

# Report for Congress

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## **Funding Postal Service Obligations to the Civil Service Retirement System**

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## Summary

On November 1, 2002, the Office of Personnel Management (OPM) notified the U.S. Postal Service (USPS) that a review of USPS payments to the civil service retirement fund for pension obligations to employees on board before 1984 revealed a much more positive picture than previously believed. USPS – unlike any other federal agency – is required to pay into the fund an amount that approximates the full cost of the Civil Service Retirement System. Because past contributions have been earning interest at a higher rate than presumed in the statutory funding formula, OPM reported that the deferred liability for pension obligations was only \$5 billion instead of \$32 billion. If USPS continues to make payments based on the latter figure, OPM said the liability will eventually be overfunded by \$71 billion. The postmaster general said that if Congress promptly passes draft legislation developed by OPM to reduce its annual payment, USPS will be able to reduce its debt by \$3 billion in FY2003, and defer the next postage rate increase from 2004 to 2006.

The General Accounting Office (GAO) reviewed OPM's figures. GAO pointed out that OPM had included as a USPS obligation the cost of retirement benefits based on prior military service of postal employees, although under current law the Department of the Treasury is responsible for those costs. Together with some other adjustments, this resulted in a conclusion that the potential overfunding is \$103 billion rather than the \$71 billion OPM calculated, and that USPS has already overfunded the part of its obligation that is current. OPM responded that making USPS responsible for the cost of military service is the practice under dynamic normal cost principles that apply to the Federal Employees Retirement System. However, OPM's accounting differs somewhat from the Administration's FY2004 budget proposal for federal agencies to fully fund CSRS. The proposed budget would have agencies begin paying the full dynamic cost of CSRS benefits, but it would not make *all* past military service an obligation of each agency, as OPM did in calculating the Postal Service's CSRS liabilities.

USPS, OPM, the Office of Management and Budget, the Department of the Treasury, postal unions, and mailers groups all supported legislation drafted by OPM, versions of which have been favorably reported by committee in the House as H.R. 735, and in the Senate as S. 380. Both bills added provisions requiring USPS to pay down its debt to the Treasury with savings from a recalculation of its required payment. This was apparently in response to a Congressional Budget Office (CBO) letter warning that returning the savings to mailers in the form of lower rates would increase deficits or reduce surpluses in the unified budget by as much as \$10 billion to \$15 billion over the period from FY2003 to FY2007, possibly requiring offsetting savings if it is enacted. Both GAO and CBO noted that there still looms an unfunded liability of \$40 billion to \$50 billion for retiree health costs.

This report provides background on USPS funding of its retirement obligations, describes and analyzes the OPM recalculation, and discusses considerations Congress may bring to bear on H.R. 735 and S. 380. It will be updated in the event of any new developments.

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# Funding Postal Service Obligations to the Civil Service Retirement System

The U.S. Postal Service (USPS) faces a long term financial prospect that calls into question its ability to provide universal service at present levels without using appropriated funds. Steadily rising costs stemming from the addition of 1.7 million new delivery points each year, and from an inability to close outmoded facilities or control its labor contracts, threaten to outstrip revenues. Use of the mail for correspondence, advertising, package delivery, and financial transactions is declining in competition with electronic and private sector alternatives. USPS, the General Accounting Office (GAO), and a growing number of postal stakeholders believe the postal business model will not work in the 21<sup>st</sup> century.<sup>1</sup> On December 11, 2002, President Bush appointed a nine-member commission to examine alternative futures for the Postal Service. The commission is to report by July 31, 2003.

Much of the concern about the Postal Service's ability to survive has stemmed from its deferred liabilities. Not only must it recover from ratepayers the direct costs of delivering their mail in the future, it must also generate enough revenue to pay its debts built up from infrastructure investments, accumulated losses, and commitments to retirees and their survivors that were made many years in the past. According to the GAO, these liabilities and obligations "amount to almost \$100 billion and threaten the Service's ability to continue to fulfill its mission."<sup>2</sup> Specifically, GAO identified a deferred liability of \$32 billion for pensions, and noted that USPS would also have to pay \$16 billion in interest associated with the pension obligations. GAO also pointed out, however, that the accounting behind this number was suspect. The mailing industry found it particularly alarming. One respected analyst warned that retirement costs could rise to \$16 billion annually by 2010 – an amount that ratepayers would have to pay before devoting a single dollar to salaries, transportation, or electricity.<sup>3</sup>

Lately, however, the Office of Personnel Management (OPM) has released a new analysis of the USPS obligation toward retirees in the Civil Service Retirement System (CSRS), showing that present contribution rates will overfund the amount needed to cover that obligation. USPS, supported by most large mailers organizations, has asked Congress to change the statutory contribution formula in a

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<sup>1</sup> For a detailed analysis of the USPS financial prospect, see CRS Report RL31069, *Postal Service Financial Problems and Stakeholder Proposals*, by Nye Stevens.

