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WOULD PROPOSED POSTAL SERVICE LEGISLATION HELP BRING DOWN COSTS?

Executive Summary

The House Committee on Government Reform unanimously sent to the House floor "The Postal Accountability and Enhancement Act" (H.R. 4341), and the Senate Committee on Governmental Affairs, also unanimously, sent to the full Senate a bill with many similarities but some differences (S. 2468). These bills would significantly change the legal framework under which the government-owned Postal Service operates.

This paper examines whether the proposals would help the Postal Service deliver mail at lower cost. High costs have troubled the Postal Service throughout its existence and are the main reason for its chronic financial problems. Especially useful would be reforms that scale back statutory restrictions where they conflict with best business practices and that better insulate the Service from political pressure.

A panel modeled on successful military base closing and consolidation commissions would help the Postal Service rationalize its inefficient facility network. The bills, instead, opt for the weaker alternative of letting the Service send Congress a report offering a plan the agency would develop.

There is much evidence that a large postal pay premium exists, relative to compensation in the private sector. Because over three-fourths of the Service's costs are labor related, narrowing the premium could save billions of dollars yearly. H.R. 4341 and S. 2468, however, largely avoid this issue. S. 2468 does call for trimming disability benefits, which is a sensible reform. H.R. 4341, though, could hinder future efforts to control labor costs by reserving for a postal-union nominee one of the seats on the Postal Service's Board of Governors.

The bills would save the Service several billion dollars yearly by reducing its contributions towards pension benefits. First, the bills would end an escrow account now that Congress is satisfied regarding how the funds would be used. More controversially, a provision opposed by the Office of Personnel Management and the Treasury would shift certain pension liabilities from the Postal Service to the Treasury. Although that within-government transfer would lower the Postal Service's costs, it would not be a cost saving for the government as a whole.

With regard to reducing costs through greater efficiency and less waste, the bills are disappointing. A few small steps in the right direction are included, but big reforms are lacking.

Other provisions of the bills, some quite worthwhile, will be reviewed in later papers.

WOULD PROPOSED POSTAL SERVICE LEGISLATION HELP BRING DOWN COSTS?

The odds have increased that Congress will pass a postal reform bill this year that will significantly change the legal framework within which the Postal Service operates. On May 12, the House Committee on Government Reform reported out, on a 40 to 0 vote, a postal bill (H.R. 4341, "The Postal Accountability and Enhancement Act") primarily developed by Rep. John McHugh (R-NY). Three weeks later, on June 2, the Senate Committee on Governmental Affairs approved, on a 17 to 0 vote, a bill (S. 2468) with many similarities but some differences, which was introduced by Sen. Susan Collins (R-ME), who heads the committee, and Sen. Thomas Carper (D-DE).

This paper asks if the bills address one of the Postal Service's main weaknesses: high costs. The bills would also make many other changes, some quite worthwhile, that will be examined in later papers.

Burdensome costs are a characteristic of government enterprises, and the Postal Service, which is owned and operated by the federal government, is no exception. As economists recognize, one reason government enterprises so often have cost problems is that they lack the normal profit and loss incentives provided by private ownership and the free market system.[1] In addition, even when the managers of these enterprises know of ways to cut costs and would like to implement them, their hands are often tied by political constraints. Typically, some politically-based restrictions on effective cost management are codified in law while others are felt through political jawboning.

At many government enterprises, high costs translate into persistent financial problems. That is true for the Postal Service. The Postal Service would be in superb financial shape if revenues rather than costs had been driving its finances. Sheltered by its dual statutory monopolies on non-urgent letter delivery and access to mailboxes, the Postal Service and its predecessor, the Post Office Department, have not experienced a year-over-year decline in sales revenues in more than half a century.[2] Notwithstanding its strength on the revenue side, however, the government mail service has generally been in financial hot water since the 1830s.[3]

For the past three years, mail volume (although not revenues) have declined due to the combination of the last recession, the anthrax attacks, and the growing use of the Internet and other electronic substitutes for mail service. Although electronic diversion cannot explain the Postal Service's long-term difficulties, it is a new source of stress that adds to the desirability of bringing the Service's costs under better control.

Costs have been lowered using current law, but more could be done if well-crafted legislation provided additional tools. Under Postmaster General John Potter, who took office in 2001, the Postal Service has made significant progress on the cost front. The most visible indicator is that total postal employment, which peaked at 906,000 in 1999, was down to 827,000 by 2003, a drop of 79,000.[4] Because of this cost-cutting effort, the government-owned mail service saw a year-over-year decrease in costs in 2002,[5] the first such decrease since the mid-1950s. Of course, the ability of the agency to quickly reduce total employees by 8.7% while maintaining service standards is evidence that the organization had an abundance of fat that should have been cut long ago.

