly as the private sector.

The Postal Service emphasizes total factor productivity, which, as mentioned earlier, relates output to all factors of production. That has risen by 12% at the Postal Service over the period 1970 to 2000. (See Chart 2.) For comparison, the roughly similar measure of multifactor productivity compiled by BLS reports average gains of 39% for manufacturing and 31% for private business over the same period.⁵ Again the message is that while the Postal Service has become more productive over time, it has not progressed as rapidly as has the private sector, on average.



Charts 3 and 4 divide the years from 1970 to 2000 into decades. In the 1970s, the Postal Service appears to have achieved respectable productivity growth compared to manufacturing and private business in general. In the 1980s and 1990s, however, the numbers suggest that productivity growth at the Postal Service slowed drastically and was much lower than the averages in manufacturing and private business.⁶

It may be that the moderately good growth of productivity at the Postal Service in the 1970s was due, in part, to the Postal Reorganization Act of 1970 (PRA), which converted the old Post Office Department into the Postal Service. The act was intended to put the organization on a more businesslike footing. Rick Geddes has carefully examined the evidence, and he concludes that the

act did significantly increase the government agency's efficiency.⁷ Murray Comarow, who was executive director of the Kappel Commission, which was instrumental in designing the conversion, credits much of the improvement to the act's removal of most political patronage from the organization. At the old Post Office Department sound business practices often suffered because "patronage ... controlled all top jobs, all postmaster and rural carrier appointments, and thousands of other positions."⁸ The relatively good performance of the Postal Service in this period suggests that it can

improve when given the chance to adopt better management techniques and business practices.

What is holding back postal productivity?

Government enterprises in this country and abroad often compare unfavorably with private sector businesses in terms of productivity and costs. Realizing this point, many state and local governments have achieved large savings

by privatizing some of their operations. For that matter, the Postal Service has had the good sense to recognize private-sector efficiency, and has lowered its costs and strengthened its bottom line through various worksharing and outsourcing arrangements, which are types of partial privatization.⁹

A basic reason why government enterprises have trouble matching the efficiency of private sector businesses is that the incentives facing management are fundamentally different in the two sectors. Private sector companies are spurred on to reduce costs while better meeting customer demands by the profit motive; more desirable products and lower costs both tend to boost profits. This incentive structure encourages productivity because one of the main ways to increase profits is to raise productivity. When private sector companies

perform poorly, investors rapidly make their displeasure known through falling stock prices. Management teams that are viewed as deficient can be replaced by the companies' boards or via takeovers by other firms. And when losses become too great, private sector businesses face bankruptcy, which may result in their resources being acquired by better run companies. In contrast, politicians and managers are usually content provided their government-run enterprises do not lose money (or, in many cases, do not lose too much money).¹⁰ Political