<sup>2</sup> U.S. General Accounting Office, *U.S. Postal Service: Moving Forward on Financial and Transformation Challenges*, GAO Testimony 02-694T, May 13, 2002, p. 12.

<sup>3</sup> Gene Del Polito, president of the Association for Postal Commerce, as quoted in Tad Clarke, "Declining Mail Volume Not USPS' Only Problem, Speaker Says," *DM News*, Sept. 19, 2002, p. 1.

way that would reduce USPS revenue needs by \$2.9 billion in fiscal year (FY) 2003, and by \$2.6 billion in succeeding years. During the last week in January, 2003, both the Congressional Budget Office (CBO) and GAO issued reports shedding new light on OPM's analysis and on the proposed legislation. Bills were introduced in the House (H.R. 735) and the Senate (S. 380) with bi-partisan sponsorship on February 12, 2003, to change the funding formula.

This report explains these developments and provides information relevant to Congress's consideration of the USPS request for statutory relief. It includes as background an explanation of how USPS pays for pensions under both the Civil Service Retirement System and the Federal Employees Retirement System (FERS), and describes both the OPM analysis leading to the conclusion that present contribution rates are too high, and GAO's review of the calculations behind that determination. It concludes with a description of the two bills introduced to change the contribution formula, and analysis of the various considerations that Congress might bring to bear on the proposed legislation.

## **Background: USPS Payments for Pensions under CSRS and FERS**

The Postal Reorganization Act of 1970 (P.L. 91-375) established the United States Postal Service and provided that "officers and employees of the Postal Service (other than the Governors) shall be covered by chapter 83 of title 5 relating to civil service retirement."<sup>4</sup> Consequently, employees of the Postal Service continued to participate in the Civil Service Retirement System, in which they had participated as employees of the Post Office Department. Today, federal and USPS employees are covered under one of two retirement systems, depending on when they were hired. Employees initially hired into permanent federal or USPS employment before January 1, 1984 are covered by CSRS. Employees initially hired into permanent federal or USPS employment after December 31, 1983 participate in FERS. FERS also covers employees who switched from CSRS during "open seasons" in 1987 and 1998.

The contributions to the Civil Service Retirement and Disability Fund (CSRDF) required of federal employees and their employing agencies are specified in law.<sup>5</sup> All monies contributed to the fund that are not needed to pay current benefits must be invested in special-issue securities of the U.S. Treasury.<sup>6</sup> By law, the investments of the fund are credited with interest at a rate equal to the average market yield of

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<sup>4</sup> See 39 U.S.C. § 1005(d). As amended by the Federal Employees Retirement System Act of 1986 (P.L. 99-335), this section now says that "officers and employees of the Postal Service (other than the Governors) shall be covered by chapters 83 and 84 of title 5."

<sup>5</sup> 5 U.S.C. 8334, 8422, and 8423.

<sup>6</sup> 5 U.S.C. 8348(c).

outstanding obligations of the United States Treasury with remaining maturities of 4 years or more.<sup>7</sup>

**Civil Service Retirement System.** The principal objective of the Postal Reorganization Act was to establish the Postal Service as a financially independent entity that would pay its personnel costs and other expenses from its own revenues. However, certain costs of pension benefits under CSRS continued to be paid from the general revenues of the U.S. Treasury. This occurred because the contributions to the CSRS made by employees and their employing agencies (including the Post Office Department and, later, USPS) were not adequate to fully fund the retirement annuities paid by CSRS. The Civil Service Retirement Amendments of 1969 (P.L. 91-93) required both participating employees and their employing agencies each to contribute an amount equal to 7.0% of basic pay to the CSRDF to finance retirement benefits under CSRS. The Postal Service pays the employer contribution for USPS employees from the revenue it receives from customers, while other federal agencies pay the employer contribution from amounts appropriated annually by Congress.

The combined contributions from employees and employing agencies – equal to 14% of employee pay – are not sufficient to finance the retirement benefits provided under the Civil Service Retirement System. The costs of CSRS that are not financed by the 7.0% employee and 7.0% agency contributions are attributable mainly to increases in future CSRS benefits that result from (1) employees' annual pay raises, and (2) annual cost-of-living adjustments in the pensions paid to CSRS annuitants. In actuarial terms, the employee and agency contributions totaling 14% of pay are equal to the *static normal cost* of CSRS benefits.<sup>8</sup> This is the benefit that would be paid if employees received no future pay raises and annuitants received no future cost-of-living adjustments. The *dynamic normal cost* of CSRS pensions includes the cost of financing future benefit increases that result from pay raises and cost-of-living adjustments.<sup>9</sup> The dynamic normal cost of CSRS has been estimated by OPM to be an amount equal to 24.4% of employee pay.

