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Pension Issues Cloud Postal Reform Debate

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Summary

Reform of the business model of the U.S. Postal Service (USPS) has been given new momentum by the July 2003 report of a blue-ribbon presidential commission. The commission concluded that USPS faces a long-term decline in mail volume and revenues, and unless its finances are shored up, a taxpayer bailout or loss of universal service is threatened. The 108th Congress held a dozen hearings on the commission's report. Broad postal reform proposals, however, have been somewhat overshadowed by controversy over two pension funding issues left unsettled by passage of P.L. 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003.

The first issue is what to do with the "savings" to USPS from the reduction in its payments to the Civil Service Retirement Fund allowed by the law. Savings for the first three years were to be used to pay off the USPS debt to the Treasury, but for FY2006 and later years, the law provided that they be held in escrow pending further congressional action. Continuation of the escrow requirement greatly concerns mailers' organizations, because anticipated new rates will extract billions from them that cannot be used to deliver the mail or support the system. The Administration opposes removal of the escrow because it would add \$3 billion this year to the budget deficit. USPS would like to use it to set up a separate fund for retiree health benefits.

The second issue concerns the provision in the 2003 act transferring from the Treasury to USPS responsibility for paying the retirement benefits earned by postal employees when they were members of the armed forces, a \$27 billion obligation. USPS argues that the Treasury pays for military service credits held by employees of every other agency, and there is no connection between the USPS mission and that of the military. USPS points out that 90% of the obligation was incurred before USPS was established as an independent entity in 1971. The Administration, however, believes that USPS should pay the full cost of its employees' pensions, including those earned in military service, because the credits have pension value only by virtue of USPS having hired veterans in the first place. The Federal Employees Retirement System (FERS), to which all postal employees newly hired since 1984 belong, fully funds military retirement costs through agency contributions.

These two issues prevented postal reform legislation, reported without dissent by the House Government Reform and Senate Governmental Affairs Committees, from reaching the floor in the 108th Congress. Both bills would have removed the escrow requirement and relieved USPS of its current obligation to pay the military pension costs of its employees. They would also require USPS to begin funding its future retiree health care obligations, but payment schedules differ between the two bills. The House bill has been re-introduced in the 109th Congress as H.R. 22.

Because the Postal Service has said it must raise rates next year, there is some urgency to resolving these two issues before a new rate case is filed in April. Without a resolution, new rates for 2006 will reflect \$3 billion for an escrow fund that cannot be used, and \$1.5 billion for repaying the Treasury for the past military service of present or former postal employees. This report will be updated to reflect significant legislative developments.

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Pension Issues Cloud Postal Reform Debate

Reform of the U.S. Postal Service (USPS) business model has become closely entwined with the congressional commitment to revisit the USPS pension funding reforms that Congress enacted in 2003. On the one hand, the prospect of a double-digit postage rate increase to cover pension-related obligations imposed by an act of the 108th Congress kept postal issues on the crowded legislative agenda in an election year. On the other hand, sharp differences between the Bush Administration and postal stakeholders over how postal pension obligations are to be handled brought to a halt the postal reform effort that had gained some momentum from the report of a presidential blue-ribbon commission.

This report explains and analyzes the postal employee pension issues currently before Congress. It supplements other CRS products that analyze broader postal reform issues: CRS Issue Brief IB10104, *Postal Reform*, by Nye Stevens; and CRS Report RS21640, *The Legislative Recommendations of the President's Commission on the United States Postal Service: An Overview*, by Nye Stevens and Kevin Kosar.

Background

For the past four years, USPS has been experiencing severe financial pressures stemming from a long-term decline in use of the mail for business and personal correspondence. Postal financial problems caused the Government Accountability Office (GAO; formerly General Accounting Office) to put USPS's transformation efforts on its High-Risk List of federal programs in April 2001, warning of the loss of universal service or a massive taxpayer bailout. The Comptroller General joined others in warning of a "death spiral" of rising rates causing further erosion in mail volume, and requiring further rate increases to cover the costs of the ever-growing delivery network. Three rate increases in 2001 and 2002 did not keep USPS from ending both of those years in the red. USPS also faced nearly \$100 billion in unfunded liabilities for pensions, health benefits for retirees, and workers compensation obligations. USPS, its board of governors, mailers associations, and GAO all agreed that the Postal Reorganization Act of 1970 no longer provides a viable business model and must be reformed.¹

¹ For further information on the causes of the long-term erosion in USPS financial prospects, see CRS Report RL31069, *Postal Service Financial Problems and Stakeholder Proposals*, by Nye Stevens. GAO has also issued a score of reports and testimonies demonstrating the point. The latest and most succinct is U.S. Government Accountability Office, *U.S. Postal Service: Key Reasons for Postal Reform*, GAO-04-565T, Mar. 23, 2004, available at [<http://www.gao.gov/new.items/d04565t.pdf>].

