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ADMINISTRATION SEEKS TO UPHOLD FIVE PRINCIPLES OF POSTAL SERVICE REFORM

Executive Summary

The Administration has called for changes in H.R. 22 and S. 662. These are bills being considered in Congress that would alter some of the laws under which the U.S. Postal Service operates. As the Administration explained in a Policy Statement in July, it is concerned that the bills would increase the federal budget deficit and would not provide enough meaningful reform.

The changes the Administration seeks would clearly lower the budget costs. The question examined here is whether the changes would also be helpful in terms of Postal Service reform. The answer is that when the Administration's proposals are evaluated strictly from a reform perspective, they are seen to be sensible, realistic, and helpful.

The Administration has consistently said that Postal Service reform should be based on five principles: governance based on best practices, improved public transparency, greater flexibility in operations, a stronger regulator to provide more accountability, and financial self-sufficiency. These are reasonable goals that have met with general approval. The changes sought by the Administration are thoroughly supportive of these goals. The Administration contends that:

- Money released from an escrow fund should be used dollar for dollar for paying down the Service's massive unfunded liabilities.
- The Postal Service should be required by statute to meet SEC reporting requirements.
- New restrictions on worksharing should be examined carefully to be sure they are reasonable and would not cripple an important vehicle for bolstering efficiency and lowering costs.
- When postal workers' pay is determined through binding arbitration, the law should require arbitrators to consider the impact of their decisions on the Postal Service's financial health.
- Most of the Service's debt limit should be reserved for its core products; a tight limit of $3 billion should be placed on borrowings for competitive-market products.

This paper reaches no conclusion on the issue of whether the Postal Service or the U.S. Treasury should pay for certain pension credits retired postal workers receive if they served in the military. However, if the Postal Service's current-law expenses in this area are reduced, any savings should be used dollar for dollar to pay down the Service's unfunded liabilities.

While one might wish for stronger reforms, the changes sought by the Administration all move in the correct direction.

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ADMINISTRATION SEEKS TO UPHOLD FIVE PRINCIPLES OF POSTAL SERVICE REFORM

The Bush Administration has taken a keener interest in Postal Service reform than any other Administration in the last 30 years. In December 2002, it established a bipartisan commission (the President's Commission on the United States Postal Service) to examine the government enterprise and make recommendations. The Commission released a widely praised report in July 2003, filled with many detailed reform recommendations.[1] In December 2003, the Administration followed up by issuing a set of five principles to guide legislative reform efforts.[2] The principles are governance based on best practices, improved public transparency, greater flexibility in operations, a stronger regulator to provide more accountability, and a Postal Service that is financially self-sufficient.

The Administration has continued its involvement and held frequent discussions with Congress. In late 2004, it sent Congress a memo insisting that any legislation revising the laws under which the Postal Service operates be revenue neutral and reminding Congress of the five reform principles. Based on those criteria, the Administration asked for changes in two Postal Service bills then being considered, H.R. 4341 and S. 2468.[3] The bills have been reintroduced this year with some modifications as H.R. 22 and S. 662, both named the Postal Accountability and Enhancement Act. The House passed H.R. 22 by a 410 to 20 vote on July 26; action on S. 662 is pending in the Senate.

On the day that the House approved H.R. 22, the Administration issued a Statement Of Administration Policy.[4] The Statement thanked Congress for working with the Administration, noted that some improvements have been made in the bills since last year, and supported the language in S. 662, compared to that in H.R. 22, on two provisions (a firm cap on postal rate increases and a modest reform of workers' compensation). However, the Administration reiterated its concerns about revenue neutrality and meaningful reform. The Statement warned that the President might veto a bill if it is not revenue neutral. The Statement also expressed disappointment that "several important reforms have not been addressed completely or at all."[5]

The Administration's desire to protect the federal budget is understandable. As Everett Dirksen is reputed to have said, "A billion here, a billion there, and pretty soon you're talking about real money."[6]

Suppose, however, that revenue neutrality is placed to the side and the changes sought by the Administration are judged purely in terms of Postal Service reform. Would they still be justified? The answer is that most of the Administration's ideas make excellent sense in terms of reform. Indeed, the Administration deserves much credit for resisting the choices that would be easiest politically and instead seeking changes that move in the direction of the five reform principles it has enunciated.

