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A Primer on the Postal Service Retiree Health Benefits Fund

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Executive Summary

The Postal Service promises its workers they will receive health benefits in retirement. Retiree health benefits are different from pensions, but both are types of deferred compensation, are expensive, and are major components of the Postal Service's labor costs.

Prior to 2006, the Service simply paid retirees' health benefit premiums when they came due. The Service put aside no money when it promised the future benefits. Paying benefits when they come due rather than funding them in advance is known as the pay-as-you-go or unfunded approach.

Early this century, Congress, the Administration, the U.S. General Accounting Office (GAO), and a bipartisan presidential commission expressed concern about the lack of funding. Although retiree health benefits are often unfunded or poorly funded, two considerations suggested the Service's retiree health care obligations should be funded: they are as firm a commitment as the Service's pensions, and they had become enormous (about $75 billion by 2006). In 2003, the presidential commission suggested establishing a reserve fund for these obligations, and the Postal Service itself sent Congress a proposal for creating such a fund.

In 2002-2003, it was discovered that the Service was contributing far more than necessary to fully fund its pensions, and Congress allowed the Service to contribute less. Congress decided the pension "savings" could help patch the retiree health benefit underfunding. In 2006, as part of the Postal Accountability and Enhancement Act (PAEA), the Postal Service Retirement Health Benefits Fund (RHBF) was established. Most of the Service's contributions to the new fund could be paid using the pension "savings." PAEA was bipartisan legislation with broad support.

Because postal rates had previously increased enough to cover pension costs and a temporary escrow account into which pension "savings" were placed in 2006, the Service's rates should have been high enough to cover its RHBF contributions. Shortly after PAEA's enactment, however, the Great Recession and accelerated electronic diversion crushed mail demand and postal revenue fell far short of earlier expectations.

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The Service has lost money nine years in a row, with total losses of $56.8 billion for 2007-2015.

In that adverse business environment, the Service has experienced enormous difficulty meeting its RHBF requirements. The challenge has been especially great because Congress specified a front-loaded RHBF contribution schedule: yearly payments averaging roughly $5.6 billion during the 10 years 2007-2016, with any remaining unfunded liability to be paid over 40 years starting in 2017. When the depth and persistence of the mail decline became apparent, Congress should have replaced the front-loaded schedule with a gradual one, but it did not.

The Postal Service has defaulted on every RHBF payment since 2010, although it had enough cash to make modest partial payments in the last couple of years. The defaults have not affected the benefits of current retirees. While defaults normally have severe repercussions, the Service has incurred no penalties.

Through 2015, the Postal Service had contributed a total of $20.9 billion to the RHBF and defaulted on $28.1 billion. The RHBF also received $17.1 billion from an overfunded pension account. The RHBF's unfunded liability was $54.8 billion at the end of 2015.

The pay-as-you-go approach can look attractive in the short run because it temporarily hides costs. However, it often leads to future financial problems. In extreme cases like Detroit and Puerto Rico, it can contribute to bankruptcy or its equivalent. At the Postal Service, the debts accumulated during decades of pay-as-you-go financing may be partially responsible for reduced service quality today; they threaten future mail users with rate increases; and they heighten the danger the Service will need a taxpayer bailout.

It is sometimes claimed the retiree health care liability includes benefits that will be owed to future workers, some not even born. According to GAO's chief actuary, however, the number includes no future workers, only future benefits already promised to past and current workers.

If the Service had continued with pay-as-you-go, its financial statements during the last decade would have appeared much less dire. It might even have eked out small profits in recent years. Unfortunately, the retiree health benefit commitments are very real and very costly. Ignoring the costs for longer would ultimately make them even harder to pay and put the Postal Service's future financial viability at greater risk.

The Service has a plan to slash its retiree health care liability by requiring Medicare-eligible retirees to enroll in Medicare or lose the health benefits promised by the Service. Medicare enrollment is now voluntary for these individuals. The House Committee on Oversight and Government Reform, chaired by Rep. Jason Chaffetz (R-UT), recently approved a bill, the Postal Service Reform Act of 2016 (H.R. 5714), whose key element is the Medicare mandate. Shifting costs to Medicare would greatly ease the Postal Service's financial problems, but the Medicare program is itself facing huge strains. Medicare Part A is projected to become insolvent in 2028.

Another bill recently voted out of committee (H.R. 5707) would let RHBF assets be invested in the stock market. That would let the Service reduce future RHBF contributions by assuming, in advance, high stock market returns. If actual returns proved disappointing, however, postal customers and taxpayers would come under intense pressure to cover the shortfall.

The Postal Service Retiree Health Benefits Fund (RHBF) is a major source of confusion for policymakers who are trying to make sense of the Postal Service's finances. Their puzzlement is understandable because the fund involves a type of deferred labor compensation and how best to pay for it. Deferred compensation arrangements, by their nature, can get very technical very fast.

The costs of the RHBF are very large, and are a big part of the massive deficits facing the Postal Service.[1] Consequently, some knowledge of the RHBF and the obligations it is intended to finance are essential to properly evaluate the Postal Service's financial condition. Unfortunately, although the Postal Service's financial condition is dire, a misunderstanding of the fund has led to the false hope in some quarters that the Service's problems are mostly artificial and can be fixed with only a few minor and easy tweaks.

The following questions and answers attempt to demystify the RHBF's purpose and importance.

Retiree health benefits at the Postal Service

Does the Postal Service provide health coverage to its workers after they retire?

Yes. The Postal Service is part of the Federal Government,[2] and that means postal workers are federal employees. As a result, career postal workers are generally eligible to receive health coverage through the Federal Employees Health Benefits (FEHB) Program. Some noncareer postal employees can also receive health benefits through the program.[3] Following their retirement, postal employees who enrolled in the FEHB Program during their working years have the option of remaining in the program. Retiree health coverage is a valuable fringe benefit for postal workers but a major expense for the Service.

Is delivery of the retiree benefits a firm commitment to current and former postal employees?

When employers in the business and nonprofit sectors offer retiree health benefits (something that is increasingly rare), it is not unusual for the organizations to retain the flexibility to reduce or eliminate the benefits based on their finances and the cost of the

1 When this paper cites numbers from the Postal Service's financial statements, the years are Postal Service fiscal years, which begin on October 1 of the prior calendar year and end on September 30 of the current calendar year. Also, when this paper mentions the health benefits of postal retirees, it should be understood that dependents qualify for benefits in many cases.

2 Although the Postal Service is sometimes called quasi-governmental or a government-private hybrid, it is actually an independent agency within the government's executive branch (per 39 U.S.C., sec. 201). Some other examples of independent federal agencies are the Central Intelligence Agency (CIA), Environmental Protection Agency (EPA), Federal Communications Commission (FCC), and Securities and Exchange Commission (SEC).

3 See, for example, "Collective Bargaining Agreement Between American Postal Workers Union, AFL-CIO and U.S. Postal Service, for May 21, 2015 to September 20, 2018," p. 168, July 25, 2016, http://www.apwu.org/sites/apwu/files/resource-files/%28Flimsy%29%202015%20Collective%20Bargaining%20Agreement.pdf. Many other noncareer employees are not FEHB eligible, however. To comply with the Patient Protection and Affordable Care Act (PPACA), the Service offers health insurance outside the federal program – and without the retirement benefit – to certain noncareer employees. (See Eric Katz, "USPS Extends Health Care to Non-Career Workers to Comply With Reform Law," *Government Executive*, April 30, 2013, http://www.govexec.com/pay-benefits/2013/04/usps-extends-health-care-non-career-workers-comply-obamacare/62899.)

benefits. At the Postal Service, however, promises of retiree health benefits are closer to a binding commitment, similar in that respect to pensions.

How do health benefits at the Postal Service compare with health benefits at non-government employers?

The FEHB Program is more generous to active and retired workers than most employer-provided health insurance in the business and nonprofit sectors. The difference is especially pronounced with regard to retirees. Few small employers have ever offered health benefits to their retirees, and the share of large businesses providing retiree health benefits has declined dramatically over the last 30 years. According to Kaiser/HRET surveys, among large employers (200 or more employees) that provide health benefits, the portion offering them to retirees has plunged from 66 percent in 1988 to 23 percent in 2015.[4]

How much did the Service pay in health benefit premiums in fiscal year 2015?

Health coverage is an expensive fringe benefit. The Service reported that approximately 492,000 active employees received health benefits in 2015, at a cost to the Service of $4.8 billion.[5] In addition, roughly 490,000 annuitants and survivors (retirement benefit recipients) were enrolled in the FEHB Program, and the Service spent $3.1 billion on their premiums in 2015.[6]

The Postal Service also offers most of its workers pension benefits. Are the two programs related?