For non-postal federal employees covered by CSRS, the federal government pays somewhat more than half of the 10.4 percentage point difference between the 14% of pay contributed by employees and their employing agencies and the 24.4% normal cost of the program. This additional contribution by the federal government is a direct transfer from the general revenues of the Treasury to CSRDF. It does not pass through individual agency budgets. The remaining cost of CSRS constitutes an *unfunded liability* of the system. This liability eventually will be borne by the Treasury when CSRS annuities are paid to retirees and their surviving dependents.

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<sup>7</sup> 5 U.S.C. 8348(d).

<sup>8</sup> A pension plan's *normal cost* is the level percentage of pay that, invested today at a particular assumed real rate of interest, will be sufficient to fully finance the retirement benefits under the plan.

<sup>9</sup> Two other elements of a pension plan's dynamic normal cost are increases in benefits that result from (1) new or expanded benefits and (2) newly covered groups of workers. These have not been significant elements of the dynamic normal cost of the CSRS benefits of Postal Service employees.

From 1974 through 1993, Congress passed several laws that gradually transferred to USPS all costs associated with CSRS benefits accrued by USPS employees since July 1, 1971, including the costs resulting from employees' pay raises and retirees' cost-of-living adjustments.<sup>10</sup> The cumulative effect of these laws has been that all CSRS benefits accrued by USPS employees since July 1971 have been fully financed, either by retroactive payments by USPS or by payments that are mandated by law to be made each year by the USPS.<sup>11</sup> A memorandum prepared by CRS in June 1997 stated that:

As a result [of these laws], there are no unfunded pension liabilities for CSRS benefits earned by USPS employees since the USPS was established. All postal employee retirement benefits accrued since June 30, 1971 have been financed either through lump-sum payments from the USPS, or are fully paid for on an ongoing basis by the combination of employee contributions and USPS payments.<sup>12</sup>

**Federal Employees Retirement System.** As of March 2002, 66% of the USPS active workforce were covered by FERS. The normal cost of the pension component of FERS has been estimated by OPM to be 11.5% of pay. For both postal workers and other federal employees, FERS is fully funded by the combination of employee contributions (currently 0.8% of pay for most workers) and agency contributions (currently 10.7% of pay). USPS pays the agency share of FERS from postal revenues. Unlike CSRS, FERS has no unfunded pension liabilities. The full dynamic normal cost of the FERS basic retirement annuity is required by law to be fully financed by the sum of employee and agency contributions. Dynamic normal cost includes the effects of employee pay raises and retiree cost-of-living-adjustments (COLAs) and the full cost of all military service (minus employee contributions).

## **The OPM Analysis of USPS Contributions for CSRS Benefits**

In the course of its review of USPS finances carried out at the request of the Senate Committee on Governmental Affairs, GAO realized that there was no contemporary accounting of the Service's obligations to the Civil Service Retirement and Disability Fund. It therefore requested that OPM review the Service's CSRS financing as if a separate retirement account had been established for income and benefit payments since USPS was established as an independent entity in 1971. OPM undertook and completed the review, though it did not report back to GAO on it. The director of OPM, Kay Coles James, wrote the postmaster general on November 1, 2002, notifying him that OPM actuaries "project that future payments

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<sup>10</sup> These laws include P.L. 93-349, P.L. 100-203, P.L. 101-239, P.L. 101-508, and P.L. 103-66.

<sup>11</sup> It is important to note that financing a defined-benefit pension plan necessarily requires a number of economic and demographic estimates and assumptions, any of which may prove to be wrong.

<sup>12</sup> CRS Congressional Distribution Memorandum, "United States Postal Service Employee Benefit Costs," Carolyn L. Merck, June 5, 1997.

required under current legislation will overfund your estimated CSRS liability by approximately \$71 billion.”<sup>13</sup>

In a memorandum summarizing their study, OPM stated that “our analysis shows that the net accumulated value of USPS payments already received is currently approaching the value of its projected future CSRS benefits. [I]f the current funding provisions remain in place, USPS will pay substantially more than will be needed to fund future benefits.” The OPM summary further stated that “the major reason for the projected over-funding is due to the excess interest earned by the fund; that is, interest earnings in excess of the 5% that was assumed under the statutory funding method.”