The escrow account and military-service credits. As a result of a retroactive recalculation of pension liabilities for employees hired before the mid-1980s, the Postal Service owes much less in yearly pension contributions than had previously been thought.[7] Under the terms of the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), this found money has been used since 2003 to repay Postal Service borrowings from the U.S. Treasury and hold down postal rates. In future years, though, the money must be parked in an escrow account pending legislative action on how it should be used.

Although the Postal Service has dodged a bullet regarding retirees' pension costs, the Administration notes that the agency has built up a huge unfunded liability — about $65 billion and growing — for another retirement-related fringe benefit: retirees' health care costs. The Administration proposes that every cent saved on pension costs be applied towards unfunded retiree health care obligations. Releasing funds from the escrow account for this purpose is financially responsible. The aim is to avert a financial crisis in the future in which the Postal Service would have to raise postal rates sharply, seek a massive taxpayer bailout, or both. The approach favored by the Postal Service of applying only some of the funds to health care costs, with the remainder used for holding down postal rates and other purposes, is less financially responsible and disciplined. The Administration is absolutely correct when it relates this issue to the Postal Service's long-term financial viability and the principle of financial self-sufficiency, stating:

> The substantial pension savings ... provide an excellent opportunity to transition to a financially self-sufficient USPS... If these unfunded retiree health benefit liabilities are not fully addressed now, unnecessarily large spending will be needed in the future to pay these health benefits costs as they come due.[8]

Of course, it would be easier in the short run to use some of the freed money for other purposes. Doing that, however, would increase what the Service owes in the long run, as well as reducing financial discipline in the near term. If the Service were going through a temporary rough patch with better times ahead, it would be reasonable to shift responsibilities into the future. However, the Service faces significant challenges ahead. Taking care of its unfunded liabilities now is the responsible course of action that will best serve mail users, taxpayers, and the Service.

When Postal Service workers retire, they are eligible for pensions. Credits are added to their pensions based on prior military service. These military credits can be viewed as a fringe benefit of Postal Service employment because the retirees only receive the pensions as a result of their work for the Postal Service. Alternatively, the credits can be viewed as a fringe benefit of military service because Postal Service workers who did not serve in the military do not receive the credits. The 2003 Postal Service pension legislation made the Service responsible for certain military credits for workers hired before the mid-1980s. This followed the federal Office of Personnel Management's assessment that doing so would be most consistent with other changes in the legislation and that the Service would still receive large net benefits from the legislation.[9]

The Administration vigorously defends the current arrangement. The Postal Service, however, strongly objects and wants the military-credit charges moved to the U.S. Treasury. The bipartisan President's Commission concurred here with the Postal Service. (This is the only substantive issue on which the Administration disagrees with the Commission's findings.) The Government Accountability Office underlined the complexity of this matter when it concluded that the arguments on both sides are reasonable.[10]

This is a difficult issue to resolve based solely on economic analysis. A more modest point will be made here. If the Postal Service is relieved of any of this liability, the most responsible way to use every cent of the newly freed funds to pay down the agency's unfunded obligations. The sooner the Postal Service's pays off its unfunded obligations, the safer future mail users and taxpayers will be.[11]

Transparency. Currently, the Postal Service is exempt from SEC reporting requirements, but does selectively provide some SEC-like material on a voluntary basis. The Administration believes the Postal Service should be required by law to comply fully with SEC reporting requirements. H.R. 22 and S. 662 have provisions moving in that direction, but the Administration thinks the provisions need strengthening. Specifically, the Administration wants the Postal Service to follow SEC reporting standards on a segment basis and objects to giving the Postal Regulatory Commission authority to weaken the reporting requirement.