No, they are separate fringe benefits. Three similarities, though, are that both are forms of deferred compensation; they are expensive; and they are increasingly uncommon outside the government sector. (Defined contribution retirement plans, such as 401(k)s, are rapidly replacing defined benefit pensions in the business and nonprofit sectors. And, as mentioned above, fewer and fewer employers outside the government sector offer retiree health benefits.)

Can the Postal Service restructure fringe benefits to reduce their cost, either unilaterally or in consultation with postal unions?

No. One might expect the agency to push hard in labor negotiations for fringe benefit reform given the enormous expense of its fringes and the reality that they are increasingly out of line with what is seen in the private and nonprofit sectors. In fact, however, fundamental restructuring of fringe benefits is basically off the table in labor negotiations. The reason is that the Postal Reorganization Act of 1970, which converted the old Post Office Department

4 Frank McArdle, Tricia Neuman, and Jennifer Huang, "Retiree Health Benefits At the Crossroads," Kaiser Family Foundation, April 14, 2014, http://kff.org/report-section/retiree-health-benefits-at-the-crossroads-overview-of-health-benefits-for-pre-65-and-medicare-eligible-retirees; and "Employer Health Benefits; 2015 Annual Survey," The Kaiser Family Foundation And Health Research & Educational Trust, September 22, 2015, http://kff.org/report-section/ehbs-2015-section-one-cost-of-health-insurance.

5 U.S. Postal Service, *Form 10-K, 2015*, pp. 10 and 25, November 13, 2015, http://about.usps.com/who-we-are/financials/10k-reports/fy2015.pdf.

6 *Ibid*., pp. 10 and 55.

into today's Postal Service, prohibits any "variation, addition, or substitution with respect to fringe benefits" that would "result in a program of fringe benefits which on the whole is less favorable to the officers and employees than fringe benefits in effect" at that time (P.L. 91-375, section 1005(f)). The Service may be able to implement some minor adjustments in fringe benefits, perhaps in consultation with its workers, but because of the legal barrier, it generally takes acts of Congress to make major changes.

A pleasant pension surprise and the establishment of the Postal Service Retiree Health Benefits Fund (RHBF)

What is the Postal Service Retiree Health Benefits Fund (RHBF)?

In 2006, the Postal Service had fully funded its pensions. However, Congress and the Bush Administration were concerned that the Service had put nothing aside to finance promised retiree health care benefits. This concern reflected the facts that the promised benefits entail massive future liabilities and that delivering the benefits is a firm commitment to current and former postal employees. Accordingly, when Congress enacted the Postal Accountability and Enhancement Act of 2006 (P.L. 109–435, known as PAEA), it established a dedicated fund for retiree health care benefits, the Retiree Health Benefits Fund (RHBF).

In 2003, Congress allowed the Postal Service to reduce its future pension contributions, and in 2006, Congress established the RHBF. How were the two actions related?

In 2002, at the request of the General Accounting Office (GAO),[7] the U.S. Office of Personnel Management (OPM) examined the adequacy of the Postal Service's pension funding. Contrary to expectations, OPM discovered that the Service would overfund its pension liabilities by billions of dollars unless it contributed less in the future.[8] In response, the Bush Administration called for legislation to head off the pension overfunding, and Congress promptly enacted the Postal Civil Service Retirement Systems Funding Reform Act of 2003 (P.L. 108-18).[9] The law permitted the Service to lower its pension contributions and directed that some of the Service's savings be used to pay down debt, some go toward delaying a rate increase, and some be held in an escrow account while Congress developed postal reform legislation.[10]

The 2003 Act also expressed the sense of Congress that "because the Postal Service still faces substantial obligations related to postretirement health benefits for its current and former employees, some portion of the savings ... should be used to address those

7 The name of this government watchdog agency was later changed to Government Accountability Office, but it kept the same acronym.

8 More specifically, OPM examined the Civil Service Retirement System (CSRS) pensions of postal workers hired before 1984. The main reason for the surplus was that the Service's contributions to the pension fund were earning higher interest rates than had originally been anticipated. For details, see 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," January 31, 2003, http://www.gao.gov/new.items/d03448r.pdf; and Senate Report No. 108-35, 108th Congress, "Postal Civil Service Retirement System Funding Reform Act of 2003," esp. pp. 2-3, https://www.congress.gov/108/crpt/srpt35/CRPT-108srpt35.pdf.

9 Legislation was needed because a statutory funding formula had to be modified.

10 P.L. 108-18, sec. 3(a).

unfunded obligations."[11] Congress was aware – and concerned – that the Service had put aside nothing to fund its billions of dollars of retiree health care liabilities. In 2006, Congress and the Administration remembered the pension relief and recognized the opportunity it provided. While PAEA's centerpiece was a new system of postal rate regulation, the act also established the RHBF.

To set the record straight, was PAEA controversial and bitterly partisan legislation that received almost no support on one side of the aisle and nearly unanimous support on the other, such as the Patient Protection and Affordable Care Act?

No, PAEA was popular, noncontroversial legislation that garnered broad bipartisan support.

It passed the House under a suspension of the rules on a voice vote, and the Senate approved it by unanimous consent.[12] PAEA was the product of much hard work and reflected compromises between Congress and the Administration, between the two houses of Congress, and on both sides of the aisle.

Did the Postal Service initially support or oppose the prefunding provision?

Although the Service is now sharply critical of the fund, the opposite was once the case. In fact, the creation of a "Postal Service Retiree Health Benefit Fund" was originally the Service's idea, contained in a proposal it submitted to Congress in 2003.[13] The Service claimed its proposed fund, which would have been a much more limited fund than the one Congress established three years later, addressed the concerns of Congress, the GAO, and the widely respected bipartisan President's Commission on the United States Postal Service about its large and growing retiree health care liability.[14] The Service observed that its proposal, as a sweetener for Congress, was structured to avoid increasing the federal deficit.

The Presidential Commission had previously recommended "funding a reserve account to address these [unfunded retiree health benefit] obligations to the extent that Postal Service finances permit" in order to improve transparency and "so future ratepayers are not forced to pay for postal services delivered to the nation today."[15]

After PAEA's enactment, the Service declared in its *2007 Annual Report*, "This [fund] is a farsighted and responsible action that places the Postal Service in the vanguard of both the public and private sectors in providing future security for its employees, and augurs well

11 P.L. 108-18, sec. 3(d)(2).

12 See Congress.gov, https://www.congress.gov/bill/109th-congress/house-bill/6407/actions.

13 See U.S. Postal Service, "Postal Service Proposal: Use Of Savings For Fiscal Years After 2005, P. L. 108-18," 2003. Also see U.S. General Accounting Office, "Postal Pension Funding Reform: Review of Military Service Funding Proposals," Appendix II: Report from the United States Postal Service," GAO-04-281, November 2003, http://www.gao.gov/assets/250/240773.pdf; and U.S. General Accounting Office, "Postal Pension Funding Reform: Issues Related to the Postal Service's Proposed Use of Pension Savings," GAO-04-238, November 2003, http://www.gao.gov/assets/250/240766.pdf.

14 The Service actually offered two proposals, according to whether Congress held it responsible for the higher pension costs of some employees who received credit from the Service for prior military service. The proposals were complicated, and it is beyond the scope of this paper to discuss their details. In advancing the plans, the Service hoped to persuade Congress that it should not be liable for the extra pension costs due to the military credits. It secured that objective when Congress passed PAEA.

15 President's Commission on the United States Postal Service, "Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service," p. 124, July 31, 2003, https://www.treasury.gov/press-center/press-releases/documents/pcusps_report.pdf.

for our long-term financial stability upon successful completion of the payments."[16] The only concern the Service expressed at the time (correctly, as later events proved) was that Congress had selected a very rapid funding schedule: "In the near term, however, these payments [for 2007-2016] will be a considerable financial challenge."[17]

The Postal Service's contributions to the RHBF and the Service's defaults

How much is the Postal Service supposed to contribute to the retiree health fund and over what time frame?

PAEA divided the catch-up funding of the RHBF into three phases.

First, to give the RHBF a head start, PAEA transferred into the new fund the Postal Service's overfunding of Civil Service Retirement System (CSRS) pensions ($17.1 billion) and the money in the temporary escrow account ($3.0 billion).[18]

Second, PAEA directed the Postal Service to make payments into the RHBF averaging about $5.6 billion annually over the 10 years, 2007-2016.[19] These payments closely matched what the Postal Service saved due to its reduced pension contributions.[20] Although Congress was aware that retirement pensions and retiree health care are separate fringe benefits, it decided that reduced pension costs increased the Service's ability to fund its retiree health care commitments. An additional consideration was the favorable effect the contribution schedule had on PAEA's 10-year budget score.

