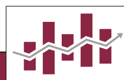

EPI BRIEFING PAPER

ECONOMIC POLICY INSTITUTE • JULY 22, 2010 • BRIEFING PAPER #268

CONGRESSIONAL MANDATES ACCOUNT FOR MOST OF POSTAL SERVICE'S RECENT LOSSES

BY FRANK CLEMENTE AND TOM KILEY

The United States Postal Service (USPS) incurred operating losses in 2007, 2008, and 2009, prompting some observers to declare the agency in a fight for its survival.[1] There is no question that the USPS faces long-term challenges that it must overcome in order to remain financially self-sustaining in the 21st century. First among these challenges is Americans' increasing use of the Internet for digital, rather than physical, mail delivery.

But these long-term challenges are not the principal cause of the USPS's recent losses. A 2006 Congressional mandate that the USPS pre-fund its retiree health benefits—a requirement imposed on no other government entity or private-sector company—accounted for all of the operating losses in 2007 and 2008 and a significant portion of the operating loss in 2009. In 2009, the recession accounted for the rest of the loss, as it sent USPS revenues plunging by over 9%.

The retiree health pre-funding mandate places a unique and counterproductive burden on the USPS, particularly at a time when it needs more flexibility and financial breathing room to plan for a viable future. For example, the Postmaster General has proposed eliminating Saturday delivery in order to achieve cost reductions in the short-term. Eliminating Saturday delivery would cost roughly 80,000 jobs[2] at a time of high unemployment and would negatively affect postal customers who rely on six-day delivery. Were it not for the retiree health pre-funding mandate, the USPS would not face the same short-term pressure that has led the Postmaster General to propose cutting Saturday delivery.

There is a course of action that would enable the USPS to fully fund its retiree health benefits without making the required annual payments from its operating funds. As the USPS Inspector General recently reported, the USPS has made $75 billion in overpayments to the federal government to cover its share of its employee pension

TABLE OF CONTENTS

An onerous pre-funding mandate on the USPS....2
Prudent management of retiree benefits by USPS....4
USPS pension overpayment should be used to fund retiree health benefits....4
Putting retiree health benefits on a pay-as-you-go basis....6
Loss of Saturday delivery puts 80,000 jobs at risk....6
Conclusion....7

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costs. If this $75 billion were restored to the USPS, it would enable the agency to fully fund its retiree health benefits *and* retire the debt it has accrued since 2006 as a result of the pre-funding requirement.

This Policy Memorandum argues that the Postal Service's finances have been prudently managed in recent years. It offers proposals for freeing the USPS of its unfair pre-funding mandate, including returning the $75 billion in pension overpayments that rightfully belong to the Postal Service. It then explains that cutting Saturday delivery should not be undertaken without a serious consideration of the implications of such a drastic action for the Postal Service's customers and employees.

An onerous pre-funding mandate on the USPS

In 2006, Congress approved and President George W. Bush signed the Postal Accountability and Enhancement Act (PAEA), P.L. 109-435. The legislation required the USPS to pay $55.8 billion into the Postal Service Retiree Health Benefit Fund between fiscal years 2007 and 2016.[3] This is an average of $5.58 billion per year. In effect, the law required that the USPS pre-fund 73% of its retiree health benefits—a 75-year obligation—on an extremely compressed timetable.[4] (The USPS pays up to 75% of the cost of health premiums for its eligible retired workers (Hay Group 2009).)

To put this in perspective, no other federal government agency, and no private-sector company, must pre-fund retiree health benefits *at all*, let alone at an accelerated rate. Government entities and private companies are free to pay retiree health benefits on a pay-as-you-go basis, out of their annual revenues. A Watson Wyatt survey of 591 Fortune 1,000 companies found that, of companies that sponsor postretirement health benefits, nearly two-thirds do not pre-fund at all (Watson Wyatt Worldwide 2009).

Among the firms in the Watson Wyatt survey that do pre-fund non-pension post-retirement benefits, including health care, the average funded status of these plans—that is, the ratio of assets to obligations—was 28% in 2008. The Postal Service has already set aside $35.5 billion for future retirees' health benefits. With $87.5 billion in total obligations, the Postal Service Retiree Health Benefit Fund is therefore 41% funded—enough to cover all benefits through at least 2025 (GAO 2010).