Having placed USPS on its High Risk List, GAO found fault with the fact that no one had ever determined whether the \$32 billion liability USPS was carrying on its books for retirement obligations of its employees who are still under the Civil Service Retirement System (CSRS) was an accurate figure.² GAO, along with nearly all other postal analysts, suspected that it was too low. GAO therefore asked the Office of Personnel Management (OPM) to recalculate the obligation so that the true extent of postal liabilities could be known. OPM's actuaries went back into the books to isolate Postal Service and postal employee contributions and interest earned on those contributions since 1971, when USPS became a standalone entity responsible for funding its own retirement obligations.

Thus it was welcome news when, on November 1, 2002, OPM Director Kay Coles James wrote the Postmaster General that the payments USPS was making to the Civil Service Retirement and Disability Fund (CSRDF) under current law would *overfund* the USPS liability for pensions to its CSRS retirees by \$71 billion. A principal reason was that interest earnings of past contributions had been credited at a statutory rate of 5%, when in fact the average rate of return on the bonds held by the trust fund has been substantially higher.³ In reviewing the OPM calculations, GAO put the potential overfunding even higher — as much as \$103 billion — since under then-current law the Treasury rather than USPS was responsible for retirement benefits based on prior military service of postal employees, and OPM's calculations treated these as obligations of the Postal Service.⁴

The Postal Civil Service Retirement System Funding Reform Act of 2003

The Postal Service, its unions, mailers' organizations, OPM, the Treasury, and the Office of Management and Budget all coalesced in support of legislation, drafted originally by OPM, to change the statutory funding formula and relieve USPS of the obligation to overfund its liability. On April 23, 2003, President Bush signed into law the Postal Civil Service Retirement System Funding Reform Act of 2003, P.L. 108-18. The act authorized USPS to reduce its annual payments to the CSRDF by \$3.5 billion in FY2003 and \$2.7 billion in FY2004. Although the law was quickly passed without dissent in either chamber, two obstacles had to be bypassed along the way. One was the budget impact.

² CSRS was closed to new entrants in 1984. Employees hired since then are in the Federal Employees Retirement System (FERS), a fully funded retirement system.

³ A much more comprehensive overview of the factors involved in OPM's recalculation, including the application of dynamic principles to valuing CSRS liabilities, is contained in CRS Report RL31684, *Funding Postal Service Obligations to the Civil Service Retirement System*, by Patrick Purcell and Nye Stevens.

⁴ U.S. Government Accountability 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, Jan. 31, 2003, available at [<http://www.gao.gov/new.items/d03448r.pdf>].

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) by as much as \$41 billion in the unified federal budget over the 10-year period from FY2003 to FY2013, depending in part on what USPS did with the savings.⁵ If USPS were to use the savings to hold down postage rates, this would reduce overall government receipts; the unified federal budget would be reduced since mailers would pay less and the flow of funds to the CSRDF would be diminished. If, on the other hand, rates were not restrained and the "saved" money were used to pay down the \$11.9 billion USPS debt to the Treasury's Federal Financing Bank, the impact on the unified federal budget would be limited to the reduction in the Bank's interest income. Partly in response to the CBO's report, the Senate (S. 380) and House (H.R. 735) bills directed USPS to use savings for FY2003, FY2004, and FY2005 to reduce the Postal Service's debt to the Federal Financing Bank. Savings (or more accurately, postage receipts above what had been needed to finance CSRS contributions at the former rate) in subsequent fiscal years were to be held in escrow until otherwise provided in law. The final CBO cost estimate for the legislation projected a maximum budget cost of \$7.2 billion over the FY2003-FY2013 period.⁶

The second issue was a provision included in the measure by OPM, where the first draft originated, relating to responsibility for military retirement obligations. This provision reversed a long-standing accounting practice that had required the taxpayer, rather than USPS, to pay the retirement costs associated with retirement credits earned by USPS employees in CSRS while they had been members of the armed forces. The legislative proposal would have USPS fund a portion of the military service costs for employees hired before 1972, and all military costs for employees hired after 1971 when USPS became independent. GAO estimated the cost of this provision to USPS as \$27.9 billion.⁷