Congress could lead the Postal Service to large additional cost savings if it were willing to enact legislation that includes key cost-management reforms. One of the most urgent needs is to scale back or remove various current-law restrictions that push up the Service's expenses without improving postal service. Major gains could also be achieved by better insulating the Service from political pressure when it tries to rationalize its sprawling, out-of-date network of facilities. To the maximum degree possible, the legislation should provide for transparency to increase public confidence that cost management decisions are made in a fair and sensible manner.

Costs of the Postal Service's facility network. The Postmaster General, the U.S. General Accounting Office (GAO)[6], the President's Commission on the U.S. Postal Service[7] and most others who have studied the organization[8] have reached the conclusion that agency has many excess facilities, a number of facilities in the wrong locations, and many that are poorly designed. A significant obstacle to rationalization, however, is that members of Congress often to feel an obligation to do what they can to defend Postal Service facilities and jobs located within their districts.

An excellent method for addressing the political problem while providing a fair and objective forum in which to examine the Postal Service's facility needs would be to establish a postal facility rationalization commission modeled on the lines of successful military base closing and consolidation commissions. Senator Carper included provisions establishing such a commission in legislation he introduced last year[9], and the President's Commission on the U.S. Postal Service strongly recommended creating such a commission[10]. In Congressional testimony, however, Postmaster General Potter insisted that the Service is the best judge of its needs regarding facilities and that decisions about facility rationalization should be done in-house.[11] With some members of Congress also unenthusiastic about a facility rationalization commission, the commission is not in either bill introduced this year. Instead, the House bill would require the Postal Service to submit a report within 16 months on facility rationalization, including a discussion of "statutory or regulatory obstacles"[12], and the Senate bill would require the Postal Service to explain its "long-term vision" for facility rationalization as part of a report on its performance goals[13]. Although reports to Congress can be useful, they are a much weaker legislative option than establishing a rationalization commission, and they fail to provide much insulation from political pressure when it comes time to make decisions. Further, having the Postal Service develop the plan concentrates more power within the agency and provides for less openness and transparency than if an independent commission were given the task.

Supply and contracting costs. The bills are largely silent in this area. However, one provision in the House bill would permit the Service to negotiate directly with airlines regarding how much it pays for international mail transportation, rather than continuing the current practice of having the Transportation Department set the airlines' rates.[14] This will yield some savings if the Postal Service is correct in its belief that the Transportation Department has approved rates for the airlines that are significantly above market rates. The Senate bill contains no comparable provision.

Labor costs. The Postal Reorganization Act of 1970 directs that Postal Service pay should be comparable to that in the private sector.[15] However, most economists who have examined wages and benefits at the Postal Service have concluded that a substantial postal pay premium exists, relative to the wages and benefits of comparable workers in the private sector.[16] Several of the more recent economic studies have found a postal pay premium, compared to the private sector, in the range of 25%-35%. The President's Commission on the U.S. Postal Service did not issue a formal finding regarding a postal pay premium but cited strong evidence that one exists: "a backlog of some 400,000 job applicants" in July 2001, "virtually no turnover", "average annual *total* compensation, including both wages and benefits, for postal clerks and for city letter carriers ... [of] nearly $60,000" [italics in original], and the "job security" of government employment, creating a "'best of both worlds'" pay package.[17] Another suggestive piece of evidence, cited by labor arbitrator Stephen Goldberg is that based on a Postal Service survey, "The average wage increase for all Postal Service new hires was 28.4% ... [which was] substantially higher than the private sector 4%."[18]

The postal pay premium is a very big issue in terms of the Postal Service's economics because the premium is estimated to be so large and labor expenses are such a big share of the Postal Service's total costs, over 75%. Given the Service's labor-related costs in 2003[19], a postal pay premium of 25%, which is below many estimates, would mean that the agency is spending over $10 billion ***extra every year*** on labor costs, compared to pay comparability. If such a premium did not exist, the agency could sharply lower rates ***and*** simultaneously record a large profit.

In examining the legal framework under which the Service currently operates, the President's Commission found that, "Unlike their private-sector counterparts ...total compensation costs [at the Postal Service] are largely outside management's control.[20] A key factor is that when the Service and a union cannot reach a collective bargaining agreement, an arbitrator sets wages, some benefits, and various other conditions. The Commission mentions other factors that push up labor costs, such as rigid work rules and "retiree health care and pension benefits [that] are effectively 'off the table' of collective bargaining" because they are set by statute[21].