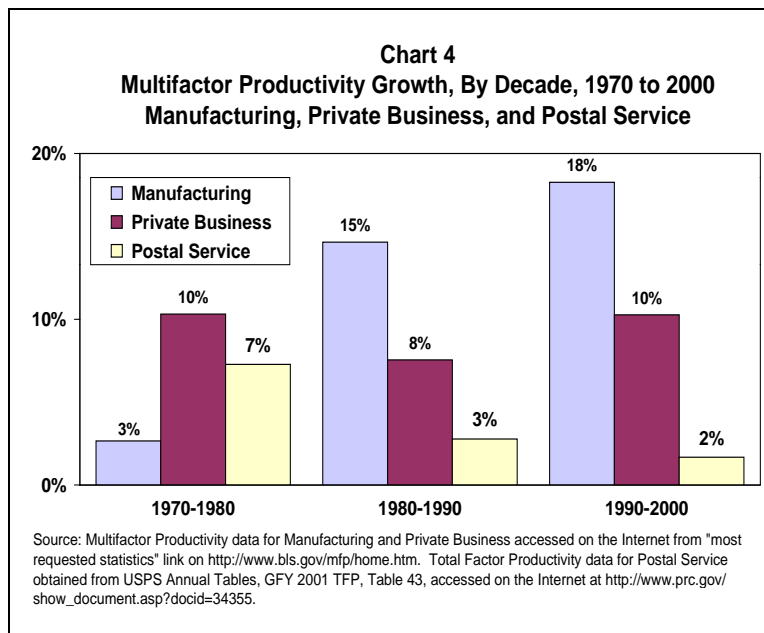
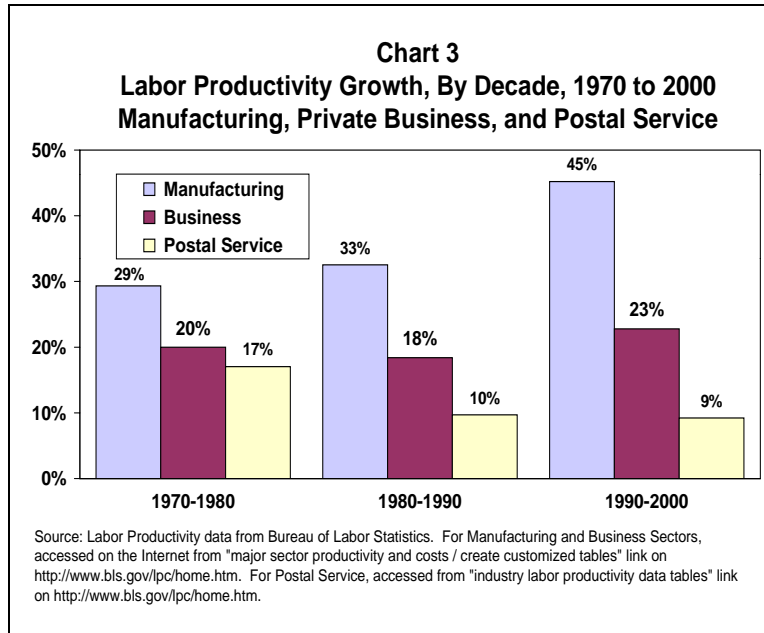
considerations often trump economic ones, either because the management behaves with politics in mind or because political pressure forces management to behave in an uneconomic manner. The discipline provided by potential takeovers and the threat of bankruptcy, with the speedy reallocation of production inputs to higher valued uses, is not present. Instead, there is the prospect of government bailouts that slow the redeployment of labor and capital and burden taxpayers.

As an example of political constraints, Congress inserted language into the 1970 act specifically barring the Postal Service from closing small post offices solely for losing money.¹¹ Congress put a further

brake on post office closings in 1976 by stipulating that a detailed evaluation, notice, and appeal procedure must precede any closing. The General Accounting Office (GAO) explains that the restrictions also apply to actions like replacing a post office with a less costly contractor-operated community post office.¹² Moreover, members of Congress frequently pressure the agency to keep specific post offices open. The result is an inefficiently large number of post offices, which increases the plant and equipment that the agency must maintain and the locations it

must staff. The constraints also make it harder for the Postal Service to reallocate labor and capital in response to changes in the geographic pattern of customer demand. Productivity would be higher without these restrictions.

Other problems also hurt Postal Service productivity. For example, the relationship between labor and management at the Postal Service is strongly adversarial. There is blame on both sides, with management often perceived by labor as being inflexible and unwilling to listen and labor often seen by management as having a chip on its shoulder. The inclination to cooperate is reduced because postal workers, like many other government employees, are



difficult to fire. And the fear of bankruptcy or loss of business to competitors, which often persuades labor and management to pull together at troubled companies, is absent at the Postal Service, which has often received government bailouts in the past, and enjoys monopoly status in its core business.

One symptom of the animosity is a huge number of worker grievances. The *Postal Service Commission On A Safe And Secure Workplace* found that there was a backlog of 126,000 grievances in 2000.¹³ Postal employee grievances required the services of more than 300 arbitrators, and the cost of the grievances was estimated at about \$220 million annually.¹⁴ Beyond the direct costs, both sides reported that the number of grievances and the delays in resolving them raise tensions and sap morale. That damages productivity. In contrast, "in the entire auto industry — with about 400,000 bargaining unit employees — only eleven grievances reached arbitration in 1998."¹⁵ A press report mentions that one postal union filed a nationwide grievance because employers were required to scan bar codes on mailboxes as they traveled their routes.¹⁶ Such hand-held scanners have been standard productivity-enhancing tools at UPS and FedEx for years. Despite efforts by management and some unions to find less contentious alternatives, grievances remain a problem that depresses postal productivity.

Productivity is also held back by craft-line restrictions on which workers can do which jobs. Some of the restrictions were imposed by arbitrators in binding arbitration decisions and some resulted from collective bargaining agreements between the Postal Service and its unions. Regardless of how the restrictions were established, though, the upshot is that postal workers sometimes cannot be used where they are most needed.