These aggressive pre-funding mandates explain *all* of the USPS's losses in fiscal years 2007 and 2008, as **Table 1** shows. **Figure A** shows how costs for retiree health benefits surged between 2006 and 2007, from $1.6 billion to over $10 billion, because of the addition of roughly

TABLE 1

Selected USPS financial data, including retiree health expense, 2004-09 ($billions)

Fiscal year	2004	2005	2006	2007*	2008	2009
Operating revenue	$68,996	$69,907	$72,650	$74,778	$74,932	$68,090
Total operating expenses, without P.L. 109-435 req'ts	65,851	68,281	71,681	71,747	72,138	70,430
Income (loss) from operations, without P.L. 109-435 req'ts	3,145	1,626	$969	3,031	2,794	(2,340)
Impact of P.L. 109-435 req'ts	-	-	-	8,358	5,600	1,400
Total operating expenses, with P.L. 109-435 req'ts	65,851	68,281	71,681	80,105	77,738	71,830
Income (loss) from operations, with P.L. 109-435 req'ts	3,145	1,626.00	969	(5,327)	(2,806)	(3,740)

* Retiree health benefits in 2007 included a $2.98 billion amount paid in 2006 into the PRHBF from an escrow account that had been established by a 2003 law and subsequently eliminated by the PAEA.

SOURCE: Authors' analysis of USPS Annual Reports for fiscal years 2004-09.

$8.4 billion in pre-funding requirements.[5] As a share of revenues, retiree health benefits therefore increased from 2.25% to an astonishing 13.5% before falling to nearly 10% in 2008, when the total pre-funding requirement cost the USPS roughly $5.6 billion (while health benefits for current retirees cost the remaining $1.8 billion).

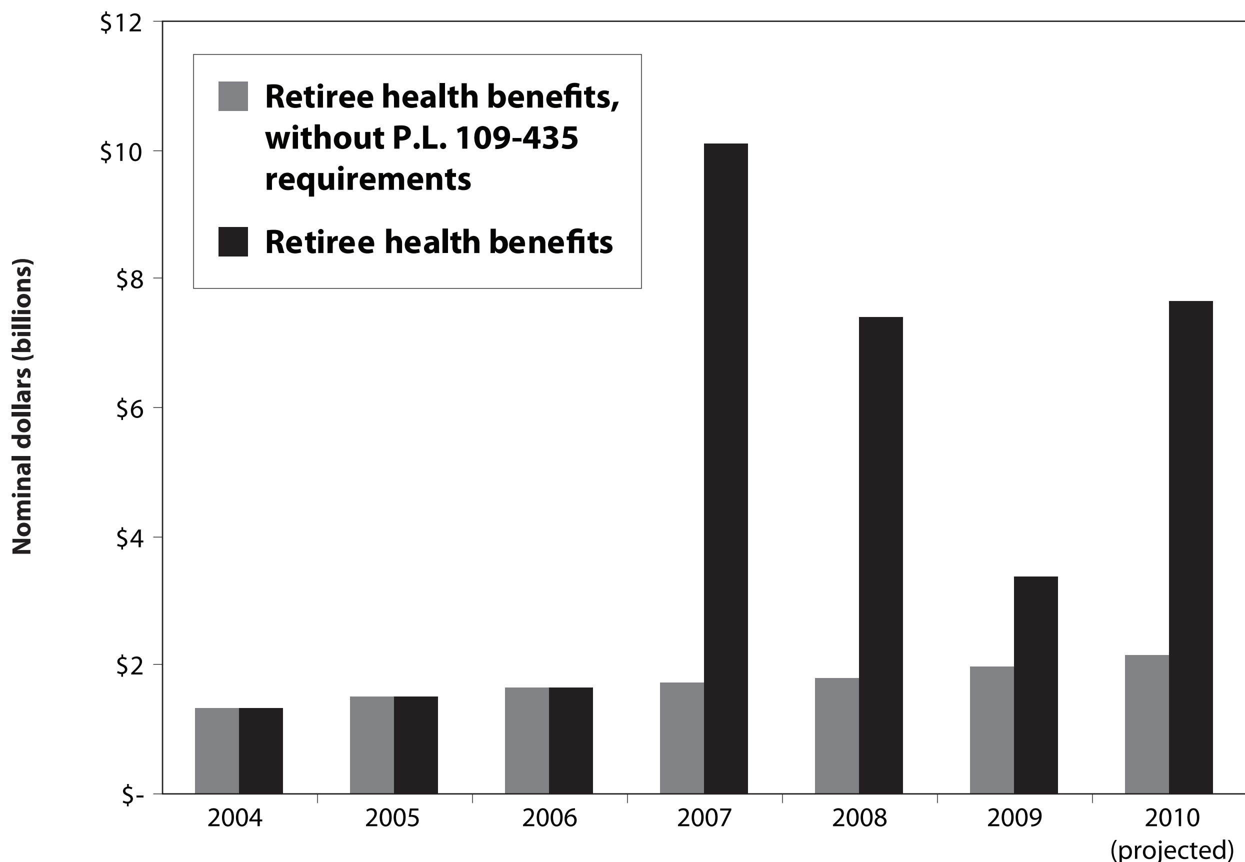
As a result of these health pre-funding mandates, the USPS lost $5.3 billion, on an operating basis, in 2007 and $2.8 billion in 2008. Without these mandates, the losses in 2007 and 2008 become operating income of over $5.8 billion. In fact, the Postal Service's operating margin excluding the retiree health benefits actually increased significantly between 2006 and 2007, remaining roughly stable into 2008.