This provision troubled proponents of the bill. Eight Democrats summarized their objection to this provision in an "additional views" addendum to the House committee report on the bill:

... (W)e do not believe that requiring the Postal Service to pay the pension costs associated with military service is a good idea.... Under current law, Treasury pays the retirement costs related to the military service of employees in CSRS. H.R. 735 shifts the burden of costs related to military service of postal employees covered by CSRS to the Postal Service. In fact, the bill not only requires the Postal Service to pay military pensions for current and future retirees, but it also makes the Postal Service reimburse Treasury for costs that have already been

⁵ Letter to Honorable Jim Nussle, Chairman, House Budget Committee, Jan. 27, 2003, available at [<http://www.cbo.gov/showdoc.cfm?index=4033&sequence=0>].

⁶ Congressional Budget Office, Cost Estimate, H.R. 735, Mar. 14, 2003, available at [<http://www.cbo.gov/showdoc.cfm?index=4106&sequence=0>].

⁷ GAO 03-448R, p. 28.

paid. The shift will require the Postal Service to pay \$27.2 billion more than it otherwise would have to pay. This is unfair to the Postal Service.⁸

Because the White House signaled that it would oppose the legislation if the military pension provision were removed, Members in the House compromised on a proposal to revisit the question later. In the words of the floor manager of the bill, Chairman Tom Davis of the Government Reform Committee,

I think this is an issue that demands further study because no other agency in the Federal Government that I am aware of funds its CSRS military obligations within the department. It may ultimately be unfair to make postal customers and ratepayers fund military retirement benefits. Working with the gentleman from California (Mr. Waxman), my ranking member, I prepared an amendment to the House version of the bill, H.R. 735, requiring the Department of the Treasury, the Office of Personnel Management, and the Postal Service to develop proposals on this issue. So this is an issue that will be revisited.⁹

Escrow and Military Pension Issues To Be Revisited

The military retirement issue was temporarily resolved by including in H.R. 735 a provision (section 2 (e)) requiring USPS, the Treasury Department, and OPM each to prepare and submit to the President, Congress, and GAO, by September 30, 2003, “proposals detailing whether and to what extent the Department of the Treasury or the Postal Service should be responsible for the funding of benefits attributable to the military service of current and former employees of the Postal Service....”

With this provision added, the Senate agreed to substitute the text of S. 735 for that of S. 380, and passed the measure by voice vote on April 2, 2003.¹⁰ Since S. 380 as passed by the Senate contained the above language approved by the House Government Reform Committee, passage of S. 380 in the House was not controversial. It passed on April 8, 2003, by a vote of 424-0.¹¹ President George W. Bush signed the bill into law, as P.L.108-18, on April 23, 2003.

As enacted, P.L. 108-18 clearly contemplated that both the escrow and the military retirement provisions would need to be reconsidered. In addition to the reports required of USPS, the Treasury, and OPM on the military retirement cost issue, the law also required (Section 3(e)) that USPS, by September 30, 2003, develop and submit a proposal for the use of savings that would accrue from the law’s enactment after FY2005. GAO was directed to review the reports from USPS

⁸ U.S. Congress, House Committee on Government Reform, *Postal Civil Service Retirement System Funding Reform Act of 2003*, report to accompany H.R. 735, H.Rept. 108-49, 108th Cong., 1st sess. (Washington: GPO, 2003), p. 22.

⁹ Rep. Tom Davis, remarks in the House, *Congressional Record*, daily edition, vol. 149, Apr. 8, 2003, p. H2904.

¹⁰ Senate debate, *Congressional Record*, daily edition, vol. 149, Apr. 2, 2003, pp. S4724-4729.

¹¹ House debate, *Congressional Record*, daily edition, vol. 149, Apr. 8, 2003, pp. H2901-2909.

and the executive branch on military retirement costs, and, within 60 days of receiving the USPS proposal for use of the escrowed savings, to submit to Congress a written evaluation of this proposal. Section 4 of the act (“Legislative Action”) provided that

Not later than 180 days after it has received both the proposal of the Postal Service and the evaluation of such proposal by the General Accounting Office under this subsection, Congress shall revisit the question of how the savings accruing to the Postal Service as a result of the enactment of this Act should be used.

This provision, while not binding, contemplated that Congress would revisit the escrow requirement by the end of May, 2004.

Administration and USPS Proposals Differ

In the year that has passed since enactment of P.L. 108-18, little progress has been made in resolving the issues that were left open by that legislation, despite the preparation of multiple reports and the holding of a dozen congressional hearings where the issues were discussed. The position taken by the Administration is sharply opposed to that taken by USPS and its stakeholders, and GAO’s reviews of the contrasting analyses have not resolved the differences. GAO has essentially concluded that the differences are policy matters for Congress to decide.