Third, in 2017, OPM is to compute the Service's remaining unfunded liability for the retiree health benefits promised to current and former postal workers, and the Service is to amortize the liability over the 40-year period 2017-2056.[21] Also, starting in 2017, the Service is to make a payment each year equal to the value of the additional retiree health benefits earned by employees that year. (For example, if postal employees will earn future retiree health benefits with a present value of $3.3 billion as a result of the work they

16 U.S. Postal Service, *Annual Report, 2007*, p. 13, https://about.usps.com/who-we-are/financials/annual-reports/fy2007.pdf.
17 *Ibid*.
18 P.L. 109–435, sec. 802 and 804. Section 804 also repealed the escrow account since that account was only intended to be a stopgap until Congress passed postal reform legislation.
19 P.L. 109–435, sec. 803.
20 In 2003, the Postal Service estimated that its pension "savings" would total $22.9 billion over the period 2007-2010. In PAEA, for the same period, the amount that Congress directed the Service to contribute to the RHBF was $21.9 billion. (See U.S. Postal Service, "Postal Service Proposal: Use Of Savings For Fiscal Years After 2005, P. L. 108-18," *op. cit*. The Service provided two sets of estimates, based on whether Congress held the Service responsible for the increased pensions received by certain postal employees due to prior military service. Because Congress relieved the Service of those costs in PAEA, the estimates reflecting that are used here.)
21 P.L. 109–435, sec. 803. PAEA directs OPM to redetermine the unfunded liability in each subsequent year and revise the amortization schedule accordingly. Starting in 2043, the amortization period is to last 15 years instead of ending in 2056.

perform in 2017, the Service is to contribute $3.3 billion to the RHBF in 2017 to finance this deferred compensation. Actuaries call this amount the "normal cost.")[22]

Prior to PAEA, the Postal Service had paid the employer portion of retirees' FEHB premiums as the premiums came due. How are the premiums due each year being paid for under PAEA?

Congress decided to have a transition period between the new and old financing systems. During the 10 years 2007-2016, while the assets in the RHBF are building up, the Service has continued paying the employer portion of the FEHB premiums that come due each year. Starting in 2017, the retiree health care premiums that arrive each year are to be paid using the assets in the RHBF.

How much has the Postal Service contributed to the RHBF so far?

The Postal Service has to date contributed $20.9 billion. In addition, $17.1 billion was transferred from the fund holding the CSRS surplus.[23]

Table 1 compares the RHBF contributions specified in PAEA with those the Service has actually made. The initial transfers, totaling $20.1 billion, occurred as scheduled in 2007. As for the 10 annual payments stipulated by PAEA, the Service made the first two: $5.4 billion in 2007 and $5.6 billion in 2008. In 2009, however, mail demand was sharply lower due to the Great Recession, intensified use of e-mail, computer bill-paying, and other electronic diversions. Mail volume was down 17.0 percent from its record high in 2006, and revenue was down 6.5 percent.[24] Under the circumstances, Congress granted short-term relief, passing legislation to reduce the 2009 RHBF contribution to $1.4 billion.[25] In 2010, Congress rebuffed Postal Service requests for further relief, and the Service made the $5.5 billion RHBF contribution required by PAEA. In 2011, Congress allowed the 2011 contribution to be delayed to 2012 after the Service informed key members of Congress it was dangerously short of cash.[26] In 2012, the Service owed both the postponed 2011 contribution and the 2012 contribution, but it remained critically short of cash, and after giving Congress advance notice, it defaulted on both payments. Having set a precedent, the Postal Service also defaulted on its 2013, 2014, and 2015 payments, and has said it will default again in 2016.[27] If all payments had occurred as originally scheduled, RHBF contributions would have totaled $75.9 billion by the end of 2016.

22 Starting in 2017, PAEA also requires the Service to gradually amortize any remaining unfunded pension liability. The two main pension systems for postal employees are the Civil Service Retirement System (CSRS) for workers hired before 1984 and the Federal Employees Retirement System (FERS) for workers hired since then. A discussion of this change, which affects the funding of the Service's other major type of deferred compensation, is beyond the scope of the present paper.

23 Specifically, the transfer was from the Civil Service Retirement and Disability Fund (CSRDF), which holds CSRS assets, to the Postal Service Retiree Health Benefits Fund (RHBF). Because the CSRDF and the RHBF are both outside the Postal Service, the transfer did not affect the Postal Service's costs or net income. On the other hand, the $3 billion transfer from the escrow account is included in Postal Service contributions because although the escrow money was in a restricted cash account, it was held by the Postal Service.

24 U.S. Postal Service, *Annual Report*, *2009*, pp. 74 and 77, https://about.usps.com/who-we-are/financials/annual-reports/fy2009.pdf.

25 P.L. 111-68. Legislation was required for the change to take effect because PAEA specified the dollar amounts owed in each year from 2007 through 2016.

26 P.L.112-33.

27 U.S. Postal Service, *Annual Reports*, various issues.

The reduced contribution in 2009 and the Service's multiple defaults have cut actual contributions in half, to $38.0 billion ($20.9 billion from the Postal Service and $17.1 billion from an interfund transfer.)

Table 1.

Contributions to the Retiree Health Benefits Fund (RHBF), Through 2016

	Contributions Required by PAEA* ($ billions)	As Later Modified ($ billions)	Postal Service's Required Contributions ($ billions)	Postal Service's Actual Contributions ($ billions)
Initial Transfers				
CSRS Surplus	17.1	N/C	****	****
Escrow Account	3.0	N/C	3.0	3.0
Yearly Contributions (Fiscal Years)				
2007	5.4	N/C	5.4	5.4
2008	5.6	N/C	5.6	5.6
2009	5.4	1.4**	1.4	1.4
2010	5.5	N/C	5.5	5.5
2011	5.5	Delayed until 2012***	5.5 (Due in 2012)	Defaulted in 2012
2012	5.6	N/C	5.6	Defaulted
2013	5.6	N/C	5.6	Defaulted
2014	5.7	N/C	5.7	Defaulted
2015	5.7	N/C	5.7	Defaulted
2016	5.8	N/C	5.8	Expected Default
TOTAL	75.9	71.9	54.8	20.9

* Postal Accountability and Enhancement Act of 2006 (P.L. 109–435)
** P.L. 111-68
*** P.L.112-33
**** This was a transfer between two federal funds, both outside the Postal Service.

Defaulting on legal obligations normally has severe consequences. What have been the consequences for the U.S. Postal Service?

Several months before its first default, then Postmaster General Patrick Donahoe warned in congressional testimony, "We have insufficient revenue to cover our costs and are rapidly approaching our statutory debt limit of $15 billion. If the Postal Service were a private company, we would be engaged in Chapter 11 bankruptcy proceedings."[28] Of course, the Postal Service is not a normal business. Following its first default, the government enterprise reported, "[W]e have suffered no penalties or damages as a result of our inability to make these payments."[29] Congress appears to be less bothered by the Service's serial defaults than by the cost-cutting that would occur if the Service were forced into reorganization or bankruptcy.

28 Statement Of Postmaster General/CEO Patrick R. Donahoe, Before the House Subcommittee on Federal Workforce, U.S. Postal Service & Labor Policy, March 27, 2012, http://about.usps.com/news/testimony/2012/pr12_pmg0327.pdf.

29 U.S. Postal Service, *Form 10-K, 2012*, November 15, 2012, p. 11, https://about.usps.com/who-we-are/financials/10k-reports/fy2012.pdf.

The Service does not have enough cash to make its full RHBF contributions, but could it make partial contributions?

In 2012, the first year it defaulted, the Postal Service truly had very little liquidity. Even after borrowing $2 billion from the U.S. Treasury, which caused it to hit its statutory credit limit of $15 billion, it finished the year with only $2.3 billion of cash and cash equivalents.[30] In 2015, the Service ended the year with a much more comfortable $6.6 billion in cash and cash equivalents.[31] It could have made a partial payment. By then, however, defaults had come to seem almost routine, and the Service was unwilling to pay any of its statutory RHBF obligation.

The Postal Service's unfunded retiree health care liability

How large is the Postal Service's retiree health care liability?

The U.S. Office of Personnel Management (OPM) estimated that the present value of the Postal Service's retiree health care liability was $105.2 billion at the end of 2015, while the assets in the RHBF were $50.3 billion.[32] The difference, $54.8 billion, is the unfunded retiree health benefit liability as of the end of 2015. For comparison, the Postal Service had total revenue of $68.9 billion in fiscal year 2015.[33]

How has the Service's unfunded retiree health benefit liability changed over the last decade?