The OPM analysis also pointed out two elements of the Postal Service’s financing of CSRS benefits that distinguish it from other federal agencies, and which are important factors in the potential overfunding of CSRS benefits for employees of the Postal Service. First, under law the Postal Service is responsible only for CSRS benefits that were earned by USPS employees after June 30, 1971. Consequently, a significant proportion of the Postal Service’s early contributions to the Civil Service Retirement and Disability Fund remained in the Fund and were credited with interest from year to year. Second, due to a series of laws passed between 1989 and 1993, USPS is required to pay for the increases in CSRS pensions that result from annual cost-of-living adjustments (COLAs). As a result, the Postal Service – unlike any other federal agency – is required to pay into CSRDF an amount that approximates the full cost of the Civil Service Retirement System. It is these two factors, *in combination with the interest earnings in excess of the assumed 5% rate of return*, that could lead to pension contributions and interest earnings exceeding the value of CSRS benefits owed to USPS retirees and their survivors.

**The interest rate used in CSRS financing.** Federal law requires the Postal Service to finance the increases in CSRS annuities that result from pay raises and cost-of-living adjustments by amortizing the increased costs over periods of 30 years and 15 years, respectively.<sup>14</sup> The payments must be made in “equal annual installments with interest computed at the rate used in the most recent valuation of the Civil Service Retirement System.”<sup>15</sup> According to OPM, “the assumed interest rate used in CSRS financing has been set at 5% since 1972.” However, while OPM uses a 5% interest rate in its *static* valuation of CSRS, it currently uses a nominal interest rate of 6.75% when valuing the liabilities of the CSRS on a *dynamic* basis.<sup>16</sup> The dynamic valuation of CSRS liabilities is a more accurate measure of the present value of future CSRS annuities. Since the enactment of the Omnibus Budget Reconciliation Act (OBRA) of 1990 – which required the Postal Service to pay for

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<sup>13</sup> See [<http://postcom.org/public/csrs/OPM%20letter%20on%20USPS-CSRS.pdf>], visited Feb. 25, 2003, for a copy of the OPM Director’s letter.

<sup>14</sup> 5 U.S.C. §§ 8348(h) and 8348(m).

<sup>15</sup> 5 U.S.C. §§ 8348(h)(2) and 8348(m)(2).

<sup>16</sup> U.S. Office of Personnel Management, *Civil Service Retirement and Disability Fund, Report for Fiscal Year 2001*, p.12; and *Funding of CSRS Benefits by the Postal Service*, Nov., 2002, p. 4.



the increase in CSRS liabilities resulting from COLAs granted since 1971 and to amortize the cost of future COLAs – USPS has been paying the full *dynamic* cost of CSRS. It could be argued that after the enactment of the OBRA of 1990, OPM should have based each new series of Postal Service amortization payments under 5 U.S.C. 8348(h) and 8348(m) on the rate of interest that it used in its most recent *dynamic* valuation of CSRS. It is important to note, however, that the Postal Service’s projected over payments to CSRS are due to the combined effects of several factors, as described immediately above. Thus, even if after 1990 USPS payments under 5 U.S.C. 8348(h) and 8348(m) had been based on the rate of interest that OPM used in its most recent dynamic valuation, the overfunding of CSRS that OPM currently projects would not have been eliminated; it would, however, have been reduced.

**Estimated amount of future overfunding.** In its analysis of USPS liabilities to CSRS, OPM estimated the present value of future CSRS benefits payable to USPS annuitants to be \$172.6 billion as of September 30, 2002.<sup>17</sup> OPM estimated the amount now in the CSRDF that is attributable to payments by USPS and its employees (and to interest credited to those payments) at \$152.1 billion.<sup>18</sup> OPM estimated the present value of future payments into the CSRDF on behalf of Postal Service CSRS participants (and interest on those payments) at \$91.5 billion. Therefore, the sum of CSRDF assets attributable to the USPS and the future income to the CSRDF is \$243.6 billion.<sup>19</sup> This exceeds the estimated present value of future benefits by \$71.0 billion, which is the amount that OPM has identified as “potential overfunding” of CSRS benefits payable to USPS annuitants and their surviving dependents.<sup>20</sup> OPM Director James’ November 1, 2002 letter to the postmaster general made it clear that, “(w)hile significant overfunding is projected to occur in the future under current law, none has occurred to date. In fact, we estimate \$20.5 billion in future benefits remains to be funded.” Future normal contributions will fund \$15.5 billion of the shortfall, leaving \$5 billion still to be funded. Still, this is considerably less than the \$32 billion shortfall that had hitherto been assumed to exist.