Proposals for Use of Escrow Funds.

In its report on use of the savings in escrow after 2005, USPS pointed out that “savings” is really a misnomer for the “potential amount of overfunding of CSRS pension costs in any given year had corrective action not been enacted.”¹² By the end of FY2005, USPS said that all of the overfunding in FY2003 through FY2005 will have been used to reduce debt and keep postage rates steady.¹³ In the future, there will be no savings because USPS will need to build into its rates the cost of funding the escrow account, an amount that would add 5.4% (or 2 cents on a first class stamp) to whatever rate increase will otherwise be required in 2006. While it would be forced to collect the funds from the mailing public, it would not be able to use them for any purpose under the terms of P.L. 108-18. CBO estimates that the escrow requirement will cost USPS (and therefore the mailing public) nearly \$3 billion in 2006 and \$36 billion over the 2006-2014 time period.¹⁴

¹² U.S. Postal Service, *Postal Service Proposal : Use of Savings For Fiscal Years After 2005, P.L. 108-18*, undated, available at [<http://reform.house.gov/UploadedFiles/Postal%20Service%20Proposal%20-%20Use%20of%20Savings%20for%20FYs%20After%2005.pdf>].

¹³ In fact, by June 2004, USPS payments to the Treasury had reduced its debt to zero, a reduction of \$11.1 billion since the end of FY2002. “Treasury Loans to USPS Fall to Zero in June Vs \$7.3 Billion End FY03,” *Morningstar.com*, Aug. 9, 2004.

¹⁴ Congressional Budget Office, *Cost Estimate, H.R. 4341, Postal Accountability and Enhancement Act*, revised July 13, 2004, p. 3.

Nevertheless, USPS recognized that simply revoking the escrow requirement and not collecting the funds was not a realistic option, because of its negative effect on the unified federal budget. Instead, it took into account the need (emphasized by GAO and specifically identified in the statute for USPS to consider in its plan) to begin funding the liability USPS faces for the future health benefits of its retirees and their dependents, an amount it estimates at \$47-57 billion. USPS proposed to devote all of the “savings” to that purpose if Congress relieved it of the burden of paying retirement benefits for military service. If Congress does not change the military service requirement, then USPS would propose to use the escrow fund amount to pre-fund retiree health benefits only for new employees, and ameliorate future rate increases by using the rest of the funds for debt repayment and capital investments. This would at least assure that postal ratepayers providing the funds would get some benefit in terms of a contribution to the costs of delivering the mail, rather than having them sit unused. USPS also expected that continuing to collect the funds but setting them aside in a fund controlled by the executive branch would neutralize the budget impact. USPS included tables in its report showing how the escrow would grow in the years after 2006, eventually peaking at \$8.7 billion annually.

GAO, as required, issued a report analyzing the two USPS proposals in late November.¹⁵ GAO did not argue for retaining the escrow provision. It found that the most equitable option was the first one (setting funds aside for all pensioners), because it struck the most equitable balance between current and future ratepayers by building benefits earned by today’s employees into its rate base. Leaving those costs largely unfunded, as the second option would do, was less fair to future ratepayers. GAO expressed some skepticism about using some of the funds for capital investments since it did not believe that USPS had provided Congress with a careful investment plan tied to reducing its workforce and its physical infrastructure.

Proposals for Allocating Responsibility for Military Costs.

The USPS report on military pay asked Congress to reverse the provision of P.L. 108-18 requiring USPS to pay \$27 billion in military retirement costs for its employees, pointing out that more than 90% of the financial obligation is the result of military service performed before the Postal Service was created.¹⁶ Had OPM adhered to the practice of assigning costs of military service to the Treasury, USPS would not be in the situation of overfunding its CSRS obligations in the future; they would already be overfunded by \$10 billion. The USPS proposal was to return the obligation to the Treasury, and to credit the \$27 billion (most of it was paid out long ago to veterans of World War II and Korea) to a separate Treasury account designated as the “Postal Service Retiree Health Benefit Fund.” USPS emphasized

¹⁵ U.S. Government Accountability Office, *Postal Pension Funding Reform: Issues Related to the Postal Service’s Proposed Use of Pension Savings*, GAO Report GAO-04-238, Nov. 26, 2003, at [<http://www.gao.gov/new.items/d04238.pdf>].