The Administration wisely recognizes here the importance of transparency in government, and the ability of firmly enforced SEC reporting requirements to improve financial transparency at the Postal Service. For a government enterprise, transparency is a front-line weapon in guarding against waste and fraud, instilling greater financial discipline, and helping citizen/voters monitor what the government entity is doing. Although SEC reporting requirements were developed for private-sector companies, an earlier paper in this series found that transparency is actually more needed at government enterprises than at private-sector businesses.[12]

Flexibility. The Administration is concerned that the bills as currently written would unduly limit the Service's ability to offer worksharing discounts and would not give it enough new authority to enter into negotiated service agreements. Because so much mail is workshared, the worksharing provisions are the more important and will be discussed here. The Service has only recently begun to enter into negotiated service agreements. Worksharing allows mailers to receive lower rates in exchange for doing some of the preliminary mail-processing work. The discounts are based on the cost savings to the Postal Service because of the work done by mailers. All parties have been very happy with the worksharing, except for some postal unions. Supporters claim worksharing has improved efficiency and encouraged greater mail use by making it more affordable. Some unions claim worksharing discounts are too large, with discounts exceeding avoided costs, which would hurt the Postal Service financially. (In terms of Postal Service employment, worksharing reduces the need for internal mail-processing workers but, because of higher volume, provides more jobs for mail carriers.)

There is much uncertainty in the postal community regarding the effects of the worksharing restrictions in H.R. 22 and S. 662. Some think the restrictions are reasonable and would have only minor effects, but others think the restrictions would be very disruptive. Given the uncertainty, the Administration is justified in being concerned and wanting to draw attention to this issue.

Making the Postal Service's financial condition a factor when arbitrators award pay increases. Many studies have found that postal workers, on average, receive much higher wages and fringe benefits than comparable workers in the private sector.[13] This places a severe financial strain on the Postal Service, and helps explain why nearly 80% of the agency's costs are labor related. Regrettably, H.R. 22 and S. 662 would do little to help the Postal Service better control its high labor costs. One positive but small step is that S. 662 would slightly trim workers' compensation benefits (for example, by imposing a three day waiting requirement.)[14]

The Administration has identified a much more meaningful reform: instruct "the arbitrator in labor negotiations to consider the financial health of USPS."[15] As government employees who provide a service for a statutory monopolist, postal workers are not allowed to strike. When a postal union and the Service cannot reach a collective bargaining agreement, the matter goes to binding arbitration. Currently, the law does not direct arbitrators to consider the Postal Service's financial health when issuing decisions.

The Administration's proposed reform would be valuable in any case, but it is especially urgent in the context of H.R. 22 and S. 662. The Administration recognizes that the bills could lead to financial disaster if this reform is not present because they seek to hold postal rate increases to no more than the inflation rate. If arbitration awards cause labor compensation to rise more rapidly than the sum of inflation and productivity growth, the Postal Service's costs will outstrip revenues, losses will mount, and the Service will either need a government bailout, violating the principle of financial self-sufficiency, or need to violate the cap on rate increases that is the central element of H.R. 22 and S. 662. (The Postal Service also recognizes this danger, which is why it would like better tools to manage its costs or, failing that, an easy way to break the rate cap that is the centerpiece of the bills.[16])

This proposed change would still leave arbitrators with the final say when setting wages and certain benefits and working conditions. It would simply ensure that arbitrators consider as one factor the effect of their awards on the Postal Service's financial viability. This is an important reform that would help the Service achieve the goal of financial self-sufficiency and correct a dangerous shortcoming in H.R. 22 and S. 662.