**Limitations of the estimates.** Each of the estimates underlying the OPM recalculation of USPS retirement obligations is, necessarily, based on assumptions about the future. OPM noted in the summary of its analysis that “the amount of projected over-funding is an estimate and will vary depending on future economic and demographic experience.” Elsewhere, OPM has stated that “the normal cost and actuarial liability of the retirement system depend primarily on the real interest rate

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<sup>17</sup> The *present value* of a future stream of income or expenditure is the amount that would be needed today to generate that stream of income or payments, assuming a particular investment rate of return.

<sup>18</sup> This is the sum of contributions by the USPS and its employees plus interest on those contributions, minus the amount paid to annuitants that is attributable to service after June 30, 1971, when USPS was formed.

<sup>19</sup>  $152.1 + 91.5 = 243.6$

<sup>20</sup>  $243.6 - 172.6 = 71.0$

and on the difference between the interest rate and the salary increase assumption.”<sup>21</sup> The estimated present value of future USPS benefits under CSRS (\$172.6 billion) is based on estimates that in the long-term, inflation will average 3.75% per year, annual pay raises will average 4.25%, and the real rate of interest will be 3.0%. (The *real* rate of interest is the difference between the *nominal* interest rate and the rate of inflation. OPM’s estimates are based on a nominal interest rate of 6.75% and an inflation rate of 3.75%). To the extent that actual experience differs from these estimates, the liabilities of the retirement system could be higher or lower than OPM has estimated.

The future liabilities of CSRS also will depend on the demographic experience of the program, mainly the number of people who receive CSRS annuities and the length of time over which those annuities are paid. Actuaries can estimate life expectancy and average age of retirement, but the timing of retirement can change as a result of government policy. For example, downsizing of agencies or privatization of government functions could lead to people retiring from the federal government earlier, and collecting benefits longer, than had been assumed. The reduction in benefits under CSRS for early retirement is 2% per year, which is lower than an “actuarially fair” reduction would be.<sup>22</sup> Changes in government policy that result in an increase in early retirement would therefore increase the liabilities of CSRS. Such changes in policy are, of course, unpredictable. Nevertheless, they provide an example of the uncertainty of the estimates of the future liabilities of the CSRS.

**GAO’s review of the estimates.** Eight Members of Congress, including the new chairs of the Senate Governmental Affairs and the House Government Reform Committees, asked the General Accounting Office to review the calculations leading OPM to the conclusion of overfunding. On January 31, 2003, GAO released its review of the OPM analysis.<sup>23</sup>

GAO’s report revealed that OPM’s analysis had treated the obligations to pay retirement benefits based on prior military service of postal employees, and for certain survivor annuities, in a way that is inconsistent with current law. OPM had included these costs as an obligation to be met from USPS contributions to the CSRDF, even though under current law the Department of the Treasury is responsible for funding those costs.<sup>24</sup> OPM’s estimate of USPS’s financial

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<sup>21</sup> *Civil Service Retirement and Disability Fund, Report for Fiscal Year 2001*, p. 7.

<sup>22</sup> Under FERS the reduction in benefits for workers who retire between ages 55 and 62, with at least 10 but fewer than 30 years of service, is 5% per year. (The reduction is 5% multiplied by the number of years between the worker’s age at the time of retirement and 62.) Under Social Security, the reduction for claiming retired worker benefits before the normal retirement age ranges from 5.0% to 6.7% per year, depending on the individual’s age at retirement and the normal retirement age.

<sup>23</sup> U.S. General Accounting Office, *Review of the Office of Personnel Management’s Analysis of the United States Postal Service’s Funding of Civil Service Retirement System Costs*, GAO-03-448R, available at [<http://www.gao.gov/new.items/d03448r.pdf>].

<sup>24</sup> *Ibid.*, pp. 2, 20. The military service contribution was much larger than the survivor (continued...)

obligations to the Civil Service Retirement System included among those obligations the cost of military service performed by CSRS-covered employees hired after July 1, 1971 and a pro-rated share of the military service performed by USPS employees hired before July 1, 1971. GAO pointed out that under current law the cost of CSRS benefits attributable to military service is borne by the U.S. Treasury (less required employee contributions).

OPM responded to GAO's comments by noting that their legislative proposal would have the Postal Service fund the CSRS on a dynamic normal cost basis, in which the agency contribution includes the cost of military service performed by employees who have made the required deposit to the CSRDF. OPM also said this was consistent with the way FERS treated the military obligation. However, OPM's accounting differs somewhat from the Administration's FY2004 budget proposal for federal agencies to fully fund CSRS. The proposed budget would have agencies begin paying the full dynamic cost of CSRS benefits, but it would not make *all* past military service an obligation of each agency, as OPM did in calculating the Postal Service's CSRS liabilities.