¹⁶ U.S. Postal Service, *Postal Service Proposal: Military Service Payments Requirements, P.L. 108-18*, undated, available at [<http://reform.house.gov/UploadedFiles/Postal%20Service%20Proposal%20-%20Military%20Service%20Payments%20Requirements.pdf>].

that no agency other than USPS is responsible for CSRS costs based on past military service; the Treasury pays these costs for all federal employees under CSRS.

The Treasury/OPM report on behalf of the Administration defended the requirement that USPS, rather than the Treasury, pay these costs, calling their assignment to the Treasury “an historical accident.”¹⁷ The Administration’s report started from the principle that all costs attributable to employee service after the 1971 reorganization should be paid by ratepayers rather than taxpayers. The Treasury (and the taxpayer) should cover only a pro-rated share of military service for employees who retired after 1971, based on the ratio of pre-1971 civilian service to total civilian service. Postal employees qualified for pensions based on military service (like other civil service benefits) only because USPS hired them; if they had not been hired, no pension costs would have been incurred. In other words, the Treasury and OPM were saying the credits should be regarded as a fringe benefit of USPS employment rather than a fringe benefit of military service. The report pointed out that FERS, which now covers most postal employees, includes the cost of military service in its dynamic funding principles, and implied that Congress would have assigned these costs to USPS in 1971 if anyone had been thinking about such issues then.

GAO’s report on the military retirement issue essentially said that the issues were matters of policy for Congress to decide.¹⁸ The GAO report did not consider the budget scoring impact of the issue. Costs assigned to the Treasury are part of the Administration’s budget, while costs paid by USPS are off-budget.

Retirement Funding Issues Addressed in Hearings

Coinciding with discussion of pension funding issues was the emergence of serious debate on broader issues of postal reform in the 108th Congress. While Representative John McHugh had tried for years to gain attention to the need for reform of the failing USPS business model, legislation drafted by his House Government Reform Postal Subcommittee had never made much headway. Postal reform re-emerged as a serious issue with the July 2003 report of the President’s Commission on the United States Postal Service. The commission confirmed a long-term decline in demand for postal services, and made 35 reform recommendations to stabilize USPS financing, 18 of which would require legislative action.¹⁹

¹⁷ *Report to Congress on the Financing of Benefits Attributable to the Military Service of Current and Former Employees of the Postal Service*, undated, available at [<http://www.treas.gov/press/releases/js775.htm>].

¹⁸ U.S. Government Accountability Office, *Postal Pension Funding Reform: Review of Military Service Funding Proposals*, GAO Report GAO-04-281, Nov. 26, 2003. [<http://www.gao.gov/new.items/d04281.pdf>].

¹⁹ See CRS Report RS21640, *The Legislative Recommendations of the President’s Commission on the United States Postal Service: An Overview*, by Nye Stevens and Kevin Kosar.

One of the recommendations of the President's Commission was that "[r]esponsibility for funding Civil Service Retirement System pension benefits relating to the military service of Postal Service retirees should be returned to the Department of the Treasury." In its discussion of the issue, the commission said

No other Federal agency is required to pay such costs for its retirees under CSRS. In the Commission's view, it is inappropriate to require the Postal Service, as a self-financing entity that is charged with operating as a business, to fund costs that would not be borne by any private sector corporation (costs associated with benefits earned while the retiree was employed by another employer). In addition, requiring federal agencies financed through Congressional appropriations to cover the military retirement benefits of its employees still taps resources from the same appropriate revenue source — taxpayers. Requiring a self-financing federal entity to follow suit is wholly different. It asks those who use the nation's postal system to subsidize the U.S. military every time they use the mail.²⁰

Since the release of the commission's report on July 31, 2003, 12 hearings have been held by the House Government Reform or the Senate Governmental Affairs Committee, including one joint hearing on March 23, 2004. While the overall focus of the hearings was on reform proposals, most witnesses addressed the escrow and military retirement cost issues in their statements. Nearly all of the witnesses urged that these two provisions of P.L. 108-18 be repealed because of their major impact on postage rates. The Postmaster General intimated that the rate increase in 2006 will be "in the double digits" including 5.4% for the escrow account alone. Press reports translated this into a 4-cent increase in the cost of a first-class stamp. Senator Susan Collins, Chair of the Senate Committee on Governmental Affairs, told Treasury Secretary John Snow at the March 23 joint hearing that "two issues that united every single witness who has testified before our committee in these six previous hearings ... are a desire to see the escrow account repealed and the return of the military pension obligation to the Treasury Department.... So the administration has a pretty lonely voice on those two issues."²¹

Differences on Escrow Requirement.