In 2009, Congress provided some temporary relief to the USPS from its pre-funding mandate, and the agency's loss was tempered: It lost $3.7 billion on an operating basis. Without the (albeit reduced) pre-funding mandate, the agency would have lost $2.3 billion. It is not hard to see why: between 2008 and 2009, the severe U.S. recession sent USPS revenues plummeting by more than 9%; although the USPS achieved significant cost reductions over that same period, they were not enough to offset lower revenues. It should be noted that nearly one in five companies among the Fortune 500 also experienced losses in 2009, up from roughly 11% in 2007.[6]

The Postal Service estimates that at least $50 billion can be saved over the next 10 years by eliminating the retiree health pre-funding requirement (USPS 2010). Clearly, an obligation of this scale would put enormous pressure on any company, particularly when the economy remains weak. No company would make pre-funding a

FIGURE A

USPS retiree health expense, with and without pre-funding mandate, 2004-09



SOURCE: Authors' analysis of USPS Annual Reports for fiscal years 2004-09.

priority in a difficult business environment like the one facing the Postal Service.

The Postal Service was debt-free at the end of its 2005 fiscal year, but ended the 2009 fiscal year—three years after the pre-funding requirement began—with $10.2 billion in debt. It could borrow another $3 billion in 2010 and could hit its $15 billion statutory debt limit in 2011. Unfortunately, the Postal Service is not using this increased debt to modernize its facilities or lay the groundwork for new services when the economy recovers (USPS 2007).

Prudent management of retiree benefits by USPS

Despite the severe statutory challenges imposed upon the USPS, the agency has nevertheless prudently managed its retiree benefits. As we saw, USPS already has the assets to cover all retiree health benefits until at least 2025. Its pension plans, meanwhile, were 99.5% funded as of the end of the Postal Service's 2009 fiscal year (September 30, 2009). The Postal Service has total assets of $273.6 billion and liabilities of $276.4 billion—leaving just a $2.8 billion unfunded liability.

Table 2 shows how the Postal Service's 99.5% funded status compares with a sample of the 10 largest private-sector employers with defined-benefit pension plans that had filed annual reports by April 7, 2010, which were drawn from the Milliman 2010 Pension Funding Study (Ehrhardt and Morgan 2010). At the end of their fiscal years on December 31, 2009, these large corporate plans were 83.4% funded, on average.[7] Assuming asset values continue to recover, the funded status of these plans will likely improve. Nevertheless, this comparison demonstrates that the USPS, far from being financially imprudent, has in fact been meeting its commitments to its retired employees.

USPS pension overpayment should be used to fund retiree health benefits

The USPS Inspector General issued a report in January 2010 showing that the Postal Service had overpaid the Civil Service Retirement System (CSRS) by $75 billion since 1971, dramatically harming the Postal Service's financial condition, as a result of an unfair actuarial determination made by the federal Office of Personnel Management (OPM).

The former U.S. Department of the Post Office became the independent U.S. Postal Service in 1971. The Postal Service is responsible for the cost of pensions under CSRS for those employees hired after 1971. For employees with service both before and after 1971, the federal government pays the share of the CSRS costs up to 1971, and the USPS pays for the costs after 1971.