Offsetting this factor to some extent was the credit to the USPS account of a special \$285 million payment made with appropriated funds in FY1975, which with compounded interest increased the postal balance by \$2.9 billion today. In adjusting the OPM figures by these two factors (and several less significant items), GAO concluded that the projected overfunding was \$103.1 billion, instead of the \$71.0 billion projected by OPM. GAO also said that instead of still being underfunded currently by \$20.5 billion, USPS has currently *overfunded* its obligation by \$4.5 billion.

## USPS Wants to Reduce Its CSRS Payments to OPM

The postmaster general announced what he called "good financial news" from OPM to the USPS board of governors and to the public on November 5, 2002.<sup>25</sup> Reaping the benefit from the original OPM recalculation, he said, would allow USPS to reduce its debt to the Treasury by \$3 billion in FY2003. Of even more significance to the mailing community, however, he also said that changing the funding formula would allow USPS to defer the next rate increase from early 2004, when it is now expected, to 2006. The news was greeted with great fanfare by mailing organizations.<sup>26</sup>

**Proposed legislation.** The postmaster general emphasized, however, that none of this could take place without a change in the law. In fact, OPM had already drafted legislation that would, if enacted, allow USPS to fund future CSRS benefits

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<sup>24</sup> (...continued)

annuity component of the recalculation.

<sup>25</sup> USPS press release, [[http://www.usps.com/news/2002/press/pr02\\_pmg1105.htm](http://www.usps.com/news/2002/press/pr02_pmg1105.htm)], Nov. 5, 2002, p. 2, visited Jan. 2, 2003.

<sup>26</sup> For one example, see Cary H. Baer, "Are We Entering an Era of 'Pax Postal'?", *DM News*, Nov. 26, 2002.

on a dynamic, normal cost basis. According to the postmaster general, “the Administration will support the change and OMB, OPM, and the Department of the Treasury have offered their support to brief lawmakers on Capitol Hill.”<sup>27</sup> The draft bill, entitled the “Postal Civil Service Retirement System Funding Reform Act,” was circulated to the House Government Reform and Senate Governmental Affairs Committees, where it formed the basis of H.R. 735 and S. 380, introduced by senior members of both committees. The President’s FY2004 budget proposes its enactment.

A statutory change would be needed for USPS to be able to reduce its contributions to CSRDF because current law specifies that USPS payments are to be based on the static normal cost of benefits. The proposed law would change the funding formula to a dynamic normal cost assumption. It would raise the USPS contribution from 7% to 17.4% for current employees, and thus fully fund current obligations for CSRS employees just as FERS employees are now fully funded. This would cost \$1.1 billion more than USPS is now paying. Where money would be saved – \$4 billion – would be in the reduction of the deferred retirement liability from \$32 billion to \$5 billion, and lengthening the amortization schedule for the remaining \$5 billion from 30 to 40 years. (On the other hand, if GAO’s figures had been adopted in the legislation, there would be no underpayment to amortize.) USPS has said that the overall effect would be a reduction of \$2.9 billion in payments to CSRDF in FY2003, and \$2.6 billion in subsequent years when the amortization schedule becomes effective. To give a perspective on these amounts, USPS expenses in FY2002 were \$67.2 billion, and the amount realized annually from the 7.7% negotiated postage rate increase on June 30, 2002 is about \$5.2 billion.<sup>28</sup>

**Initial support for the legislation.** Soon after the original OPM announcement, mailers organizations asked the White House and their members to press their contacts on Capitol Hill to support the legislation OPM has drafted. In announcing the recalculation of USPS’s retirement fund obligations, the postmaster general not only emphasized that the Administration supported the proposal, he also put the benefits in terms that mailers could readily understand. He said that if legislation were passed to reduce the Service’s contributions to CSRDF, it would delay the next rate increase by 2 full years, to 2006. It would also allow USPS to pay down its debt to the Treasury, now about \$11.9 billion, by \$3 billion in the current fiscal year. This also would benefit mailers because it would reduce annual interest payments to the Treasury, which in turn would lower the revenue requirement that is ultimately paid by mailers through the rate process. In their communications on the issue, mailers say that ensuring postage rate stability until 2006 will allow them to invest billions of dollars in their businesses, stimulating the economy locally and nationally. “Businesses would use those funds to hire employees, boost advertising dollars and stimulate consumer spending. However, if Congress fails to pass the

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<sup>27</sup> USPS press release no. 83, [[http://www.usps.com/news/2002/press/pr02\\_083.htm](http://www.usps.com/news/2002/press/pr02_083.htm)] Nov. 5, 2002, p.2, visited Jan. 2, 2003.