The Commission offered a number of recommendations for moving toward best business practices in the determination of postal compensation, with an emphasis on new workers and gradual change over time. Whether or not the Commission's specific recommendations are accepted, however, this is an area where statutory reforms could achieve major cost savings.

Regrettably from an economic perspective, the bills introduced in the House and Senate tread very lightly in this area. The Senate bill would scale back disability compensation on a prospective basis.[22] This is a worthwhile reform, but it is unfortunate that this is the only significant provision in either bill specifically crafted to bring down labor costs. Both bills would add a mediation stage in collective-bargaining disputes.[23] This change is sensible, but it is modest.

William Burrus, President of the American Postal Workers Union (APWU), points to a number of recommendations made by the President's Commission that are absent from the House (or Senate) bill. Among the omitted Commission recommendations in the labor compensation area, as Mr. Burrus describes them, are: giving a regulator "the power to cut wages and benefits in order to make them 'comparable' to workers in the private sector"; "[m]aking health care and retirement benefits — now guaranteed by law — 'negotiable'; "[e]liminating the union's no-layoff clause and making new hires subject to federal reduction-in-force (RIF) procedures;" and "[u]ndermining collective bargaining rights by changing the ground rules for contract negotiations"[24]

One provision in the House bill could make it more difficult than at present to control labor costs and would certainly increase union power. Although H.R. 4143 says that the Postal Service's Board of "Governors shall represent the public interest generally" and "not be representatives of specific interests using the Postal Service"[25], the bill would require that one Governor be chosen by the postal unions.[26]

Faced with high internal costs, mostly for labor, the Postal Service has greatly reduced its expenses, by billions of dollars, through worksharing arrangements.[27] Under worksharing, a mailer agrees to help process its mail in return for a discounted postal rate. Worksharing allows both the Postal Service and the mailer to save money if two conditions are met: the mailer can do the work at less cost than the Postal Service and the discount divides the cost saving between the parties. The House and Senate bills would require, with some exceptions, that worksharing discounts not exceed the costs the Service avoids.[28] This requirement makes economic sense in that the whole idea behind worksharing is to create a win-win situation by saving money for both sides through a more efficient allocation of mail-processing work. Having the Postal Service's regulator monitor whether worksharing arrangements meet this test also makes sense, in that it is consistent with objectivity and transparency. To do its job well, it will be important for the regulator to make careful determinations of whether proposed worksharing agreements would save money for the Postal Service and, for proposed agreements which pass that test, to allow them to proceed.

Pension costs. The pension coverage for postal workers hired before 1984 is generally provided under the Civil Service Retirement System (CSRS). In 2002, the federal Office of Personnel Management (OPM), in consultation with GAO, conducted a special study comparing the amounts needed to fund CSRS pension benefits against the sum of the Postal Service's contributions and the interest earnings on those contributions. OPM discovered a huge difference in the results depending on whether interest earnings were computed using actual interest rates or the 5% rate that was assumed under the funding method required by statute.[29] OPM's finding meant that if Congress decided to change the law so that interest earnings reflected actual interest rates, not 5%, the Postal Service could save several billion dollars yearly in its payments to the U.S. Treasury for CSRS pension benefits.[30]

Congress did approve this statutory change in 2003[31], but as part of the legislative package (1) it required that savings after 2005 go into an escrow account pending submission of a satisfactory Postal Service plan regarding how to use the cost savings, and (2) it transferred from the Treasury to the Postal Service responsibility for the increased CSRS benefits paid to some postal employees as a result of their years in the military.[32]

Both H.R. 4341 and S. 2468 would free post-2005 savings from the escrow account.[33] Because the Service has apparently satisfied Congress regarding how the funds would be used, repealing the escrow account seems reasonable.

More controversially, the bills would also relieve the Postal Service of responsibility for the higher CSRS pensions of some postal employees due to credits for military time (shifting that expense back to the U.S. Treasury). This change is supported by the Postal Service and recommended by the President's Commission[34]. However, it is opposed by OPM, which administers most federal-employee retirement programs, and the U.S. Treasury[35], which regard the 2003 pension legislation as a package deal that retroactively changed the interest rate used in the Postal Service's pension liability calculations provided the Service assumed responsibility for military-time credits. The issue is difficult to sort out because military service raises the CSRS benefits of certain Postal Service annuitants, but the annuitants qualify for CSRS due to their Postal Service employment and would not receive CSRS benefits if they only served in the military. Should the credits be viewed as a fringe benefit of military service or Postal employment? Also, CSRS does not usually charge civilian agencies for the higher benefits of their annuitants due to military credits, but the newer Federal Employee Retirement System (FERS), which applies to most civilian federal employees (including those of the Postal Service) hired since the mid 1980s, does. Should that distinction control what is done here? Further, given the other changes in the 2003 pension legislation, would altering the package now be unfair to taxpayers relative to mail users? In examining the matter, GAO noted that the issues are complicated, and concluded that each position is defensible despite some flaws.[36]