As a final example of the assortment of obstacles the Postal Service has encountered, consider its efforts to automate much of the mail sorting process. As with many initiatives at the agency, productivity has increased, but not as quickly or by as much as the Postal Service hoped. The titles of two GAO reports from the 1990s aptly

characterize the below-expectations progress: "Automation Is Restraining But Not Reducing Costs"¹⁷ and "Automation Is Taking Longer and Producing Less Than Expected".¹⁸ The latter report found, "The savings from automation continue to be small compared to overall labor costs and more difficult to achieve than the Postal Service anticipated."¹⁹ Still, the Postal Service has done much better than many government agencies, such as the IRS with its botched, decades long, multibillion dollar effort to modernize its computer systems.²⁰

Recent progress. After swelling to almost 906,000 employees (career and non-career) in 1999, the postal workforce has declined by several thousand in each succeeding year.²¹ The deepest cuts on a percentage basis, although not in absolute numbers, have been in administration. Postmaster General John E. Potter reports that 800 positions were eliminated at headquarters and 2,000 administrative staffing positions were eliminated in the field.²² The drop in mail volume caused by the recession and the anthrax attacks added greater urgency to cost containment, and in fiscal year 2002, the Postal Service reduced the number of career employees by 23,000 (about 3%) and cut the number of workhours by 77 million.²³ Most of the reductions were accomplished through attrition.

This downsizing was made possible by automation and the more effective use of employees in other ways. It also reflected the Postal Service's rapid response (at least for a government agency) to the drop in mail volume due to the recession and the anthrax attack. For instance, the Postal Service has begun reevaluating mail-delivery routes more frequently to see whether some routes can be combined, especially in areas where mail volume is low. This has enabled the agency to eliminate 1,600 mail-delivery routes (about 1% of the total) in the last year.²⁴ In another recent consolidation, the Postal Service closed one of three "mail recovery" centers for undeliverable mail.²⁵ Postmaster General Potter said in Congressional testimony that next year the agency will begin reducing the number of mail-processing plants, which now exceeds 300, adding that this would be done without layoffs.²⁶

By more carefully watching how it utilizes labor, the Postal Service was able to increase its labor productivity by 2.1% in 2001 and, according to Mr. Potter, 1.9% in 2002, despite the recession and the anthrax attacks.²⁷ The cost cutting also helps to explain how the organization was able to close the 2002 fiscal year with a loss of less than \$1 billion, after earlier fearing the loss might exceed \$4 billion.²⁸

This recent progress should not be oversold, however. Jim O'Brien, director of distribution and postal affairs at Time Inc., comments, "Jack Potter is doing a fine job of drawing labor costs out of the system, but everybody got a raise [so] he's just keeping himself even."²⁹ David Fineman, vice chairman of the Postal Service's Board of Governors, is concerned that members of Congress may block some facility consolidations and various other businesslike efforts to cut costs and improve efficiency.³⁰ Charles Guy, former director of the Office of Economics, Strategic Planning at the U.S. Postal Service and an expert on the measurement of postal productivity, questions why the Postal Service is not projecting a bigger productivity gain for 2003, given the reductions in labor hours it plans. His conclusion is that "over one-half of the anticipated savings from work hour reductions in FY 2003 are to be 'reinvested' in other areas, rather than truly saved."³¹ The Postal Service reveals that it costs the agency 24¢ to sell one dollar of postage stamps at a post office counter, compared to 10¢ at a contract postal unit and 1.6¢ at a supermarket or drugstore.³² And despite the cost cutting, the big postal rate hike in June, and an optimistic projection for volume growth, the Postal Service predicts it will earn only a small net income in 2003, which makes future rate hike requests likely.

It should also be recognized that the workforce reductions at the USPS are modest compared to those achieved by some foreign postal services. In consultation with its unions, New Zealand's postal service reduced its workforce by 40% from the late 1980s to the mid 1990s.³³ Germany's postal service lowered its workforce by 38% from 1990 to 1999 without layoffs.³⁴ And Sweden's postal service trimmed its labor force by 30% from 1990 to 2000³⁵

Recommendations / Conclusion. The Postal Service has increased its productivity over time, but at a much slower rate than the average productivity gains achieved in the private business sector. While rising productivity at the Postal Service has improved its performance and helped its bottom line, productivity has not been sufficient to counterbalance the high level of postal pay and the government agency's other costs.