<sup>28</sup> See CRS Report RS21192, *The 2002 Postage Rate Increase*, by Nye Stevens.

legislation, businesses will instead spend those billions of dollars on increased postage rates.”<sup>29</sup>

Supporters of the legislation have emphasized that there is certain sense of urgency about it. Because the normal rate-setting process takes a minimum of 10 months after a case is filed with the Postal Rate Commission, preparations for the filing, which have already begun, need to move into high gear almost immediately if increased rates are to take effect early in 2004. Preparations for a rate case are a major investment not only for USPS, but also for interveners like mailers, unions, and competitors.

**H.R. 735 and S. 380.** On March 5, 2003 the Senate Committee on Governmental Affairs ordered reported S. 380, as amended. On March 6, the House Committee on Government Reform ordered reported an amended version of H.R. 735. Both bills would require the Postal Service to contribute annually to the CSRDF on behalf of employees covered by CSRS an amount equal to the dynamic normal cost of CSRS minus the amount contributed by employees. The dynamic normal cost of CSRS is currently estimated to be equal to 24.4% of payroll. Employees covered by CSRS are required to have 7.0% of pay withheld and deposited in the CSRDF. Thus, the required Postal Service contribution would be equal to 17.4% of payroll. Because the dynamic normal cost of CSRS includes the effects of future employee pay raises and retiree COLAs, the separate payments that the Postal Service is required to make under current law to fund the future increases in CSRS annuities that result from pay raises and COLAs would no longer be necessary. Consequently, H.R. 735 and S. 380 would repeal the provisions of law that require the Postal Service to amortize over 30 years and 15 years, respectively, the increases in future CSRS annuities that result from annual employee pay raises and retiree COLAs.

Both bills would require the Office of Personnel Management to estimate any “supplemental liability” of the Postal Service with respect to CSRS benefits earned by current or former USPS employees and to amortize (pay off, with interest) this supplemental liability over 40 years. The bills define the supplemental liability as the amount by which the present value of CSRS benefits earned by current or former employees of the Postal Service exceeds the present value of past and future contributions of the Postal Service and its employees, plus interest credited to those contributions. Under current law, CSRS benefits that are attributable to military service are paid from the general revenues of the U.S. Treasury (minus any employee deposits to the CSRDF). H.R. 735 and S. 380 would include the value of CSRS benefits attributable to military service as a financial obligation of the Postal Service in the calculation of the Postal Service’s supplemental liability.

H.R. 735 and S. 380 would require the Office of Personnel Management to compute the amount of any savings resulting from enactment of the legislation. Both H.R. 735 and S. 380 would express “the sense of the Congress” that (1) if enacted, the savings accruing to the Postal Service would be sufficient to allow it to hold postage rates unchanged until at least 2006; (2) some portion of the savings should be used to address the Postal Service’s unfunded obligations related to

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<sup>29</sup> [[http://www.postcom.org/public/csrs/postcom\\_csrs\\_q&a.htm](http://www.postcom.org/public/csrs/postcom_csrs_q&a.htm)], visited Jan. 2, 2003.

post-retirement health benefits for its current and former employees; and (3) none of the savings should be used to pay bonuses to Postal Service executives.

H.R. 735 would require any savings realized in fiscal years 2003 and 2004 to be used to reduce the debt owed by the Postal Service to the Federal Financing Bank of the Treasury “in consultation with the Secretary of the Treasury.” The Postal Service would be prohibited from incurring new debt that would offset these savings. Savings realized in FY2005 would be used to hold Postal rates unchanged and to reduce the postal debt, “to such extent and in such manner as the Postal Service shall specify (in consultation with the Secretary of the Treasury).” Savings realized after FY2005 would be held in escrow until otherwise provided for by law. S. 380 would require savings realized by the Postal Service through the end of FY2007 be used to reduce the postal debt “to such extent and in such manner as the Secretary of the Treasury, in consultation with the United States Postal Service, shall specify....” The distinction is important for two reasons. USPS prefers the House version because it puts USPS, rather than the Treasury, in control of deciding how to direct the savings to debt reduction. Second, the escrow provision has the effect of reducing the budget costs of the measure, since it would require that savings would actually have to be accrued through postal rate increases. Mailers dislike the provision for the same reason.

