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POSTAL REFORM BILLS THAT WOULD NOT DELIVER

Executive Summary

The government-owned U.S. Postal Service insists that it can only become financially healthy if it receives new powers to set postal rates with less regulatory oversight and to move more aggressively beyond its core market of non-urgent letter delivery. Two prominent legislative proposals that would give the Postal Service much of what it seeks are a series of bills known collectively as H.R. 22 that were introduced beginning in the mid 1990s, and a successor bill, H.R. 4970, that was introduced in 2002.

Would legislation similar to these bills provide a sound foundation for postal reform? Now is a good time to ask. The President created a Commission on the U.S. Postal Service last December, and the Commission is scheduled to issue recommendations by the end of July.

The Postal Service's financial problems are mainly due to its high costs, not restrictions on its rates or on expansion. Unfortunately, both H.R. 22 and H.R. 4970 virtually ignore the Postal Service's costs. One of the main reasons why the labor-intensive Postal Service has high costs is that it pays its workers much more than the same workers would earn in the private sector. Both H.R. 22 and H.R. 4970, however, promise *not* to touch the postal pay premium. If anything, the bills would make it harder to control labor costs by placing a union appointee on the Postal Service's Board. High labor costs could be made less burdensome by easing restrictions in current law that limit postal worker productivity, but neither bill contains pro-productivity reforms. Nor does either bill include reforms for reducing the Postal Service's nonlabor costs.

Expansion and greater price setting power are questionable in any case and particularly ill-advised when dealing with a government agency burdened with cost problems. A more fruitful legislative approach would be to ease various provisions in current law that push the Postal Service's labor costs above those for comparable work in the private sector, increase its nonlabor costs, and hold down its productivity. Bills like H.R. 22 and H.R. 4970 would almost certainly fail to meet their objectives of strengthening the Postal Service financially while keeping postal rates low.

POSTAL REFORM BILLS THAT WOULD NOT DELIVER

The Postal Service has argued for many years that it can only become financially healthy if it receives new powers both to set postal rates with less regulatory oversight and to move more aggressively into competitive markets beyond its core monopoly market of non-urgent letter delivery. These changes, which would require congressional legislation, are controversial because current restrictions were enacted out of concern that the Postal Service could abuse its powers as both a government-owned enterprise and the possessor of a huge statutory monopoly.

Beginning in the mid-1990s, the House Postal Service Subcommittee, under Chairman John M. McHugh (R-NY), considered a series of bills to try to reform the Postal Service and strengthen its finances and operations. The bills, collectively known as H.R. 22, were an effort to forge a compromise that would be acceptable to the Postal Service, postal unions, large mailers, and others. Among other things, the bills would have let the Postal Service change its rates with less regulatory control and given it more authority to expand in competitive markets. The bills also included various provisions that, it was hoped, would protect the Postal Service's workers, customers, and competitors. H.R. 22 was a major legislative effort, but it never advanced beyond the (since disbanded) Postal Service Subcommittee. A successor bill, H.R. 4970, "The Postal Accountability and Enhancement Act", was introduced in 2002, and was voted down in the full House Government Reform Committee in June of that year. Postal issues are still of concern to the Government Reform Committee, however, and Representative McHugh was selected this year to lead the Committee's Special Panel on Postal Reform and Oversight.

Why the bills are still worth examining. So far this year, the legislation receiving the most attention concerns the Postal Service's contributions for its retirees' pensions.[1] H.R. 22 and H.R. 4970 are still frequently mentioned, however, as possible blueprints for further postal reform. The Postal Service continues to insist that the bills' general approach is correct, namely, that the government agency needs a freer hand with regard to pricing and expansion if it is to be financially viable and deliver satisfactory service in the long run. The Postal Service argued along these lines in the "Transformation Plan" it released in April 2002, and it has made similar points before the Presidential Commission on the U.S. Postal Service.

President Bush created the Commission on the U.S. Postal Service in December 2002, and directed it to issue recommendations by July 31. The Commission was established primarily because of concern about the Postal Service's finances, but it was also given a broad mandate to consider what role might be appropriate for the Postal Service in the 21st century. The approach taken in H.R. 22 and H.R. 4970 is among the many ideas the Commission is examining.

Given how often H.R. 22 and H.R. 4970 are mentioned in discussions of postal reform, this Advisory explores whether these or similar bills would provide a solid foundation for improving the Postal Service. It concludes that they would not, and suggests that an alternative direction for reform would better serve postal customers, taxpayers, and the Postal Service.