At the March 23, 2004 joint hearing, Treasury Secretary John Snow pointed out that the escrow requirement did not originate with the Administration. He did not defend it conceptually, beyond observing that by budget scoring conventions, "if the monies are allowed to flow out of the escrow account, they would be charged against the deficit and add \$3 billion to the deficit."²² The Administration would accept an offset of this amount elsewhere in the budget, but would oppose lifting the

²⁰ President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service*, (Washington: GPO, July 31, 2003), pp. 125-126. The report is available at [<http://www.treas.gov/offices/domestic-finance/usps/>].

²¹ *Senate Governmental Affairs and House Government Reform Committees Hold Joint Hearing on Restructuring the U.S. Postal Service*, FDCH Transcripts, Mar. 23, 2004, pp. 17-18.

²² *Ibid.*, pp. 15-16, 38-39.

requirement without an offset. House Government Reform Chairman Tom Davis countered that the requirement is a “job killer,” because a 5.4% across the board postage increase would be bad for the economy. “These are postal dollars that ultimately ought to be used for the post office.”²³

Apparently the committee is seeking to obtain this objective by structuring an arrangement that would be neutral from the perspective of the unified budget, yet still allow postal ratepayers to gain some benefit from the dollars that are now scheduled to flow into the escrow fund. According to a policy statement adopted by voice vote of the committee on February 26, 2004,

This year, the Committee intends to include in postal reform legislation language cancelling the escrow requirement.... If the escrow is allowed to take effect, the Postal Service would be required to raise billions of dollars from ratepayers that it would be unable to spend, which inflates the baseline unified budget. Cancelling the escrow will have the inverse effect. Using CBO’s baseline estimate of the effect of the escrow, we estimate that canceling the escrow will cost the unified budget \$12.5 billion through FY09 and \$35.7 billion through FY14.²⁴

The committee went on to say that these amounts would be partially offset by establishing the Postal Service Retiree Health Benefits Fund in OPM and funding it with USPS payments above what is now going into CSRS of \$5.1 billion over five years and \$11.0 billion over 10 years. This still leaves a hole in the unified budget of \$7.4 billion through FY2009 and \$24.7 billion through FY2014. The committee is working with the Congressional Budget Office to determine whether changes to the postal rate-setting process, certain to be addressed in postal reform legislation, could be fashioned in such a way as to have a positive effect on the unified budget.²⁵

Differences on Military Retirement Costs.

Treasury Secretary Snow discerned that the Administration’s position on the incidence of military retirement costs was not well understood by its critics in Congress and the mailing community. His statement before the March 23, 2004 joint hearing, therefore, spelled out in more detail the rationale behind the Administration’s strong opposition to reversing the provision of P.L. 108-18 that relieved the Treasury of its obligation to pay pension costs of postal employees arising from their service in the armed forces.²⁶ In some contrast to the arguments made in the September 2003 OPM-Treasury report to Congress, Secretary Snow cast the argument this time in terms of general principles of equity, fairness, good government, and financial prudence.

²³ Ibid., pp. 38-40.

²⁴ U.S. Congress, House Committee on Government Reform, *Views and Estimates on the Fiscal Year 2005 Budget of the United States*, committee print, Feb. 26, 2004, p. 7.

²⁵ Ibid.

²⁶ U.S. Department of the Treasury, *Hearing Testimony of the Honorable John W. Snow*, Mar. 23, 2004, available at [<http://www.treas.gov/press/releases/js1255.htm>].

An important element of the Administration's defense of its position is that "no other agency has ever received the benefit of a dynamic analysis of its investment flows, as was the case for the Postal Service. It provided the Postal Service with a properly calculated, enormous gain of \$78 billion at the expense of other CSRS participants."²⁷ The statement pointed out that USPS, unlike virtually all other federal agencies, is obliged to manage its finances in a manner that covers its full costs. The Secretary also said that the Administration's proposal "is fair and equitable because the Postal Service has also been the beneficiary of significant taxpayer funded appropriations, which more than cover the attribution to Postal of the \$27 billion in military costs."

The Secretary's testimony characterized the application of FERS-like principles to CSRS payments as "a 'good government' initiative."

There are a number of voices that advocate a return of these obligations to the taxpayer because the impact on the federal budget can be minimized by having the Postal Service allocate these funds to cover other unfunded retirement obligations.... Good government dictates that we consider this as a real economic cost, dollar for dollar, no matter how these funds might be accounted for in the federal budget.²⁸

Finally, the statement said it would be financially imprudent to treat USPS in a manner different from the FERS funding paradigm, because to "tinker with" FERS across agencies would have implications throughout the government retirement structure, with potentially enormous costs.