The difference between private-sector and government incentives is a general problem that will reduce productivity growth at the Postal Service unless the organization is privatized. Short of privatization, however, much can be done by easing specific legislative and work-rule constraints that hold back the Postal Service's productivity. The Postal Service could use its resources better and not pile up as much red ink if it had more flexibility to close or consolidate money-losing post offices or convert them into contractor-operated community post offices, or if it could more readily assign employees to tasks based on what most needs doing at the time. It would be helpful in this regard if Congress ordered a study to identify and estimate the magnitude of various legal and contractual restraints impeding efficiency gains at the USPS, and then repealed as many of the obstacles as it could.

In contrast, if the goal is greater efficiency and productivity, Congress should not allow the Postal Service to set its prices with less regulatory oversight, nor should Congress give the agency more power to expand into markets already served by private-sector firms. The Postal Service requested these prerogatives in the "transformation plan" it issued in April 2002. Giving the Postal Service these powers would reduce the sense of urgency it now feels to improve its finances by better controlling costs. Postal Service expansion would also harm productivity because the agency could use its government backing to displace more efficient private sector businesses.

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Endnotes

1. See Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No. 131, July 24, 2002; Michael Schuyler, "How To Bring Postal Compensation Into Line With The Private Sector," *IRET Congressional Advisory*, No. 132, August 28, 2002; and Stephen J. Entin, "The Postal Service: A Monopoly That Loses Money," *IRET Congressional Advisory*, No. 130, June 3, 2002.
2. This is not to say that all postal workers receive more pay than comparable workers in the private sector. For example, the Postal Service has experienced difficulties recruiting and retaining qualified workers in some technical areas, which suggests that postal pay in those areas is not above what the same workers could earn in the private sector.
3. The Postal Service computes a labor productivity data series, also. It differs somewhat from the BLS series and reports cumulative labor productivity growth of 30% over the period 1970-2000. (See *USPS Annual Tables, GFY 2001 TFP*, Table 44, accessed on the Internet at http://www.prc.gov/show_document.asp?docid=34355.)
4. In 1970, the organization was still the Post Office Department. It was in the process of converting itself into the Postal Service. The conversion was effective on July 1, 1971.
5. Labor productivity generally increases faster than multifactor productivity. The reason is that labor productivity relates output only to labor inputs. When other factors of production increase, labor has more tools with which to work and becomes far more productive than otherwise. (Think of a person digging a ditch by hand versus with a backhoe.) Multifactor productivity (and the Postal Service's total factor productivity) try to measure productivity gains after accounting for changes in all factors of production.
6. The pattern is somewhat different according to the Postal Service's own measure of labor productivity. Labor productivity growth as computed by the Postal Service was much lower in the 1970s than as computed by BLS, somewhat lower in the 1980s, and slightly higher in the 1990s. (The Postal Service's labor productivity growth numbers for the three decades are 9%, 7%, and 11%.) According to these numbers, the Postal Service badly trailed average labor productivity growth in the private sector in all three decades.
7. Rick Geddes, *The Postal Reorganization Act Of 1970: Assessment And Proposals For Reform* (Washington, DC: American Enterprise Institute, forthcoming).
8. Murray Comarow, "The Demise Of The Postal Service?" Joint Conference of the National Academy of Public Administration's Panel on Executive Organization and Management and the John Hopkins Center for the Study of American Government, June 25, 2001, accessed on the Internet at http://www.postcom.org/public/2001/2001news/demise_of_the_usps.htm.
9. For a discussion of the cost savings from worksharing, see Robert H. Cohen, William W. Ferguson, John D. Waller, and Spyros S. Xenakis, "The Impact Of Using Worksharing To Liberalize A Postal Market," white paper presented at a fWissenschaftliches Institut für Kommunikationsdienste GmbH (WIK), 6th Koenigswinter Seminar on Postal Economics, "Liberalization of Postal Markets," February 19-21, 2001, accessed on the Internet at <http://www.postinsight.pb.com/go.cfm?file=WIK2001WinterSeminar%2Epdf>.
William Burrus, President of the American Postal Workers Union, strongly opposes worksharing, which reduces his union's membership, and claims that it hurts the Postal Service financially. (See, for example, William Burrus, "Why The Postal Service's 'Discounts' Are Flawed," Burrus Update #14-02, July 16, 2002, accessed on the Internet at <http://www.apwu.org/burrusupdates/burrusupdate1402.htm>.) However, the independent Postal Rate Commission, which regulates postal rates and must approve worksharing discounts via ratemaking cases before they can take effect, has consistently found that they bolster efficiency and save money for both the Postal Service and mailers.
10. For a good discussion of this issue in terms of property rights and transferable ownership shares, see Geddes, *op.cit.*
11. 39 U.S. Code, Section 101(b).
12. General Accounting Office, "Information On Post Office Closures, Appeals, And Affected Communities," GAO/GGD-97-38BR, March 1997, p. 2.