Understanding why the Postal Service's finances are so shaky. The primary sources of the Postal Service's chronic financial difficulties are its high costs and lagging productivity. For example, although the Postal Service regularly complains that it needs greater pricing flexibility and more products to boost its revenues, it recorded increasing revenues in every year from 1972 (when the old Post Office Department became the Postal Service) to 2002. Nevertheless, because costs usually outstripped revenues, the government agency reported losing money almost two-thirds of the time during that period (in 20 out of 31 years).[2] The financial potency of determined cost management was demonstrated in 2002. Although the year was extremely difficult for the Postal Service because of the recession and the anthrax attacks, the agency used cost cutting — not any new powers over prices and expansion — to hold its loss to $676 million, after earlier warning that the loss might hit $4.5 billion.

How might legislation help manage costs? The Postal Service is a labor intensive organization: over three-fourths of its expenditures are labor related. Consequently, postal wages and benefits have a massive impact on the organization's bottom line.

Most economists who have studied labor compensation at the Postal Service have concluded that postal workers receive much more than the same workers would earn in the private sector (not in every case, but on average). Many neutral, third-party arbitrators have made similar determinations based on the evidence.[3] The extra pay is often called the postal pay premium.

Because the Postal Service is so labor intensive, legislation that helped better to match postal compensation with private sector compensation would yield enormous financial benefits. There are many techniques that could be used to bring postal wages and benefits closer to those in the private sector, if the political will is present.[4]

Productivity is also extremely important. High productivity can to some degree offset high labor costs. When workers are very productive and make large contributions to output, they are worth more than if they were less productive and contributed less to output. A worker who increases the value of output by $25 an hour is worth twice as much to an employer as a worker who raises the value of output by $12.50 an hour. This means that even if legislation does not reduce the postal pay premium, it could still ease the financial burden created by high labor costs if it leads to improved labor productivity.

The Postal Service also has many nonlabor expenses, such as for buildings, equipment, and transportation. Although these are less than one-quarter of total costs, the agency is so large that nonlabor costs still totaled about $15 billion in 2001. Accordingly, legislation could also improve the Postal Service's bottom line if it enables the agency get to a better handle on its nonlabor expenses.

Would H.R. 22 or H.R. 4970 have reduced the postal pay premium? The answer is no. The bills would have left in place the rules and procedures that have caused postal wages and benefits to substantially exceed compensation in the private sector. Each bill contains explicit language in two places promising to avoid wage and benefit issues. For instance, one of the admonitions in H.R. 4970 reads:

> NONINTERFERENCE WITH COLLECTIVE BARGAINING AGREEMENTS. — Nothing in this Act or any amendment made by this Act shall restrict, expand, or otherwise affect any of the rights, privileges, or benefits of either employees of or labor organizations representing employees of the United States Postal Service under chapter 12 of title 39, United States Code, the National Labor Relations Act, any handbook or manual affecting employee labor relations within the United States Postal Service, or any collective bargaining agreement. [Capitalization in original.][5]

H.R. 22 and H.R. 4970 would have further protected high postal wages and benefits by granting a union appointee one of the seats on the Postal Service's Board of Governors (which H.R. 22 would have renamed the Board of Directors).[6] Moreover, the bills would have let the unions keep their appointee on a short leash by limiting that appointee's term to three years, instead of the usual nine.

Although the decision not to tackle labor costs may be understandable politically, it gravely undercuts the potential of the proposals to strengthen the Postal Service financially.

Would either bill have removed current-law restrictions that lower worker productivity? If postal pay remains high, the next best option would be to look for ways to increase labor productivity, in order that postal employees become more valuable on the job. To do this, legislation should seek out provisions in current law that prevent postal workers from carrying out their jobs as well as they might, or in other ways reduce their efficiency. For example, would H.R. 22 or H.R. 4970 have reformed current postal-worker grievance procedures, which now tie up huge quantities of labor and management time and often reduce on-the-job flexibility? Or would they have given the Postal Service greater freedom to assign employees to tasks based on what needs to be done rather than to which craft union a worker belongs? Unfortunately, H.R. 22 and H.R. 4970 included no such pro-productivity reforms.[7]

Would either bill have helped reduce nonlabor costs? At present, the Postal Service spends more than it needs to for nonlabor inputs because of various restrictions Congress has written into law or has imposed via less formal political jawboning. One notorious example is that postal management confronts legal and political obstacles whenever it tries to close a small and inefficient post office, which raises both labor and nonlabor costs. Neither H.R. 22 nor H.R. 4970 contained provisions easing such cost-increasing restrictions. In fact, H.R. 22 reiterated the current-law dictum that "no small post office ... shall be closed solely by reason of operating at a deficit."[8,9]

The bills' rate-setting rules would not lead to lower costs. H.R. 22 and H.R. 4970 were strongly influenced by the Postal Service's insistence that its problems are mainly due to regulatory restrictions on the prices it can charge and on the products it can offer in competitive markets. Some supporters of H.R. 22 and H.R. 4970 may have hoped that although the bills do not specifically address costs, their revised rate-setting procedures would indirectly lower costs by motivating the Postal Service to watch its expenses more carefully. That is unlikely because the Postal Service is a government entity, not a private-sector company.