Under S. 380 the Postal Service would submit to the House, Senate and the GAO by December 31, 2004 a report recommending the disposition of future savings. Similar reports would be required not later than 8 months before the Postal Service requests a rate adjustment. The report would consider whether and to what extent future savings should be used to address debt repayment, prefunding of post-retirement healthcare benefits, capital investment, maintaining postal rate stability, and any other matter. Under H.R. 735 the Postal Service would be required to submit to the President and Congress by September 30, 2003, a proposal detailing how any savings accruing after FY2005 should be expended. The report would consider whether and to what extent future savings should be used to address debt repayment, prefunding of post-retirement healthcare benefits, capital investment, delaying or moderating increases in postal rates, and any other matter. Within 180 days of receiving both the Postal Service proposal and the GAO’s evaluation of the report, Congress would reconsider the question of how savings accruing to the Postal Service should be used.

S. 380 would require the Postal Service by December 31, 2003 to submit to the President and Congress a report describing how it proposes to address its unfunded obligations for post-retirement healthcare benefits for current and former employees. The report must describe how prior and future accrued costs for post-retirement healthcare benefits, and amounts needed to prefund those costs, are treated in financial statements and in establishing postage rates and fees for postal services. In preparing the report, the Postal Service would be required to consider the report of the President’s Commission on the U.S. Postal Service. Within 60 days of the Postal Service submitting its report, the General Accounting Office (GAO) would be required to submit an evaluation of the report to the House and Senate.

**Obstacles to the legislation.** There has been no publicly voiced opposition to the legislation so far, and both bills were reported favorably by committee without

dissent. Several obstacles could arise, however. One is the budgetary impact of the bill. In reviewing OPM's draft of the legislation, the Congressional Budget Office (CBO) said that while the legislation would improve the financial position of USPS, it could increase deficits (or reduce surpluses) in the unified federal budget depending in part on what USPS did with the savings.<sup>30</sup> If USPS were to use the savings to hold down postage rates, as it says it will, this would reduce overall government receipts. CBO said that the impact could be a deficit increase of as much as \$10 billion to \$15 billion over the FY2003-2007 period, and as much as \$36 billion to \$41 billion over the 10-year period from FY2003 to FY2013. Under past budget enforcement procedures, this reduction in the USPS contribution to the CSRS Fund might have required the enactment of offsetting savings elsewhere in the budget. Partly in response to the CBO's report, the two bills that have been introduced direct USPS to use the savings realized in the first 3 years (H.R. 735) or 5 years (S. 380) following enactment to reduce the Postal Service's debt to the Federal Financing Bank. The House and Senate FY2004 budget resolutions, as reported by the House and Senate Budget Committees, both assume passage of versions of the legislation. CBO has rescored the bills in light of the revised provisions.<sup>31</sup>

It could be argued that now is not a propitious time for Congress to act. The President has just appointed a blue ribbon commission to review the Postal Service, and it is expected to report on July 31, 2003.<sup>32</sup> Deferring a decision on the funding question until the commission has made its recommendations could allow the matter to be addressed in a larger context, taking into account the overall financial situation and prospects of USPS in the decades to come. On the other hand, it could also be argued that providing USPS some relief from short-term cash flow problems could allow some breathing room for thoughtful consideration of reform measures, and that a smaller USPS debt to the Treasury is unlikely to be regarded as constraining by the commission.

Both GAO and CBO in their reports made another argument in the direction of caution toward legislative action. They both pointed to another very large obligation that USPS has for funding health care benefits for its retirees, which is treated in USPS financial statements on a pay-as-you-go basis. The *Postal Service 2002 Annual Report* estimates the amount at \$40 billion to \$50 billion.<sup>33</sup> GAO and CBO both suggest that treating pensions completely independently of mounting health care costs for retirees would be somewhat myopic. H.R. 735 and S. 380 both would require USPS to consider the impact of funding post-retirement health care benefits in reports to Congress on how the savings would be used.

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<sup>30</sup> Letter to Honorable Jim Nussle, Chairman, House Budget Committee, Jan. 27, 2003, available at [<http://www.cbo.gov/showdoc.cfm?index=4033&sequence=0>].

<sup>31</sup> CBO's cost estimates are available on its Web site: [<http://www.cbo.gov/showdoc.cfm?index=4120&sequence=0>] for (S. 380) and [<http://www.cbo.gov/showdoc.cfm?index=4106&sequence=0>] for (H.R. 735).

<sup>32</sup> U.S. President George W. Bush, "President's Commission on the United States Postal Service," Executive Order 13278, *Federal Register*, vol. 67, Dec. 13, 2002, p. 76671.

<sup>33</sup> At page 26.