Whatever one's position, however, two points about the consequences of relieving the Postal Service of this responsibility should be understood. First, it is a big-ticket item. The Postal Service's bottom line was greatly helped by the 2003 pension legislation, and this would give it an additional lift. To provide an idea of the dollar magnitudes involved, consider it in terms of the Postal Service's unfunded liabilities. Unfunded liabilities are obligations incurred as a result of past and current operations but not yet paid. The President's Commission estimated that the Postal Service's unfunded liabilities totaled $93 billion as of May 2003.[37] (Yes, that is a big number.) If the pension costs at issue are transferred from the Postal Service to the Treasury, the Postal Service's unfunded liabilities would drop to around $65 billion. Second, the proposed legislation would not remove this cost from the government as a whole, but shift it within the government (i.e., the overall cost saving for the federal government would be zero). The Postal Service (and ultimately ratepayers) would owe less but the Treasury (and ultimately taxpayers) would owe that much more.

Indirect effect of transparency on costs. A number of provisions in the bills attempt to increase the transparency of the Postal Service's financial reporting, with particular emphasis on accurate cost accounting.[38] Transparency does not directly reduce costs. However, the improved knowledge that results from greater transparency should help those inside and outside the agency spot expenditure-related problems more quickly and clearly, which may lead to more effective cost-control efforts.

Conclusion. The Postal Service has suffered financial problems throughout its history, due primarily to high costs. The agency could improve its efficiency and lower many of those costs if not for restrictions imposed by statute or by informal political pressure. Accordingly, one of the most promising avenues for meaningful postal reform would be to enact legislation removing some of those barriers to efficiency and cost effectiveness.

Bills introduced this year in the House and Senate would revamp the statutory framework under which the Postal Service operates. An area in which they would do relatively little, however, is remove barriers to greater efficiency and more effective cost management. Although one title in the bills dealing with pensions would provide the Service with a major cost saving and financial boost, it would accomplish that chiefly by shifting cost obligations within the federal government, not by reducing the federal government's overall expenses. With regard to bringing down the Postal Service's expenditures by allowing it to pursue more effective cost management (i.e., reducing government waste), the bills are major disappointments. The Senate version is somewhat better than the House version in that regard.

This paper is not intended to provide an overall assessment of the two legislative proposals. The focus here is on costs. While costs are extremely important, the bills also cover many other areas. On issues like transparency and focusing the Postal Service on its core mission, which will be examined in later papers, the bills do have some desirable features.

Michael Schuyler
Senior Economist

Endnotes

1. As economist Rick Geddes discusses in a recent study, an awareness of the inherent inefficiency of government ownership has led a number of economists who have closely examined the Postal Service to recommend that the organization be privatized. (See Rick Geddes, "Do Vital Economists Reach A Policy Conclusion On Postal Reform?" *Econ Journal Watch*, Volume 1, Number 1, April 2004, pp. 61-81, accessed on the Internet at http://www.econjournalwatch.org/pdf/Geddes%20Do%20Economists%20April%202004.pdf.) In a book evaluating the Postal Service's performance since it was created from the old Post Office Department, Geddes presents his own proposal for privatization. (See Rick Geddes, *Saving The Mail: How To Solve The Problems Of The U.S. Postal Service* (Washington, DC: The AEI Press, 2003), esp. ch. 5 and 7.) Currently, however, there is little support for privatization among the general public or in Congress and the Administration. (For the results of one public opinion survey, see President's Commission on the United States Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, pp. 18-20, accessed on the Internet at http://www.treas.gov/offices/ domestic-finance/ usps/pdf/report.pdf.)

2. U.S. Postal Service, *Annual Report*, various issues; and U.S. Bureau Of The Census, *Historical Statistics Of The United States: Colonial Times To 1970*, Vol. 2 (Washington, DC: Government Printing Office, 1975), p. 804.

3. Postal Service, *Annual Report*, various issues; and *Historical Statistics, op. cit.*.

4. U.S. Postal Service, *Annual Report, 2003*, p. 58, accessed on the Internet at http://www.usps.com/history/anrpt03/2003ar.pdf. The reduction was primarily accomplished through attrition and buyouts, without layoffs.

5. *Ibid.*, p. 60. Costs also decreased in 2003, but that year-over-year decline was due to a change in law (the Postal Civil Service Retirement System Funding Reform Act of 2003, PL 108-18) which lowered the contributions the Postal Service must make for certain employee pensions. (See *Ibid.*, p. 21.)