As shown in Table 2, the Service's liability was $74.8 billion at the end of fiscal year 2006, and it was all unfunded.[34] After PAEA's enactment, however, the assets of the RHBF built up rapidly. By the end of fiscal year 2010, the retiree health benefit liability was $91.1 billion but the fund had assets of $42.5 billion.[35] Hence, from 2006 to 2010, the unfunded liability dropped from $74.8 billion to $48.6 billion, and the funding ratio rose from 0 percent to 47 percent. Because the Postal Service has defaulted on all subsequent contributions, however, fund assets have risen slowly since then, with interest earnings on prior contributions the only source of growth. By the end of fiscal year 2015, the funding ratio, at 48 percent, was close to what it had been in 2010, but the dollar amount of the unfunded liability had increased from $48.6 billion to $54.8 billion.[36] If the Service had been able to maintain PAEA's funding schedule, the liability would now be approximately 80 percent funded.[37]

30 *Ibid*. p. 109..
31 U.S. Postal Service, *Form 10-K, 2015*, op. cit., p. 12
32 *Ibid*., p. 26.
33 *Ibid*., p. 37.
34 U.S. Postal Service, *Annual Report, 2007*, p. 26, https://about.usps.com/who-we-are/financials/annual-reports/fy2007.pdf.
35 Statement of Lori Rectanus, Director, Physical Infrastructure Issues, Government Accountability Office, "U.S. Postal Service: Continuing Financial Challenges and the Need for Postal Reform," Testimony Before the Committee on Oversight and Government Reform, House of Representatives, GAO-16-651T, p. 15, May 11, 2016, https://oversight.house.gov/wp-content/uploads/2016/05/Rectanus-GAO-Statement-5-11-Postal-Reform.pdf.
36 *Ibid*.
37 This was computed by the author by adding to fund assets the difference between the payments specified in PAEA and actual contributions, plus interest on the difference.

Is retiree health care the Postal Service's largest unfunded liability?

Yes, it is more than twice as big as the next largest. The Service's three main unfunded liabilities at the end of 2015 were retiree health benefits at $54.8 billion, pensions at $24.1 billion, and workers compensation at $18.8 billion. [38] Another major Postal Service liability is the $15 billion it has borrowed from the U.S. Treasury.

Table 2

Postal Service's Retiree Health Benefits Liability, 2006-2015

Amounts in billions

Fiscal Year	Total Liability, End of year	Contributions	Funded, End of year	Unfunded, End of year	Funding Ratio
2006	$74.8	$0.0	$0.0	$74.8	0.0%
2007	80.8	25.5	25.7	55.0	31.8%
2008	86.1	5.6	32.6	53.5	37.9%
2009	87.5	1.4	35.5	52.0	40.6%
2010	91.1	5.5	42.5	48.6	46.7%
2011	90.3	0.0	44.1	46.2	48.8%
2012	93.6	0.0	45.7	47.9	48.8%
2013	95.6	0.0	47.3	48.3	49.5%
2014	97.7	0.0	48.9	48.9	50.1%
2015	105.2	0.0	50.3	54.8	47.8%

Notes.
The 2007 contribution is the sum of $17.1 billion transferred from the CSRS fund, $3.0 billion from the escrow fund, and USPS's 2007 contribution of $5.4 billion.
The funded amount reflects contributions and interest earned on contributions.
The estimated total liability changes over time due to updated assumptions about the workforce, medical costs, interest rates, and other factors.
Sources: Government Accountability Office and Postal Service.

Are estimated liabilities too high because of demographic differences between postal workers and other federal workers?

In a series of reports, the Postal Service's Office of Inspector General (OIG) has argued that the Service's pension and retiree health liabilities could be estimated more accurately if OPM used demographic assumptions specific to active and retired postal workers, rather than the overall federal workforce.[39] The OIG calculated that postal-specific assumptions would trim pension liabilities by about $11 billion and increase retiree health liabilities by about $2 billion.[40]

38 Rectanus, *op. cit*., p. 13. The pension number is the sum of the $20.4 billion unfunded pension liability of the Civil Service Retirement System (CSRS), which is for employees hired before 1984, and the $3.7 billion unfunded pension liability of the Federal Employees Retirement System (FERS), which is for employees hired since then.

39 Office of Inspector General, U.S. Postal Service, "Using U.S. Postal Service-Specific Assumptions for Calculating the Retiree Health Care Liability," FT-MA-13-022, September 27, 2013, https://www.uspsoig.gov/sites/default/files/document-library-files/2013/ft-ma-13-022.pdf; Office of Inspector General, U.S. Postal Service, "Using U.S. Postal Service-Specific Assumptions for Calculating the Federal Employees Retirement System Liability," FT-MA-13-024, September 27, 2013, https://www.uspsoig.gov/sites/default/files/document-library-files/2013/ft-ma-13-024.pdf; and Office of Inspector General, U.S. Postal Service, "Using U.S. Postal Service-Specific Assumptions for Calculating the Civil Service Retirement System Liability, FT-MA-13-023, September 27, 2013, https://www.uspsoig.gov/sites/default/files/document-library-files/2013/ft-ma-13-023.pdf.

40 *Ibid*.

GAO agrees this would be a reasonable change if it would improve accuracy, but cautions that independent experts, such as OPM's Board of Actuaries, should be in charge of setting the postal-specific assumptions to ensure objectivity.[41] (Long-run actuarial estimates are extremely sensitive to their assumptions. Unobjective, self-serving assumptions could easily skew the results.)

Funded versus pay-as-you-go approaches to financing retiree health care costs

What do the terms funded (sometimes called pre-funded) and pay-as-you-go mean?

An employer's promises to pay future benefits are said to be fully funded if there is a dedicated fund with assets equal to the present value of expected future payments to current and former workers. For example, if an employer has a $10 billion liability for future pension benefits to current and former workers and if the employer has a pension fund with assets of $10 billion, the pension plan is 100 percent funded. In contrast, pay-as-you-go means putting aside nothing when future benefits are promised and, instead, dealing with the costs only when they come due. For example, if an employer hopes to finance pension commitments as they come due in the future solely out of future earnings, that would be a 100 percent pay-as-you-go approach.

A rough analogy may also be helpful in distinguishing between the approaches. If a couple saves in anticipation of retirement, that is similar to the funded (or pre-funded) approach. If a couple decides not to worry about post-retirement-age expenses during their normal working years, but wait until after they have reached retirement age, that is similar to the pay-as-you-go approach, which may require them to keep working.

It sounds like the RHBF shifts retiree health care financing away from the pay-as-you-go (i.e., unfunded) model and toward the funded approach. Is that correct?

Yes. If the Postal Service had made all its RHBF contributions, the retiree health benefits of current and former postal employees would now be close to fully funded. As it is, retiree health benefits promises, at 48 percent funded, are about halfway between pay-as-you-go and funded.

41 Statement of Frank Todisco, Chief Actuary Applied Research and Methods Government Accountability Office, "U.S. Postal Service: Action Needed to Address Unfunded Benefit Liabilities," Testimony Before the Subcommittee on Federal Workforce, U.S. Postal Service and the Census, Committee on Oversight and Government Reform, House of Representatives, GAO-14-398T, March 13, 2014, http://www.gao.gov/assets/670/661637.pdf.

Pay-as-you-go's delayed financing is attractive near term, but can it cause problems later?

Yes. The pay-as-you-go method allows an employer to make expensive promises that temporarily appear inexpensive because there is little or no negative impact in the short run on reported income and cash flow. This causes short-term financial statements to understate true costs and may lead to a false sense of confidence. Eventually the bills come due. At that point, they can produce significant financial strains if the employer was not careful when making the commitments.

Is the pay-as-you-go approach sometimes sensible?

Yes, it may be reasonable in three cases. First, if an employer's finances are currently weak but expected to become much stronger in the future, putting off obligations until they can be dealt with more easily may be a smart choice. Second, if the future obligations are small, it may not be worth the administrative expense of setting up a dedicated funding source. Third, if the future benefits are not a firm commitment but contingent on the employer's future financial capacity, and may be reduced if needed, the pay-as-you-go route does not add much risk. None of these conditions apply to the Postal Service. It cannot expect rapid future income growth when demand for its most profitable product, First-Class Mail, continues to decline; its future costs for retiree health care are huge; and its promise to provide retiree health benefits is binding.

What are the strengths of paying for commitments when they are made?