The difference is very important. Consider how private-sector businesses respond to price regulation. Private-sector businesses normally try to operate as efficiently as possible because greater efficiency rewards the owners with higher profits. A private-sector business loses the profit-driven motivation for efficiency, though, if the business's prices are set by government regulators and if the regulators fix prices so that profits are the same whether the company is efficient or not. Those who study the economics of regulation have long been aware that short-circuiting the profit motive causes this problem. They have often recommended that regulators harness the profit motive and the resulting efficiency gains by letting regulated private-sector enterprises, such as utilities, earn higher profits if they operate efficiently than if they do not.

In contrast, government-owned enterprises like the Postal Service are not strongly motivated by profits. They typically give more weight to political and bureaucratic goals such as keeping political supporters happy and claiming more turf, subject only to the relatively weak financial constraint of breaking even. For that reason, the rate-regulation changes that are major elements of H.R. 22 and H.R. 4970 are unlikely to motivate the Postal Service to strengthen its cost management.[10] A more probable response to looser rate regulation is that the government entity would try to shift more costs onto postal consumers within the monopoly and away from products the organization sells in competitive markets.[11]

Bigger is not better. Supporters of H.R. 22 and H.R. 4970 also hope that letting the Postal Service expand aggressively in competitive markets would be a tonic for its bottom line.[12]

In fact, expansion would tend to hurt financially, not help. The problem is that new ventures in competitive markets would be burdened with above-market labor costs and have the additional handicaps of facing spirited competition from private sector companies that are usually more nimble, innovative, and adept at reading consumer demand than is the Postal Service. A 1998 study by the U.S. General Accounting Office provided a dose of reality when it found that most new Postal Service products introduced in the mid 1990s lost money.[13] Rather than generating profits to stabilize rates within the agency's core market, expansion would tend to produce losses that would push up postal rates faster.

The argument that greater size would lower unit costs rests on the dubious proposition that the already huge Postal Service can become more efficient simply by becoming bigger. Another consideration, which is rarely stated, is that because the Postal Service is a federal entity, it enjoys a variety of indirect government subsidies compared to private-sector businesses. For example, it is exempted from paying many of the taxes that private-sector businesses must pay; it is exempted from paying vehicle licensing fees; and it has a low-cost credit line directly with the U.S. Treasury. These and other hidden subsidies would grow in size if the Postal Service expanded.[14] These hidden government subsidies would help the Postal Service relative to private-sector businesses, but it is unlikely they could overcome the Postal Service's high costs and other shortcomings.

Conclusion. The failure of H.R. 22 and H.R. 4970 to address the Postal Service's high costs and lagging productivity greatly reduces the odds that those or similar bills could meet their stated purpose, which is to put the Postal Service on a solid financial footing while keeping postal rates low. Regrettably, H.R. 22 and H.R. 4970 deliberately steered clear of the types of legislative reforms that would give the Postal Service more control over its spending.

Expansion and greater price setting power are questionable in any case and particularly ill-advised when dealing with a government agency burdened with cost problems. A more fruitful legislative approach would be to ease some of the provisions in current law that have pushed the Postal Service's labor costs above those for comparable work in the private sector, increased its nonlabor costs, and held down its productivity.

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Endnotes

1. In general, postal workers hired before 1984 are covered by the Civil Service Retirement System (CSRS). The General Accounting Office (GAO) was concerned that no accurate accounting existed of the Postal Service's unfunded liabilities for the pensions and health care benefits of its CSRS retirees. Accordingly, it had the federal Office of Personnel Management (OPM) examine the matter. Unexpectedly, it was found that if the Postal Service continues funding CSRS pensions under current-law formulas, it will overfund those obligations by about $100 billion. The investigation confirmed, though, that the Postal Service is underfunding the cost of retirement health benefits for its CSRS workers by $40 billion to $50 billion. Members of Congress quickly responded with two roughly similar measures, H.R. 735 and S. 380, and the Postal Service promised that enactment of such legislation would allow it to delay the next rate increase until 2006. The bills would lower the Postal Service's pension contributions to prevent overfunding there, but they would not address the underfunding of CSRS retirement health benefits. Both Houses of Congress have now passed S. 380, the "Postal Civil Service Retirement System Funding Reform Act of 2003", and the President has indicated he will sign it.