Most postal stakeholders adhere to the view that the costs of military defense should not be attributed to postal ratepayers, because they are a national obligation. While it is unlikely that USPS will be hiring many new employees who are in the CSRS system, it strikes postal stakeholders as unfair to penalize USPS for having hired veterans in the past, when those without military service credits would have been cheaper.

USPS and mailers groups also dispute that USPS has been the beneficiary of generous appropriations from Congress. It should be noted in this regard that USPS, though entitled to by law, has not requested a public service appropriation to cover the costs of universal service since 1982, well before the advent of FERS. While USPS has received regular appropriations totaling billions as a congressional subsidy for free or reduced rate mail for non-profit organizations, the blind, and overseas voters, this was to reimburse it for not charging full costs to such beneficiaries.²⁹

²⁷ Ibid., p. 2. It should be noted, however, that P.L. 108-18 made no changes in the law that raised the costs of other CSRS participants.

²⁸ Department of the Treasury, *Hearing Testimony*, Mar. 23, 2004, p. 3.

²⁹ For more information on appropriations to USPS, see CRS Report RS21025, *The Postal Revenue Forgone Appropriation: Overview and Current Issues*, by Nye Stevens.

Mailers organizations have circulated widely a study that asserts “(i)nstead of draining the federal budget, USPS has actually been subsidizing it.”³⁰

The Postal Service Office of the Inspector General (OIG) has also weighed in on the issue. On April 9, 2004, the OIG issued a report saying that the decision of place additional liabilities on USPS for the escrow and military retirement costs is “wrong,” and motivated by an attempt to keep higher payments coming into the CSRDF than is necessary to cover the expenses borne by postal customers. “The money should not be given to OPM to subsidize appropriated tax dollars. This would constitute a hidden tax for Postal Service customers that has not been appropriated by Congress.”³¹

Legislation Introduced

Postal stakeholders recognized that the President would likely veto a free-standing bill that would add the escrow account to the deficit and return the military retirement obligation to the Treasury. Their strategy was to package military and escrow provisions in a broader postal reform measure that enacts some of the far-reaching recommendations of the President’s own blue-ribbon commission.

On May 12, 2004, Representatives Tom Davis, Waxman, Danny Davis, and McHugh introduced H.R. 4341, a comprehensive postal reform measure drawn in large part from previous postal reform efforts developed by Representative McHugh. The bi-partisan bill also contains provisions repealing the escrow provision of P.L. 108-18, and returning responsibility for the military cost of postal retirees to the Treasury Department, while also requiring the Postal Service to significantly fund its retiree health benefit liability. The bill was ordered to be reported the same day by the House Committee on Government Reform by a vote of 40-0. Chairman Tom Davis recognized that the bill will need further refinements before it is ready of floor consideration.

Senators Collins and Carper introduced S. 2468 on May 20, 2004. The bill is similar in many respects to H.R. 4341, and would also reverse the escrow and military pension provisions of P.L. 108-18.³² It too would require USPS to use the savings from elimination of the escrow account to begin pre-funding its obligation to pay health care costs for retirees. The two bills differ, however, in their payment schedules for resolving the health care liability. S. 2468 would require USPS to pay more into the retiree health benefit fund in early years (approximately 6% of the total liability in 2006, for example) and then slowly reduce payments over the next 20 years. H.R. 4341 requires a lower initial payment (of about 2%), but then would

³⁰ Saturation Mailers Coalition, *The State of Pension and Retiree Benefit Obligations for the Postal Service and the Need for Reform*, Dec. 2003, available at [<http://www.postcom.org/public/2004/pension.and.benefit.pdf>].

³¹ U.S. Postal Service, Office of the Inspector General, *Postal Service’s Funding of the Civil Service Retirement System*, product number FT-OT-04-002, Apr. 9, 2004, p.2.

³² For a comparison of the two bills, see CRS Report RL32402, *Postal Reform Bills: A Side-by-Side Comparison of H.R. 4341 and S. 2468*, by Kevin R. Kosar.

require sharply higher payments over the 10 subsequent years, especially from 2010 to 2015. Both bills propose a faster funding pace than USPS had proposed. The Postmaster General warned in a May 26, 2004 speech that the pace of funding will place upward pressure on prices, and that the \$3.9 billion payment for 2006 in the Senate bill could add 6.5% to the next rate case.