The funded approach more accurately shows the costs of current operations on financial statements, which motivates employers to better manage costs and be more careful about what they promise. The most basic advantage, though, is that if employers put aside money as they promise benefits, the odds increase that they can make good on their promises. Additionally, for employers in the business and nonprofit sectors, the funded approach lessens the danger that the deferred costs of today's commitments will lead to bankruptcy tomorrow. For government employers, the funded approach reduces the hazards that unfunded obligations will eventually require large tax increases, such as those being felt now by Chicago property owners as the city tries to shore up dangerously underfunded pensions,[42] drastic cuts in government services, and, in extreme cases like Detroit and Puerto Rico, contribute to bankruptcy or its equivalent. For a government-owned enterprise with a large monopoly market, such as the Postal Service, the risks due to not funding deferred compensation are cutbacks in service quality for monopoly-market customers, higher postal rates within the monopoly, shifting costs to other government programs, and perhaps a taxpayer bailout.

42 Tim Novak, "18 Aldermen Avoid Hefty Property Tax Hikes, 5 Pay Less," *Chicago Sun-Times*, July 30, 2016, http://chicago.suntimes.com/news/watchdogs-18-aldermen-avoid-hefty-property-tax-hikes-5-pay-less.

Does the RHBF try to force the Service to prefund benefits to workers it has not yet hired?

Critics of the RHBF often level this charge. For instance, according to one account, the 2006 postal act was an "an incredible piece of ugliness" that forces the Service "to PRE-PAY the health care benefits not only of current employees, but also of all employees who'll retire during the next 75 years. *Yes, that includes employees who're not yet born!*"[43] [Emphasis in original.] The accusation is false. GAO's chief actuary, Frank Todisco, addressed this claim in congressional testimony: "Contrary to statements made by some employee groups and other stakeholders, these liabilities do not include any amounts for future USPS employees not yet hired or born."[44] To be clear, the retiree health benefits liability does look into the future because it is based on the expected benefits that active and retired employees have earned as a result of their current and past labor services, and many of those employees will still be receiving benefits years from now. However, the present liability does not include any benefits that may be promised in the future to future workers; it only includes benefits that have already been earned. There is still much confusion on this point. For instance, in its Form 10-K for 2015, the Postal Service wrote that PAEA forces it to fully fund the retiree health benefits promised to "current retirees and current and *future* Postal Service employees."[45] [Emphasis added.]

Isn't it common for retiree health plans to have much lower funding ratios than pensions, with many of them operating on a pay-as-you-go basis?

This is true. For example, state governments, on average, have funded less than 10 percent of their retiree health care liabilities.[46] This comparison might seem to suggest that the Postal Service has already provided more than enough funding and can rest on its laurels. The question that should be asked, though, is whether the Service's retiree health liabilities are large enough and binding enough to pose significant risks to future mail users and taxpayers. The answer is yes, and that argues for full funding or as close to full funding as the Service's finances permit. It might be added that the Postal Service is not the only organization where large unfunded retiree health care costs are a threat. For example, massive retiree health benefit liabilities are contributing to Illinois's budget difficulties today[47] and were a factor in the bankruptcy of Central Falls, Rhode Island in 2011.[48]

43 Jim Hightower and Phillip Frazer, "The Post Office Is Not Broke – and It Hasn't Taken Any of Our Tax Money since 1971," *The Hightower Lowdown*, March 2012, https://www.hightowerlowdown.org/sites/hightowerlowdown.civicactions.net/files/1203Lowdown.pdf.

44 Todisco, *op. cit*., p. 6.

45 U.S. Postal Service, *Form 10-K, 2015*, op. cit., p. 10.,

46 The Pew Charitable Trusts and the John D. and Catherine T. MacArthur Foundation, "State Retiree Health Plan Spending," p. 5, May 2016, http://www.pewtrusts.org/~/media/assets/2016/05/stateretireehealthplanspending.pdf.

47 Kevin Hoffman, "Pew: Illinois Has More Than $56.3 Billion in State Employee Health Care Debt," *Reboot Illinois*, May 11, 2016, http://www.rebootillinois.com/2016/05/11/editors-picks/kevin-hoffmanrebootillinois-com/pew-illinois-has-more-than-56-3-billion-in-state-employee-health-care-debt/57554.

48 Richard Simon, "Rhode Island's Central Falls Reeling From Underfunded Pension," *Los Angeles Times*, August 3, 2013, http://articles.latimes.com/2013/aug/03/nation/la-na-adv-central-falls-20130804.

An ambitious funding schedule

Was the retiree health benefit funding schedule in PAEA front-loaded?

It clearly was. Congress and the Administration told the Postal Service to eliminate within a decade 80 or 85 percent of an unfunded liability that had built up over several decades of pay-as-you-go financing, with the remainder to be eliminated more gradually over a longer time frame.

Did the funding schedule seem feasible at the time?

In late 2006, when PAEA was enacted, the Postal Service appeared much stronger than it does today. Notwithstanding warnings about electronic diversion and a temporary dip in volume following 9/11 and the anthrax attacks, total mail volume hit a record of 213.1 billion pieces in 2006, and total revenue increased until 2007.[49] On the cost side, the Service had achieved major savings by reducing its workforce 12 percent over the period 1999-2006, almost entirely accomplished through attrition, while skillfully maintaining service quality. Moreover, the Service's CSRS pensions were much better funded than had been feared several years earlier, allowing the Service's future pension contributions to be cut significantly. As a result of these positives on the revenue and cost sides, 2006 was the fourth year in a row the Postal Service had been profitable, and the government enterprise's borrowings from the U.S. Treasury had been cut from $11.3 billion at the end of 2001 to $2.1 billion at the end of 2006. In addition, the economy had avoided a severe recession for a quarter century, which led to a widespread belief that the economy had entered "The Great Moderation." Although many observers were concerned mail demand would eventually falter, William Burrus, the president of the American Postal Workers Union (APWU), was still able to insist in congressional testimony, "Does the expansion of e-mail and electronic bill payment mean that a decline in hard-copy communication is inevitable? Not at all. ... In fact, mail volume is increasing."[50] There seemed to be a window of opportunity for fixing the Service's largest unfunded liability while the Service was still on the upswing. In retrospect, of course, we know that vision was too optimistic.

The Postal Service's RHBF contributions are a major expense. Is their cost built into the postal rate base?

To a large degree it is. The explanation requires revisiting the rate-setting process that existed before PAEA became law. Under old law, rates were set on a cost-of-service basis. Accordingly, rates were set sufficiently high to cover costs, including the large amounts the Postal Service spent to fund its pension promises. As noted above, the 2003 relief legislation greatly reduced the Service's pension contributions, but required that, starting in 2006, all pension "savings" go into an escrow account. The escrow payments, which the Service could not then touch, counted as an expense.

49 The data in this paragraph are from U.S. Postal Service, *Annual Reports*, various issues.
50 William Burrus, President, American Postal Workers Union, "Setting the Record Straight on Postal Reform," Submitted to Senate Homeland Security and Government Affairs Committee, April 14, 2005.

In 2005, the Service sought a 5.4 percent across-the-board rate increase solely to cover the escrow expense. The Postal Rate Commission (PRC) approved the request, which took effect in January 2006.[51] In May 2006, the Postal Service sought a second, larger rate hike, with a small portion of that attributed to the escrow expense. In early 2007, the PRC approved this second request, with rate increases averaging 7.6 percent.[52] (Although the decision was issued after PAEA's enactment, it was based on pre-PAEA law.) In other words, postal rates were increased to give the Service enough revenue to cover the escrow expense, as well as its other costs. When PAEA eliminated the escrow account in favor of RHBF contributions, the dollar amount of expenses stayed roughly the same, even though the nature of the expenses changed. Accordingly, postal rates had been set high enough to cover the new RHBF contributions.[53]

But if the RHBF expense was effectively in the rate base, why did the Service plunge into deficit immediately after PAEA's enactment? The answer is that, under the old system, rates were set to generate enough sales revenue to cover costs – based on expectations of mail demand. When demand suddenly and unexpectedly crashed, revenue plummeted and deficits resulted. Under the old rate-setting regime, the Service would probably have asked for very large rate increases, similar to those seen in countries like Canada and the U.K., to restore budget balance. Under the current rate-setting process, however, price increases for market dominant products are generally limited to the inflation rate. (PAEA has a provision allowing an exigent rate increase if certain "extraordinary or exceptional circumstances" are met, and based on that provision, market dominant postal rates exceeded the inflation cap for a limited time, starting in January 2014 and ending in April 2016.) The Postal Service can raise the prices of competitive products at a faster clip, but it appears to be more interested in volume growth for those products than in profit maximization.[54] The Service has tried to narrow its deficits through cost reductions, but its efforts there have been slowed because of various cost-management restrictions it faces as a government enterprise.

Should there have been a midcourse correction to the PAEA funding schedule?

Absolutely. Postmaster General Megan Brennan recently declared in congressional testimony, "While this schedule [for 2007-2016 contributions] may have been considered manageable at the time the PAEA was enacted, volume trends and revenue impact since that time have upended that belief."[55] The front-loaded contribution schedule was designed for a Postal Service enjoying growing volume and revenue.