2. U.S. Postal Service, *Annual Report*, various issues. During that period, the Postal Service reported drops in mail volume in 4 years, but in those years rate increases offset the small volume declines. All years are fiscal years.

3. These findings are discussed more fully in an earlier *IRET Congressional Advisory*. See Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No. 131, July 24, 2002.

4. These options are examined in more detail in Michael Schuyler, "How To Bring Postal Compensation Into Line With The Private Sector," *IRET Congressional Advisory*, No. 132, August 28, 2002.

5. Sec. 405(a) of H.R. 4970, the "Postal Accountability and Enhancement Act," 107th Congress, 2d Session. Roughly similar language is also present in Sec. 8G(e) within Sec. 602(b) of the bill. In H.R. 22, the "Postal Modernization Act of 1999," 106th Congress, 1st Session, see Sec. 3733(g) within Sec. 201(a), and Sec. 8G(e) within Sec. 702(b). (The "Postal Modernization Act of 1999," 106th Congress, 1st Session, is the version of H.R. 22 that is cited in this paper.)

6. Sec. 212(b) of H.R. 22, the "Postal Modernization Act of 1999", and Sec. 401(c) of the "Postal Accountability and Enhancement Act".

7. The passage cited above not to "affect any of the rights, privileges, or benefits of either employees of the United States Postal Service, or labor organizations representing employees of the United States Postal Service" covers work rules, not just pay. It means, for instance, that if a bargaining agreement or arbitration decision gives a certain job to one union and prevents supervisors or members of other unions from doing that job, the restriction stays in place.

8. Sec. 2806(a) within Sec. 602(a) of H.R. 22, the "Postal Modernization Act of 1999".

9. The bills do call for several studies, and it is conceivable that one or more of the studies would suggest ways to lower costs and bolster productivity. But a study by itself does not decrease costs or improve productivity. That is dependent on whether the study makes useful recommendations and, if it does, whether Congress and the Postal Service act on those recommendations.

10. To use a bit of technical jargon, postal rates are currently set on a cost-of-service basis. H.R. 22 would replace that with a rate-cap regime. H.R. 4970 would let the regulator choose any "modern" rate-setting procedure, subject to general guidance contained in the bill.

11. Both bills contain rules that would supposedly protect consumers within the monopoly from being forced to cross-subsidize other postal products, but many experts doubt the safeguards would prove effective and workable. Ruth Y. Goldway, a Commissioner on the Postal Rate Commission, which is the agency that would be responsible for attempting to enforce the protections, explains, "I am skeptical that even the best-equipped and well-intentioned regulatory agency will be able successfully to manage a hybrid system whereby half the mail is subject to controls and the other half is not. Accounting and cost allocation methods are arts, not sciences. The last draft postal legislation circulated by the House Committee on Government Reform in 2002 [H.R. 4970] basically threw up its hands and said: ‘Let the regulator figure it out.’ This is not an acceptable approach." (Ruth Y. Goldway, "Comments to the President’s Commission on the United State Postal Service," February 3, 2003, accessed on the Internet at http://www.postcom.org/public/2003/goldway_statement.htm).

12. With regard to non-postal products, early versions of H.R. 22 contained no specific restrictions on Postal Service expansion into those markets (e.g., retail, finance, or transportation activities far removed from mail delivery). Later versions of H.R. 22, and H.R. 4970, would prohibit the ***direct*** participation of the Postal Service in expanded non-postal activities. However, these later versions of H.R. 22 (but not H.R. 4970) contained the major loophole that the Postal Service could expand in these areas indirectly through a "private corporation" that would be wholly owned by the Postal Service.

13. U.S. General Accounting Office, "Development and Inventory of New Products," GAO Report No. GAO/GGD-99-15, November 1998.

14. A curious feature of H.R. 4970 is that it would have made the Postal Service compute "assumed income tax" on its competitive-market products (Sec. 302 of H.R. 4970). The Postal Service would not pay this "assumed income tax" to the IRS, however. Rather, it would keep the funds (in the Postal Service Fund maintained for it at the U.S. Treasury) and could use the funds to support its operations, subject to certain restrictions. Under this scheme, the Postal Service would retain its tax subsidies.

Note: Nothing here is to be construed as necessarily reflecting the views of IRET or as an attempt to aid or hinder the passage of any bill before the Congress.