Legislative Action in the 108th Congress

Both bills faced uncertainty in the crowded end-of-session legislative calendar. Representative McHugh said, however, that he had assurances from House leaders that the bill would be brought to a floor vote in the House. S. 2468 was approved in the Senate Governmental Affairs Committee by a 17-0 vote on June 2. It faced obstacles from the budget perspective, however, and lacked a leadership commitment to bring it to the floor.³³ In the end, neither bill was brought to the floor for a vote.

An alternative strategy pressed by some mailers' groups was to urge Congress to approve a rider in an appropriations measure, perhaps an omnibus bill, that would relieve USPS from the obligation to collect the escrow amount in its next rate case (i.e., for a two-year period). This too did not succeed. One reason was that the Administration raised the level of its opposition to the legislation very late in the session.

On November 10, 2004, the Administration circulated to insiders on the Hill a plain-paper criticism of the postal reform legislation. The two-page document led with an assertion that the bills failed the test of self-financing for USPS, citing CBO's estimates of its budget impact.

Treatment of Military Service Obligations — The Administration believes that the Postal Service, not ratepayers, must continue to be responsible for its pension costs connected with military service credit for postal employees under the Civil Service Retirement System (CSRS). Last year, significant pension relief was provided for USPS totaling \$78 billion. The house and Senate bills would grant an additional \$27 billion in relief by transferring the military service obligation to the Treasury.

Elimination of the Escrow Requirement — The House and Senate provisions making funds available fo the Postal Service by abolishing the existing statutory escrow requirement in 2006 must be altered so there is no adverse budget impact. The Administration supports the underlying policy of abolishing the escrow, and has proposed a solution to eliminate the requirement in a budget neutral manner

³³ CBO has said that enacting H.R. 4341 would not affect how much the federal government spends on pension or health care benefits for USPS retirees, but it would increase future budget deficits as measured by the unified federal budget. There would be an on-budget saving of \$24.1 billion (from funding the Postal Service Retiree Health Benefits Fund in the Treasury), but an off-budget cost of \$34.5 billion, for a net cost to the unified budget of \$10.4 billion for the FY2005-FY2014 period. See Congressional Budget Office, *Cost Estimate, H.R. 4341, Postal Accountability and Enhancement Act*, July 13, 2004, p. 5. Available at [<http://www.cbo.gov/showdoc.cfm?index=5644&sequence=0&from=6>]. CBO has a somewhat higher net estimate — \$15.7 billion — for the Senate bill, S. 2468. Available at [<http://www.cbo.gov/showdoc.cfm?index=5601&sequence=0&from=6>].

by requiring the Postal Service to use these resources to fully pre-fund current substantial unfunded liabilities for retiree health benefits.

Legislative Action in the 109th Congress

Taking up the postal reform measures, with their pension implications, is regarded as an urgent priority by mailer groups and key Committee proponents. Representative McHugh re-introduced the House version of postal reform legislation with only minor modifications as H.R. 22 on the first day of the 109th Congress, for himself, Government Reform Committee Chairman Tom Davis, Ranking Minority Member Waxman, and Representative Danny Davis. According to the Committee's website, "overall, the major provisions of the Postal Accountability and Reform Act remain the same as the version introduced last year."³⁴

USPS plans to raise its rates (for the first time in three and one-half years) early in 2006. Preparations for the rate case before the Postal Rate Commission have already begun, and most observers expect a new rate case to be filed in April 2005. If the military and escrow provisions are not resolved by then, the rate case will need to incorporate their costs in the new rate request. (In 2006, this would mean \$3 billion for the escrow fund, and \$1.5 billion for the military retirement repayment.)

In the meantime, mailers are beginning to question whether P.L. 108-18 was the unalloyed boon to postal commerce that it seemed to be at the time. According to a widely read mailers newsletter:

While the immediate windfall from the change in the funding formula allowed the USPS to postpone the next rate increase by two years, the organization now finds itself facing the real possibility it will have to build those \$3 billion costs back into the next rate case **and** absorb the military retirement costs. In short, it gets no savings in 2006 plus it has to pick up the military costs of \$27 billion — a cost it didn't have to pay in the past.... (P)erhaps the industry would have been better off if the CSRS law were never changed. The question will be moot only if Congress can pass legislation lifting the escrow requirement and shifting the military costs to the Treasury.³⁵

³⁴ [<http://reform.house.gov/GovReform/News/DocumentSingle.aspx?DocumentID=6437>].

³⁵ "Benefits from CSRS Fix Are Slipping Away," *Business Mailers Review*, Apr. 12, 2004, p. 3.