51 For the PRC's decision, see Postal Rate Commission, "Opinion And Recommended Decision," Docket No. R2005-1, November 1, 2005, http://www.prc.gov/docs/47/47278/R2005-1Op.Rec.Dec.pdf.

52 See Postal Regulatory Commission, "Opinion And Recommended Decision," Vol. 1, Docket No. R2006-1, February 26, 2007, http://www.prc.gov/docs/55/55901/Vol1R2006-1Op.pdf.

53 The military credits mentioned earlier add a wrinkle, but it is still accurate to say that the RHBF contributions were in the rate base. During the 2005 and 2006 rate cases, the Service's costs included responsibility for the military credits. Because those rate cases increased the Service's prices sufficiently to meet all costs, that means the credits were effectively in the rate base. Consequently, when PAEA replaced both the escrow account and responsibility for the military credits with roughly the same amount of RHBF contributions, the earlier price increases should have covered the RHBF's cost.

54 See Don Soifer, "Practices of the U.S. Postal Service That Imply Anti-Competitive Behavior: Historical Parallels and Remedies Across Other Regulated Sectors," *Lexington Institute*, June 2016, http://lexingtoninstitute.org/wp-content/uploads/2016/06/Anti-Competitive-Behavior.pdf.

55 Megan Brennan, Postmaster General, U.S. Postal Service, Written Testimony, House Oversight and Government Reform Committee Hearing, "Reforming the Postal Service: Finding a Viable Solution," May 11, 2016, https://oversight.house.gov/wp-content/uploads/2016/05/Brennan-USPS-Statement-5-11-Postal-Reform.pdf.

Unfortunately, within a year of PAEA's enactment, the Great Recession began, electronic diversion intensified, and mail demand nosedived. Congress made the right call when it lowered the 2009 RHBF contribution from $5.4 billion to $1.4 billion. However, Congress made the wrong call in later years when it failed to permit further adjustments, except for a one-year delay in 2011. When it became clear that mail usage had shifted from growth to decline, Congress should have replaced the front-loaded RHBF contribution schedule with a much more gradual schedule. By not approving a midcourse correction, Congress forced the 2012 default and emboldened the Service to refuse, since then, to contribute even a cent to the RHBF.

Retiree health benefits and the Service's finances after 2016

Was it initially expected the Service would have its retiree health care obligations well in hand by 2017?

Yes, it was thought the Service would have mostly funded its retiree health care obligations by 2017 and could then gradually amortize any small remaining unfunded liability based on the post-2016 contribution schedule.

Have events borne out that rosy forecast?

No, the numbers are sobering. Postmaster General Brennan expects the Service will need to make annual RHBF contributions of about $3 billion to amortize its unfunded retiree health care liability, even under the 40-year schedule that begins in 2017.[56] She further expects that funding the additional future benefits pledged each year in return for work that year will require another $3.3 billion, for a total of about $6.3 billion.[57] That is about $2.5 billion less than the Service was supposed to contribute in 2015 or 2016, but it is about $3.2 billion more than the Service actually contributed.[58] The numbers are big because the unfunded liability remains very large and retiree health benefits are very expensive.

Why didn't anyone warn us before now that the Postal Service would have continuing problems paying for its retirees' health care costs?

There have been warnings but they went mostly unheeded. Some of the clearest and most accurate came from GAO. By 2010, GAO recognized the Service could not pay as much into the RHBF as Congress told it to pay during the period 2007-2016. However, GAO also recognized failing to make the contributions would mean greater burdens later on.

56 *Ibid.*
57 *Ibid.*
58 As noted earlier, the Service paid $3.1 billion for retiree health care premiums in 2015 and was supposed to contribute $5.7 billion to the RHBF that year. The Service paid the $3.1 billion but defaulted on the rest.

Accordingly, GAO consistently advised, “It is important that USPS fund its retiree health benefit obligations–including prefunding these obligations–to the maximum extent that its finances permit.”[59]

Financial Statement Impacts

While the pay-as-you-go approach was in force, how did it affect the Service’s bottom line?

A basic property of the pay-as-you-go approach is that it initially understates costs and overstates net income. The reason is that the deferred costs of current production are ignored until they come due years later. For example, suppose that in return for labor services this year, a worker receives a pledge of future retiree health benefits with a present value of $2,500. Although the $2,500 is an expense related to current operations, it does not appear as a cost this year. Hence, the costs of current operations seem $2,500 lower than they really are and the net income from current operations appears $2,500 higher. In future years, when the bills have to be paid, the pay-as-you-go approach has the reverse effects on financial statements: by its nature, it automatically creates legacy costs that increase future expenses relative to future income.

Does the funded approach also distort the bottom line?

No, the funded approach accurately portrays the costs and income of each year’s operations. The reason is that the full costs of operations are reported when they occur. For example, if a worker receives a pledge of future retiree health benefits with a present value of $2,500 as partial compensation for this year’s labor services, the funded approach requires the employer to put aside $2,500 for paying the future bills. Hence, the $2,500 of deferred compensation appears as a current cost, which accurately aligns when costs are incurred and when they are reported.

Does moving from the pay-as-you-go to the funded approach temporarily elevate reported costs and decrease reported income?

This does occur during the transition. As a result of prior pay-as-you-go financing, there are legacy costs from past production that must be paid. In the case of the Postal Service’s retiree health benefit obligations, these unfunded liabilities had built to $74.8 billion by the time PAEA was enacted.[60] With the switch to the funded approach, those obligations from the past must be paid and, in addition, the full costs of the future retiree health benefits pledged each year in return for current labor services must be reported and paid.

59 Statement of Phillip Herr, Director Physical Infrastructure Issues, Government Accountability Office, “U.S. Postal Service: Action Needed to Facilitate Financial Viability,” Testimony Before the Committee on Oversight and Government Reform and Its Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, House of Representatives, p. 6, April 15, 2010, http://www.gao.gov/assets/130/124419.pdf.

60 U.S. Postal Service, *Annual Report, 2007*, p. 26, https://about.usps.com/who-we-are/financials/annual-reports/fy2007.pdf.

In 2007-2015, how do the Service's RHBF contributions compare to its net losses?

The Postal Service suffered a multibillion-dollar loss every year during the period 2007-2015. Total losses over the nine years summed to $56.8 billion.[61] Over the same period, the Service's required RHBF contributions (including payments on which it defaulted) were $49.0 billion.[62]

Why not let bygones be bygones and forget about the legacy costs of pay-as-you-go?

It would be nice if legacy costs could be wished away, but someone must pay them in some form. In the case of the Postal Service's unfunded retiree health care liability, one alternative to making the Service pay would be to force taxpayers to bail out the government enterprise. Another would be to shift costs to other government programs. A third option would be to place the burden on postal retirees by denying them the benefits they were promised. The costs have to be paid one way or another, and holding the Service to its promises may be more equitable and efficient than most alternatives.

The Service has begun highlighting what it calls controllable income, which excludes RHBF contributions from expenses and makes several smaller adjustments.[63] Based on the controllable income concept, the Service claims it actually earned a $1.2 billion profit in 2015 and a $1.4 billion profit in 2014.[64] Is this evidence the Service's problems have been exaggerated and its true financial condition is favorable?

No. The Postal Service has massive debts as a result of many decades of the pay-as-you-go approach. The Service's finances would be much brighter if those debts did not exist, but they do exist, notwithstanding the "controllable income" concept. After weighing those debts against the Service's other costs and its revenues, GAO has reached the reluctant conclusion that the "USPS continues to incur deficits that are unsustainable."[65] To be fair, the Postal Service could argue that losses over the period 2007-2015 have been enlarged because of the accelerated retiree health benefit funding schedule in PAEA. If the funding schedule had been more gradual, the Service's income statements over the period 2007-2015 would have looked better. While a more gradual funding schedule would, in retrospect, have been sensible, it would have left more of the unfunded liability to be reported in future years and dragged down income then.

61 U.S. Postal Service, *Form 10-K*, various years.

62 *Ibid*. As can be seen from Table 1, total required RHBF contributions over the period 2007-2015 were $66.1 billion (after the adjustment in 2009), but $17.1 billion of that was a transfer from the fund holding CSRS assets. That leaves the Postal Service's required contributions for 2007-2015 at $49.0 billion.

63 See U.S. Postal Service, *Annual Report, 2015*, esp. pp. 20-23, https://about.usps.com/who-we-are/financials/annual-reports/fy2015.pdf; and U.S. Postal Service, *Form 10-Q, Quarter II, FY 2016*, p. 16, May 9, 2016, http://about.usps.com/who-we-are/financials/financial-conditions-results-reports/fy2016-q2.pdf.