13. United States Postal Service Commission On A Safe And Secure Workplace, *Report Of The United States Postal Service Commission On A Safe And Secure Workplace* (New York, NY: National Center On Addiction And Substance Abuse At Columbia University, August 2000), pp. 4, 51-52, accessed on the Internet at <http://www.casacolumbia.org/usr%5Fdoc/33994.pdf>.
14. *Ibid.*
15. *Ibid.*
16. Rick Brooks, "Mail Disorder: Blizzard Of Grievances Add To Package Of Woes At U.S. Postal Service," *Wall Street Journal*, A1, June 22, 2001, accessed on the Internet at interactive.wsj.com/archive/retrieve.cgi?SB993155888396217223.djm.
17. General Accounting Office, "Automation Is Restraining But Not Reducing Costs," GGD-92-58, May 12, 1992, accessed on the Internet at <http://archive.gao.gov/d32t10/146568.pdf>.
18. General Accounting Office, "Automation Is Taking Longer and Producing Less Than Expected," GGD-95-89BR, February 22, 1995, accessed on the Internet at <http://archive.gao.gov/f0902a/153532.PDF>.
19. *Ibid.*, p. 2.
20. Judi Hasson, "IRS Criticized Over Modernization," *Federal Computer Week*, March 7, 2002, accessed on the Internet at <http://www.fcw.com/fcw/articles/2002/0304/web-irs-03-07-02.asp>.
21. U.S. Postal Service, *Annual Report, 2001* (Washington, DC: U.S. Postal Service, 2002), p. 45.
22. John E. Potter, "Remarks by Postmaster General John E. Potter at National Postal Forum," September 23, 2002, accessed on the Internet at http://www.postcom.org/public/2002/pmg_boston_npf.htm.
23. *Ibid.*
24. Rick Brooks, "Amid Cuts, Postman Sometimes Rings Late," *Wall Street Journal*, September 4, 2002, pp. B2, B4.
25. *Ibid.*
26. Bill McAllister, "Postmaster Vows Plant Reductions Won't Spur Layoffs," *Denver Post*, September 30, 2002, accessed on the Internet at <http://www.denverpost.com/cda/article/print/0,1674,36%257E53%257E892098,00.html>. Mr. Potter's testimony was before the Senate Subcommittee on International Security, Proliferation and Federal Services.
27. Mr. Potter provides the number for 2002 in Potter, *op. cit.*
28. Randolph E. Schmid, "Post Office Continues To Cut Costs," *Associated Press*, September 27, 2002, accessed on the Internet at <http://www.washingtonpost.com/wp-dyn/articles/A11810-2002Sep27.html>.
29. Quoted in Glenn J. Kalinowski, "Time Inc. Speaker Says USPS In Decline," *DMNews*, September 27, 2002, accessed on the Internet at http://www.dmnews.com/cgi-bin/artprevbot.cgi?article_id=21675.
30. Melissa Campanelli, "Official Hints At Closings As Group Protests Postal Forum," *DMNews*, September 25, 2002, accessed on the Internet at http://www.dmnews.com/cgi-bin/artprevbot.cgi?article_id=21656.
31. Charles Guy, "The Postal Service's Business Strategy: Spend Savings Now, Raise Rates Later," *Issue Brief*, Lexington Institute, September 16, 2002, accessed on the Internet at <http://www.lexingtoninstitute.org/postal/strategy.htm>.
32. United States Postal Service, *United States Postal Service Transformation Plan*, April 2002, p. 15, accessed on the Internet at <http://www.usps.com/strategicdirection/transform.htm>.
33. *Transformation Plan, op. cit.*, p. H-23.
34. *Ibid.*, p. H-19.
35. *Ibid.*, p. H-28.