6. See David M. Walker, Comptroller General of the United States, United States General Accounting Office, "Bold Action Needed To Continue Progress On Postal Transformation," Testimony of David M. Walker, before the Senate Committee on Governmental Affairs, GAO-04-108T, November 5, 2003, accessed on the Internet at http://www.gao.gov/new.items/d04108t.pdf.

7. President's Commission on the U.S. Postal Service, *op. cit.*, ch. 5.

8. See, for example, Lexington Institute, "Eleven Former BRAC Commissioners Endorse Plan to Close Unneeded Postal Facilities," Press Release, October 1, 2003, accessed on the Internet at http://www.lexingtoninstitute.org/postal/pr031001.htm.

9. S. 1285, sections 303-306, introduced June 18, 2003.

10. President's Commission on the U.S. Postal Service, *op. cit.*, esp. p. 80.

11. John E. Potter, Postmaster General/CEO, United States Postal Service, "Testimony of John E. Potter," before the Committee on Governmental Affairs, United States Senate, November 5, 2003, accessed on the Internet at http://www.usps.com/communications/news/speeches/2003/sp03_pmg1105.pdf; and John E. Potter, Postmaster General/CEO, United States Postal Service, "Testimony of John E. Potter," before the Special Panel on Postal Reform and Oversight, Committee on Government Reform, United States House of Representatives, January 28, 2004 accessed on the Internet via http://www.usps.com/communications/news/speeches/welcome.htm.

12. H.R. 4341, Sec. 709.

13. S. 2468, Sec. 302.

14. H.R. 4341, Sec. 805.

15. Postal Reorganization Act of 1970 (PL 91-375), sec. 101(c) and 1003(a).

16. For a survey of economic studies in this area, see Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No. 131, July 24, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-131.PDF. Of course, the postal pay premium is an average; in some specialized areas where private-sector pay is high and the Postal Service has difficulty attracting and retaining qualified workers, there does not appear to be a pay premium.

17. President's Commission on the U.S. Postal Service, *op cit.*, p. 109.

18. 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.

19. U.S. Postal Service, *Annual Report, 2003*, p. 26.

20. President's Commission on the U.S. Postal Service, *op. cit.*, p. 110.

21. *Ibid.*

22. *Ibid.*, sec. 901-902.

23. S. 2468, sec. 505 and H.R. 4341, sec. 407.

24. William Burrus, President, American Postal Workers Union, "House Committee Adopts Postal Reform Bill; Rejects Recommendations of President's Commission," *Burrus Update*, No. 7-2004, May 13, 2004, accessed on the Internet at http://www.apwu.org/burrusupdates/2004/Update%2007-2004.htm.

25. H.R. 4341, sec. 401(a).

26. H.R. 4341, 401(c). The Governor selected with the "unanimous concurrence" of the unions would have a shorter-than-normal term of only 3 years, which would have the effect of keeping that Governor on a short leash.

27. 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 fWissenschaftliches Institut für Kommunikationsdienste GmbH (WIK), 6th Köenigswinter 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.

28. H.R. 4341, sec. 206 and S. 2468, sec. 201.

29. Postal Service, *Annual Report*, 2002, p. 50.

30. *Ibid.*

31. Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18).

32. The size of a Postal Service pensioner's defined benefit pension is based, in part, on the employee's length of service. As a federal entity, the Postal Service counts time in the military towards years of service when computing these pension benefits. (If the Postal Service were a private company and not part of the federal government, it almost surely would not include time in the military when determining the size of its employees' pensions.)

33. H.R. 4341, sec. 903 and S. 2468, sec. 804.

34. President's Commission On The U.S. Postal Service, *op. cit.*, pp. 125-126.

35. See John W. Snow,"Hearing Testimony, The Honorable John W. Snow, Secretary Of The Treasury, On Reform Of The United States Postal Service," before a Joint Session of the Committee On Government Reform, United States House Of Representatives and Committee On Governmental Affairs, United States Senate, March 23, 2004, accessed on the Internet at http://www.treas.gov/press/releases/js1255.htm?IMAGE.X=20\&IMAGE.Y=12.

36. See U.S. General Accounting Office, "Postal Pension Funding Reform: Review of Military Service Funding Proposals," GAO-04-281, November 2003, accessed on the Internet via http://www.gao.gov.

37. President's Commission On The U.S. Postal Service, *op. cit.*, p. 4.

38. See, for example, H.R. 4341, sec. 103 and the accounting recommendations to be developed by the Secretary of the Treasury under sec. 301.