64 *Ibid*.

65 Rectanus, *op. cit*., p. 1.

When the Service defaults on statutory funding contributions, how is that recorded?

The required contribution amount is reported as a cost, and it reduces profits or widens losses. Because no contribution is actually made, there is no addition to fund assets. For instance, the Postal Service's statutory RHBF contribution in 2015 was $5.7 billion. Together with other costs, that obligation contributed to the Service's $5.1 billion net loss in 2015. However, because the Service defaulted on the payment, it obviously did not reduce cash on hand, did not add to RHBF assets, and did not reduce the unfunded retiree health benefits liability.

Since mail demand and revenue began falling, the Service has limited its spending on deferrable maintenance and nonessential capital projects. Although this restraint has reduced costs, there is a danger it may erode the quality of mail service and require large remedial expenditures in the future. To what extent have RHBF obligations reduced the Service's ability to undertake maintenance and capital spending?

As can be seen in Table 1, the Postal Service contributed a total of $20.9 billion to the RHBF, all of which occurred in the years 2007-2010. Those contributions may have influenced decisions by the Service to reduce maintenance and capital spending. On the other hand, $20.9 billion overstates the cash drain because, as mentioned earlier, the burden was mostly covered by PAEA's repeal of the escrow account. Moreover, even if the Service reduced maintenance and capital spending because of low cash holdings, later RHBF contributions had no effect on maintenance and capital spending since the Service made no later contributions. In fact, with the Service contributing nothing to the RHBF but benefitting from lower pension contributions and repeal of the escrow account, the Service's cash flow after 2010 was actually stronger than it would have been if pension relief had not been granted and the RHBF not created. This is not to deny the severity of the Service's financial difficulties. It is to caution that the problems extend much deeper than the RHBF contribution schedule.

Medicare proposals

In 2011 and 2012, the Postal Service developed a plan to dramatically lower its health benefit costs and render further RHBF contributions unnecessary.[66] What were the main features of that plan?

The Postal Service proposed withdrawing all active and retired postal workers from the federal government's FEHB Program and transferring them into a new health program the Postal Service would oversee. The Service claimed it could operate the program at less cost than the existing FEHB Program while delivering comparable benefits.

66 See Statement Of Postmaster General And Chief Executive Officer Patrick R. Donahoe, Before The Committee On Homeland Security And Governmental Affairs, United States Senate, February 13, 2013, http://about.usps.com/news/testimony/2013/pr13_pmg0213.pdf; and Office Of Inspector General, U.S. Postal Service, "U.S. Postal Service Alternative Health Care Plan Proposal," FI-MA-12-014, August 22, 2012, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/fi-ma-12-014.pdf.

The Service also proposed to require all Medicare-eligible retirees in its health benefit program to enroll in Medicare. The Medicare mandate would have shifted significant costs from the Postal Service to Medicare. The Senate, but not the House, passed legislation, the "21st Century Postal Service Act of 2012" (S. 1789, 112th Congress), that would have permitted these changes if postal unions agreed. Union support was doubtful, however, because of concerns about whether the revised benefits would be as advantageous as current ones. Two other concerns were whether the Postal Service could successfully manage what would be one of the largest health benefit programs in the nation and whether splitting the current FEHB Program in two would be disruptive.[67] Broader public policy issues were whether it would be desirable to shift costs to the financially struggling Medicare program and whether other elements of the plan, such as letting the Service invest fund assets in risky securities, would be financially prudent.

The Postal Service later modified its proposal. What was the major change?

Following consultations with postal unions and other major stakeholders, the Service dropped its demand that postal workers leave the FEHB Program.[68] This change eliminated the component of the proposal that had the most potential to lower total federal health benefit spending. However, the revised proposal would still require postal retirees receiving retirement health benefits to enroll in Medicare if they are Medicare-eligible. That preserved the element of the plan letting the Postal Service lower its health benefit costs by shifting more of them to Medicare.

Are postal retirees now eligible for Medicare and do they participate?

Like other seniors, federal retirees, including those from the Postal Service, are generally able to enroll in Medicare if they are at least 65 years old. Because of the health benefits they already receive through the FEHB Program, however, not all choose to participate. Approximately 9 percent of eligible postal retirees and dependents do not enroll in Medicare Part A (Hospital Insurance) and 27 percent do not participate in Medicare Part B (Medical Insurance).[69] Few federal retirees enroll in Medicare Part D (Prescription Drug Coverage) because the FEHB Program generally gives them comparable or superior benefits.[70]

67 For a fuller discussion, see U.S. Government Accountability Office, "U.S. Postal Service: Proposed Health Plan Could Improve Financial Condition, but Impact on Medicare and Other Issues Should Be Weighed before Approval," GAO-13-658, July 2013, http://www.gao.gov/assets/660/656011.pdf.

68 For an overview, see Statement of Jeffrey C. Williamson, Chief Human Resources Officer and Executive Vice President, U.S. Postal Service, Before the Subcommittee on Federal Workforce, U.S. Postal Service and the Census, United States House of Representatives, March 13, 2014, https://oversight.house.gov/wp-content/uploads/2014/03/Williamson-USPS-Statement-USPS-Unfunded-Liabilities-3-13.pdf.

69 Brennan, op. cit.

70 See U.S. Office Of Personnel Management, "Letter from OPM about Medicare Part D," https://www.opm.gov/healthcare-insurance/healthcare/medicare/letter-from-opm-about-medicare-part-d.

How would the Postal Service save money if it forced all Medicare-eligible postal retirees to participate in Medicare as a condition for receiving retiree health benefits?

When a participant in the FEHB Program enrolls in Medicare Part A or Part B, Medicare becomes the primary insurer for claims covered by Part A or Part B, and FEHB becomes the secondary insurer. Consequently, FEHB pays less of the claim because Medicare pays more. Medicare Parts A and B already substantially reduce the Postal Service's retiree health benefit costs since most Medicare-eligible postal retirees participate, but the Service would save more if every Medicare-eligible postal retiree had to enroll.[71]

To realize the savings from mandatory Medicare Part D participation, the Postal Service would use a device known as an Employer Group Waiver Plan (EGWP). EGWPs, which sometimes go by the nickname "Egg Whip,"[72] can be traced to the Medicare Modernization Act of 2003 (P.L. 108-173) and were enhanced by the Patient Protection and Affordable Care Act (P.L. 111–148). When private companies or state or local governments offer retiree health benefits, they often use EGWPs to lower their costs by maximizing subsidies from the Medicare program and obtaining Medicare-required prescription drug discounts. Under the Service's plan, which would require Congress's approval before it could be implemented, postal retirees would not enroll directly in Part D. Instead, the health plans they select within the FEHB system would deal with Medicare (Centers for Medicare and Medicaid Services) to obtain Part D subsidies and prescription drug discounts. Most of the savings would then be passed through to the Postal Service.

How much does the Postal Service think it would save from the Medicare proposal?

Postmaster General Brennan recently told Congress that the Medicare proposal, which the Service calls full or proper Medicare integration, would make the unfunded retiree health care liability almost go away, with the funding shortfall dropping by more than $50 billion.[73] According to 2014 testimony from the Service's chief human resources officer, slightly more than half the savings would come from the EGWP procedure for extracting Medicare Part D prescription drug subsidies and discounts and the remainder would come from requiring all Medicare-eligible retirees to enroll in Medicare Parts A and B.[74]

71 An important but technical detail is that, under current law, the FEHB plans do not segregate postal retirees from other federal retirees. Hence, the reduction in FEHB premiums due to Medicare savings actually depends on the share of all federal retirees who participate in Medicare, not just postal retirees. The Service's proposal would require plans with more than 1,500 postal members (active and retired) to segregate postal members and set their rates based on postal-only costs. That would let the full savings from mandatory Medicare participation be passed along to the Postal Service (which pays the majority of the premiums) and postal retirees (who pay a smaller share).

72 Consultants often bestow colorful nicknames on the strategies they develop or promote. See, for example, Schiff Benefits Group, "What Is an Employer Group Waiver Plan "Egg Whip" (EGWP) and Why Is It Important?" http://schiffbenefitsgroup.com/employer-group-waiver-plan-series-800.

73 Brennan, *op. cit*. The Service would still have a multibillion-dollar liability for the future retirement health benefits it has promised to current and former workers in exchange for their past labor services, but the assets in the RHBF would almost equal the liability.

74 Williamson, *op. cit*.

Would the Medicare proposal impose any costs on postal stakeholders?