Civil Service Retirement System benefits are based on workers' years of service and their average salary during their three highest-paid years of service (their "high-three"). The $75 billion overpayment arose from the fact that, from 1971 onward, the federal government only assumed the cost of benefits based on workers' highest pay as of

TABLE 2

Funded status of employee pension plans, USPS and 10 large corporate employers, FY 2009 ($billions)

	U.S. Postal Service*	10 largest corporate plans
*Pension assets**	$273.60	$476.30
*Pension liabilities**	$276.40	$571.00
*Unfunded liability**	$2.80	$94.70
Percent funded	**99.50%**	**83.42%**

* USPS pension assets and liabilities are the total of two separate pension plans, the Civil Service Retirement System (CSRS) and the Federal Employees' Retirement System (FERS). The total unfunded liability includes a CSRS pension deficit of $9.6 billion and a FERS pension surplus of $6.8 billion.

SOURCE: USPS 2009 annual report and authors' analysis of data from Milliman 2010 Pension Funding Study.

June 30, 1971, rather than their high-three salary as of the day they retired.

As the Congressional Research Service notes,

> Because CSRS pensions are based on both an employee's years of service and the average of an employee's highest three consecutive years of pay, pension costs rise as employee pay rises. As a consequence, the percentage of CSRS pension costs allocated to the USPS is greater than the proportion of the worker's career that he or she spent as an employee of the USPS.[8]

An analysis by the Hay Group, an actuarial firm hired by the Inspector General, shows that this inequity can result in the Postal Service being responsible for 70% of a retiree's pension even if that retiree had spent just 50% of his or her career with the Postal Service (Hay Group 2010).

Currently, the USPS has an unfunded liability of $9.6 billion (-5.0%) in the CSRS. Paying off this $9.6 billion in liabilities out of the $75 billion that has been overcharged to the USPS would still leave the Postal Service with a $65.4 billion CSRS surplus, which could be added to the $35.5 billion already in the retiree health benefits fund. As **Table 3** shows, this $101 billion would fully cover the $87.5 billion liability of the Postal Service Retiree Health Benefits Fund (PSRHBF) and still leave a surplus of $13.4 billion, enough to pay off the USPS's current debt of $10.2 billion.

Crediting the Postal Service Retiree Health Benefits Fund with the net $65.4 billion surplus would not alter the overall financial position of the federal government's retiree trust fund accounts. It simply would raise the unfunded liability in the overall CSRS by the amount transferred and increase the assets in the PSRHBF. In its role as fiduciary of CSRS funds, OPM has resisted making this accounting change without direction from Congress.

Ironically, OPM uses the employee-years-of-service method of allocating costs of retiree health care premiums for retirees who have worked both for the old Post Office Department and the new Postal Service. As the Inspector General noted,

> Allocating pension responsibility on a years-of-service basis would align the pension methodology OPM uses with the methodology OPM uses for retiree *health care* obligations. Currently, they are at odds with each other as they are applied to the Postal Service. (USPS 2010)

The Postal Service has asked the Postal Regulatory Commission to provide its "opinion on the fairness and equity of the current OPM method used to apportion the CSRS obligation" of USPS. An actuarial consultant is expected to issue a report on the matter by July 2010.

TABLE 3

Effect of using USPS overpayment to CSRS to fully fund PSRHBF

U.S. Postal Service accounts	Amount ($billions)
CSRS pension funds deficit	($9.60)
Overpayment to CSRS pension	75.00
CSRS pension surplus	65.40
Postal Service Retiree Health Benefits Fund (PSRHBF) assets	35.50
PSRHBF assets with CSRS pension surplus	100.90
PSRHBF liabilities	(87.50)
PSRHBF surplus	13.40

SOURCE: Authors' analysis.

There are several steps Congress should take to correct the $75 billion pension overpayment:

- First, it should direct OPM to fairly calculate the Postal Service's pension obligations. As recommended by the USPS Inspector General, Congress should direct OPM to recalculate the Postal Service's pension liabilities using accurate and fair methodologies that take account of employees' high-three salaries.

- Second, it should transfer the pension surplus to the Postal Service Retiree Health Benefits Fund, as described above.

- Third, it should permit the USPS to use the $13.4 billion surplus (left over after using the $75 billion to fully fund CSRS and PSRHBF obligations) to reduce the Postal Service's debt. With both the USPS pension plan and the retiree health benefits plan fully funded, there is no reason that at least a portion of the $13.4 billion could not be made available to the Postal Service's general operating fund, allowing it to eliminate the $10.2 billion debt it has run up to make retiree health pre-funding payments. This would free up resources to finance restructuring costs as the agency develops a new business model to maintain self-sufficiency over the long-term.[9]

By taking the three steps outlined above, Congress could relieve the Postal Service of the need to make the additional pre-funding payments (averaging $5.5 billion per year) and give it access to the PSRHBF immediately to cover the $2 billion annual cost of current retiree health benefits (access that is denied under current law until 2017). Together, this would save the Postal Service roughly $7.5 billion per year, restoring some stability and allowing the Postal Service to begin the hard work of transforming itself to meet its customers' evolving needs in the Internet age.