For the most part it would not. Postal retirees would remain in the FEHB Program and would largely retain the overall health coverage they have now, although more of it would come through Medicare. One group that would see higher costs is the minority of postal retirees not currently enrolled in Medicare Part B because they would have to start paying Part B's premiums.[75] (This issue would not arise with Part A because it has no premiums.) Meanwhile, with less financial pressure on the Postal Service, it would be less likely that changes burdening stakeholders, such as higher postal rates, further reductions in the postal workforce, the closing of more postal facilities, or a rethinking of postal employees' fringe benefits, would be undertaken.

Would the proposal impose any costs on Medicare?

Clearly it would. That is a concern because Medicare's long-term finances are even worse than those of the Service, with Medicare Part A projected to go broke in 2028.[76] Although the Postal Service emphasizes that the extra costs on the Medicare program would be small relative to Medicare's total current costs, the percentage is small only because Medicare's total costs are so large.

Has legislation been introduced in Congress that would carry out the Postal Service's plan?

In July, the House Committee on Oversight and Government Reform, under the leadership of Rep. Jason Chaffetz (R-UT), approved the Postal Service Reform Act of 2016 (H.R. 5714). The proposed legislation's cornerstone is the Medicare mandate for Medicare-eligible postal retirees.[77] With strong support from other committee members, Rep. Chaffetz hopes to move the bill to the House floor.

What are some of the broad policy issues Congress may wish to consider?

The Postal Service's Medicare proposal would help the Service's bottom line but impose costs elsewhere. The most obvious policy question for Congress to weigh is whether it would be appropriate to shift more costs onto the strained Medicare program in order to assist the Postal Service.

75 For the objections of postal retirees to the proposed mandate, see Richard G. Thissen, "Keep Promises Made to Postal Retirees," *The Hill*, July 20, 2016, http://thehill.com/blogs/congress-blog/economy-budget/288389-keep-promises-made-to-postal-retirees.

76 The Boards of Trustees, Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds, *2016 Annual Report of the Boards of Trustees of The Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, June 22, 2016, pp. 4-5, https://www.cms.gov/Research-Statistics-Data-and-Systems/Statistics-Trends-and-Reports/ReportsTrustFunds/Downloads/TR2016.pdf. Medicare is burdened by swiftly rising per capita health costs and the growing share of the population age 65 and over. Looking at several scenarios for the growth of Medicare expenditures, Medicare's Trustees write, "Growth under any of these scenarios, if realized, would substantially increase the strain on the nation's workers, the economy, Medicare beneficiaries, and the Federal budget." (*Ibid*., p. 9.)

77 This paper will not attempt to review the bill's details, but for the news release announcing the committee's approval of the bill, see "Oversight Committee Passes Bipartisan Postal Reform Legislation," House Committee on Oversight and Government Reform, July 12, 2016, https://oversight.house.gov/release/oversight-committee-passes-bipartisan-postal-reform-legislation. The news release contains a link to the bill's text. For a summary of the draft legislation prior to markup, see "Draft Postal Service Reform Act of 2016; Summary," House Committee on Oversight and Government Reform, https://oversight.house.gov/wp-content/uploads/2016/06/Summary-of-Postal-Service-Reform-Act-FINAL5.pdf. The main change in markup was revision of a section dealing with the Service's Board of Governors.

Because the shift would have budget consequences, another question is whether Congress should enact a measure that would increase the federal deficit in light of the already enormous federal budget deficit. Congress might also want to ask some questions involving the overall federal workforce. If the Postal Service is permitted to shift some of its costs to the Medicare Program, should other federal agencies be allowed to do the same? Instead of trying to make as few changes as possible to a very expensive fringe benefit for federal workers, including those at the Postal Service, should Congress treat this as a wake-up call and ask why federal workers receive retirement benefits far richer than those received by most American workers? Benefits already promised should not be rescinded, but, to improve equity and efficiency, should Congress consider prospective changes that would bring federal workers' retirement benefits more into line with those of other U.S. workers?

In testifying about the Service's Medicare proposal, Postmaster General Brennan presented the Service's estimates of potential savings through 2020, but the numbers show the combined effects of mandatory Medicare participation and "L-Fund investment for postal retiree health plans."[78] What is L-Fund investment?

The Postal Service wants Congress to let it invest a portion of RHBF assets in stocks and other risky securities. In her testimony, the Postmaster General says these investments are a component of the Service's proposal. The RHBF now invests in special government securities. Postmaster General Brennan identifies "L-Fund" as "the longest-term L Fund in the [Federal] Thrift Savings Plan."[79] In July 2016, that fund was 84 percent invested in stocks.[80] The advantage of stock investments to the Service is that it could assume – in advance – that its investments would earn high returns, and those large assumed returns would allow the Service to cut dramatically its future RHBF contributions. This strategy will work out nicely if the investments actually do earn high returns, but the danger is that equity investments, precisely because they are tied to the variable earnings of the underlying businesses, sometimes earn low or negative returns. If the investments encountered a prolonged period of low returns, the Service's unfunded liability would mushroom and taxpayers would almost surely have to cover the shortfall. One can think of this strategy as "heads the Postal Service wins" and "tails the taxpayer loses." Regardless of what Congress decides regarding mandatory Medicare participation, it should be skeptical of the stock market proposal. The House Committee on Oversight and Government Reform has approved legislation that would permit these investments (The Postal Service Financial Improvement Act of 2016, H.R. 5707). The Committee separated it from the rest of the Service's Medicare proposal because of apprehension about how the Congressional Budget Office (CBO) will score its budget cost.

78 Brennan, *op. cit*.
79 *Ibid*.
80 See Thrift Savings Plan, Lifecycle Funds, L 2050, https://www.tsp.gov/InvestmentFunds/FundOptions/fundPerformance_L2050.html.

Claims the Postal Service would be healthy except for the RHBF

Is the Postal Service, which officially lost $56.8 billion during the years 2007-2015, actually profitable or nearly so?

As an example of this position, Ralph Nader said in 2011, “The deep hole of debt that is currently facing the U.S. Postal Service (USPS) is entirely due to the burdensome prepayments for future retiree health care benefits imposed by Congress in the PAEA. … If the prepayments required under PAEA were never enacted into law, the USPS would not have a net deficiency … but instead be in the black. …”[81] More recently, the American Postal Workers Union (APWU) asserted, “The USPS financial crisis is a manufactured one. … If not for that [prefunding] requirement, the Postal Service would have done quite well financially over the last few years.”[82] The basic flaw in these arguments is that they try to wish away the Service’s retiree health care obligations. If those obligations did not exist, the Postal Service would indeed be close to profitable and the RHBF would be unjustified. As explained earlier, however, the Service’s retiree health care promises, and the costs associated with them, are very real and very large.

The APWU publication cited immediately above also claimed, “The USPS ‘financial crisis’ is a hoax – a pretext for cutting service and paving the path to privatization.”[83] Was the RHBF created to crush the Postal Service financially and push it toward privatization?

No. As discussed earlier, Congress, the Administration, GAO, and the bipartisan President’s Commission on the United States Postal Service were all worried by a postal retiree health care liability that was extremely large, entirely unfunded, and rapidly growing, reaching $74.8 billion by the end of 2006. None of these parties advocated privatization, and the presidential commission explicitly rejected that path.[84] When Congress enacted PAEA, the RHBF and the act’s other components were expected to protect the long-term financial viability of a Postal Service that remained part of the federal government.[85] In hindsight, the RHBF’s funding schedule should have been more gradual, but the main weakness of PAEA was that it did not give the Service better tools to manage costs and keep them in line with revenues.

81 Ralph Nader, “The Manufactured ‘Financial Crisis’ of the U.S. Postal Service,” *Monthly Review*, September 21, 2011, http://mrzine.monthlyreview.org/2011/nader230911.html.

82 American Postal Workers Union (APWU), “Our U.S. Postal Service Is Under Attack,” 2016, http://www.apwu.org/sites/apwu/files/resource-files/Our%20U.S.%20Postal%20Service%20Is%20Under%20Attack.pdf.

83 *Ibid*.

84 See President’s Commission, *op. cit*., esp. pp. 18-20.

85 Those who truly believe that refusing to fund deferred obligations is a good way to avoid privatization should look at the experience of Royal Mail in the United Kingdom. Royal Mail enjoyed a 13-year pension contribution holiday from 1990 to 2003. The holiday resulted in a pension “black hole,” and that “black hole” was one of the reasons why Parliament, with the support of all major parties, passed legislation in 2011 that privatized an organization which had been part of the government for almost 500 years. (See Michael Schuyler, “An Ounce Of Prevention Is Worth A Pound Of Cure: A Cautionary Lesson For The U.S. Postal Service From Great Britain’s Royal Mail,” *IRET Congressional Advisory* No. 250, February 4, 2009, http://iret.org/pub/ADVS-250.PDF.)