As Senator Tom Carper of Delaware, who heads the Senate subcommittee with jurisdiction over the Postal Service, recently said, "If [the Inspector's General] findings [about the $75 billion] are accurate, fixing this error could go a long way towards addressing the Postal Service's current and future challenges."[10]

Putting retiree health benefits on a pay-as-you-go basis

Should Congress fail to require OPM to recalculate the Postal Service's share of workers' CSRS benefits and return the $75 billion in overpayments, an alternative option exists for providing the USPS with some fiscal breathing room: Putting retiree health benefits back on a pay-as-you-go footing. The USPS has offered this option as a recommendation; the U.S. Government Accountability Office has presented it as well.[11]

In ordinary times, when finances permit prefunding of retiree health benefit obligations, such fiscal prudence should clearly be encouraged. But with the recession putting short-term pressure on the Postal Service's financial condition, it would be sensible to permit the USPS to limit payments for retiree health benefits to current retirees, as other federal agencies and most corporations do. The Postal Service paid nearly $2 billion in 2009 for health benefits for current retirees; it could continue to make such payments out of its annual revenues.

Loss of Saturday delivery puts 80,000 jobs at risk

One cost-cutting proposal outlined by the Postmaster General is the elimination of Saturday mail delivery to homes and businesses, and the discontinuance of Saturday collections from mail receptacles. Estimates provided by the USPS to its employees' unions show that eliminating Saturday delivery would cost roughly 80,000 jobs (including full-time and part-time jobs and full-time equivalent positions).[12] The proposal could also harm businesses and consumers and accelerate customers' migration away from physical mail delivery, harming the Postal Service's financial condition.

The savings from this service change are estimated at between $2.2 billion and $3 billion, according to the Postal Regulatory Commission and the USPS, respectively.[13] These are relatively modest sums when compared with the Postal Service's overall budget of roughly $70 billion, and a heavy trade-off when the Postal Service cuts 17% of its mail delivery days for about a 4% reduction in spending. More important, these cuts may not be necessary if the recommendations made regarding the

pre-funding of retiree health benefits and the $75 billion pension fund overpayment are accepted by Congress.

Many firms, especially smaller ones, rely on Saturday delivery and weekend processing of checks for their financial viability. For example, thousands of community newspapers, many of which are delivered by mail on Saturday, could be affected by the loss of that day's delivery.[14] CVS/Caremark depends on Saturday delivery to get drugs to patients in a timely way, which is why the Pharmaceutical Care Management Association recently announced opposition to switching from six-day delivery to five-day delivery.[15]

Before taking the drastic step of eliminating Saturday delivery, the USPS should satisfactorily answer key questions posed by the Government Accountability Office:[16]

- How would eliminating Saturday delivery impact the Postal Service's efforts to grow mail volume and encourage commercial mailers to continue using the mail?
- How will consumers and business customers be affected by a move to five-day delivery? How does the Postal Service plan to mitigate these effects?
- What other options has the Postal Service considered that could significantly reduce costs without reducing delivery service?

Perhaps the most important question is: How accurate are the Postal Service's projections of a steep—and permanent—decline in the use of mail, which is its basis for dropping Saturday delivery? At the start of the fiscal year, the Postal Service projected a $3.6 billion loss through April; the actual loss was $2.3 billion, a difference of $1.3 billion.[17]

Conclusion

The Postal Service, in cooperation with its employee unions, cut costs by an unprecedented $6.1 billion in 2009, in part by eliminating the equivalent of 65,000 jobs.[18] The USPS and its unions will need to continue to work together to respond to economic conditions and to develop a viable, financially self-sustaining plan for the future.

As the USPS weighs the best course for the future, it should have the breathing room to make important decisions free of avoidable financial pressure. First and foremost, this means finding a way to eliminate the annual $5.5 billion PSRHBF payments that have turned gains to losses in recent years, preferably by restoring to the USPS the $75 billion in pension benefit overpayments it made to the federal government. Clearly this step must be taken before the USPS considers any action as drastic as eliminating Saturday delivery.

—The authors would like to thank the National Association of Letter Carriers and the Public Welfare Foundation for their support.

Endnotes

1. See, for example, Kingsbury, Alex, "U.S. Postal Service Fights for Survival", *U.S. News & World Report*, August 14, 2009. Available at http://www.usnews.com/articles/news/national/2009/08/14/us-postal-service-fights-for-survival.html.
2. Job impacts are based on estimates provided by USPS to its employees' unions in February 2010. The 80,000 figure includes full-time positions, part-time positions, and full-time equivalent (FTE) positions. The four unions that received estimates are the American Postal Workers Union (2,250 FTEs); the National Association of Letter Carriers (25,075 full-time jobs); the National Postal Mail Handlers Union (450 FTEs); and the National Rural Letter Carriers Association (3,386 full-time jobs and 49,354 part-time jobs).
3. P.L. 109-435, 120 STAT 3251.
4. Testimony of Postmaster General John E. Potter before the U.S. House of Representatives Committee on Oversight and Government Reform, April 15, 2010, pg. 5.
5. Mandatory pre-funding of retiree health benefits in 2007 was roughly $8.4 billion (rather than $5.4 billion) because it included a $2.98 billion amount paid in 2006 into the PRHBF from an escrow account that had been established by a 2003 law and subsequently eliminated by the PAEA.
6. On a net income, not operating, basis.
7. The plans chosen for this analysis are the 10 largest plans from the Milliman Pension Funding Study (Ehrhardt and Morgan 2010). The Milliman study examines data from the 100 largest U.S. public corporations that sponsor defined-benefit pension plans and whose annual reports were released by April 7, 2010. As Milliman notes, these data may include figures for companies' nonqualified and foreign pension plans, which are subject to different funding standards than those for U.S. qualified pension plans. The Milliman data do not represent the funded status of the companies' qualified plans under the Employee Retirement and Income Security Act (ERISA). If U.S. qualified plans could be evaluated separately, the average funded status may be higher than the figure discussed here. Both the U.S. Postal Service figures and the 10 companies' figures were prepared in accordance with FAS (now ASC) accounting rules. We therefore believe that this is a reasonable basis for making the comparison, although it should be noted that plan sponsors will use different assumptions when valuing assets and liabilities.
8. Written testimony of Kevin Kosar, Congressional Research Service, before the U.S. House of Representatives Committee on Oversight and Government Reform, April 15, 2010, page 8.
9. The $75 billion appears only to reflect the cumulative overpayment through fiscal year 2009. As the Inspector General notes, the figure does "not include the reduction in liability from allocating a smaller share of CSRS payments to the Postal Service in the future." See page 3, footnote 5, in "The Postal Service's Share of CSRS Pension Responsibility", USPS Office of Inspector General, January 20, 2010.
10. Opening statement of U.S. Senator Tom Carper, Chairman of the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, at hearing on "The Future of the United States Postal Service," April 22, 2010, available at http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_id=3a5a1421-5ace-4ad3-b1b2-65a27a97d20e.
11. Testimony of U.S. Postmaster General John Potter before the U.S. House of Representatives Committee on Oversight and Government Reform, April 15, 2010, pg. 4. U.S. Government Accountability Office, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, April 2010, pg. 23.
12. See note 2 for more information on job impacts.
13. See testimony of Postal Regulatory Commissioner Ruth Goldway (2009, 6) and USPS (2009, 12). Note that the PRC figure is a gross estimate, while the USPS figure is a net estimate (for example, it includes an estimate of revenues lost due to elimination of Saturday delivery).
14. Press release from the National Newspaper Association, "NNA continues support for six-day mail delivery," April 12, 2010, available at http://www.nnaweb.org/?/nnaweb/nnanews02/1388/.
15. See April 22, 2010 letter from Pharmaceutical Care Management Association to Members of Congress, available at http://www.pcmanet.org/wp-content/uploads/2010/04/PCMA-Senate-Postal-Service-Letter-4-22-10.pdf.
16. Testimony of Phillip Herr, Government Accountability Office, before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, March 18, 2010, pg. 8, available at http://www.gao.gov/new.items/d10538t.pdf.
17. USPS Unaudited Preliminary Financial Information, available on the Web site of the Postal Regulatory Commission at http://prc.gov/prc-docs/home/whatsnew/APR-10_PRC_-_Final_967.pdf
18. For more detailed information on cost reductions, see USPS (2009) pgs. 8-9.

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