Limit Postal Service borrowing for its competitive-market products. When the Postal Service borrows, the Congressional bills would have the Service do so either through the Postal Service Fund, which would mainly be for its monopoly-sheltered, core products, or through the Competitive Products Fund, which would mainly be for products the Service sells in competitive markets. The Administration observantly noticed that while the bills retain the Service's overall debt limit of $15 billion, they place no separate sub-limit on how much of that can be used by the Competitive Products Fund. To be sure that most borrowing by the Postal Service is related to its core products and that the Service does not go on a debt-fueled expansion binge of up to $15 billion in competitive markets, the Administration calls for a $3 billion sub-limit on Competitive Products Fund debt. This is a prudent limitation given that the Postal Service has in the past often cast envious glances at competitive markets[17] and that many foreign postal services have become heavily involved in or are exploring peripheral markets like banking, life insurance, stock-market trading, being Internet service providers, and logistics.

Conclusion. Many advocates of Postal Service reform believe that H.R. 22 and S. 662 are weak in that they emphasize a redesign of how Postal Service rates are regulated instead of giving the agency better tools to manage its costs. Don Soifer, Executive Director of the U.S. Consumer Postal Council, expressed this frustration when he wrote, "It's a shame that the new bill [H.R. 22] is so ineffective on these crucial matters, especially since it caps 25 years of Congressional efforts to repair the USPS."[18] There are also several troubling anti-reforms, such as a provision in H.R. 22 that would let postal unions fill the first vacant seat on the Postal Service's board.

The Administration has noticed some of the weaknesses, and has asked whether the bills without modification contain enough meaningful reform to be worth enacting. It is not sufficient for legislation merely to espouse desirable objectives; to be effective, the legislation must contain statutory language that actually helps implement those goals. Fortunately, the Administration has identified a number of ways to improve H.R. 22 and S. 662 that are consistent with reform principles and the aims of the bills' authors. The members of Congress working on Postal Service legislation should accept the Administration's pro-reform ideas.

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Endnotes

1. See President's Commission on the United States Postal Service, *Embracing The Future; Making The Tough Choices To Preserve Universal Mail Service*, July 31, 2003, accessed on the Internet at http://www.treas.gov/offices/domestic-finance/usps/pdf/report.pdf.

2. U.S. Department of the Treasury, Office of Public Affairs, "Bush Administration Announces Principles For Postal Reform," JS-1044, December 8, 2003, accessed on the Internet at http://www.treas.gov/press/releases/js1044.htm.

3. Administration document titled "Postal Reform," given to members of Congress working on Postal Service legislation, posted by Postcom on Nov. 18, 2004, originally accessed on the Internet at http://www.postcom.org/public/reform/WH.PDF.

4. Executive Office of The President, Office of Management and Budget, "Statement Of Administration Policy; H.R. 22 - Postal Accountability and Enhancement Act," July 26, 2005, accessed on the Internet at http://www.whitehouse.gov/omb/legislative/sap/109-1/hr22sap-h.pdf.

5. *Ibid.*

6. Senator Dirksen often expressed this sentiment, but it is not clear if he used these exact words. See The Dirksen Congressional Center, "A billion here, a billion there . . ." http://www.dirksencenter.org/print_emd_billionhere.htm. But also see Bartleby.com, http://www.bartleby.com/73/800.html.

7. The issue is complicated. For a detailed explanation, 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," GAO-03-448R, January 31, 2003, accessed on the Internet at http://www.gao.gov/new.items/d03448r.pdf.

8. Administration Policy Statement, *op. cit.*

9. Military credits are normally charged to civilian government agencies for workers hired since the mid-1980s (under the Federal Employee Retirement System, FERS) but not for workers hired earlier (under the older Civil Service Retirement System, CSRS). The Office of Personnel Management (OPM) concluded that certain military credits for older hires should be charged to the Postal Service as part of the 2003 legislative package. OPM reasoned that the 2003 legislation retroactively gave the Postal Service FERS-like treatment for older hires, and to be consistent with FERS, the agency should pay the military credits.

10. See U.S. General Accounting Office, "Postal Pension Funding Reform; Review of Military Service Funding Proposals," GAO-04-281, November 2003, accessed on the Internet at http://www.gao.gov/new.items/d04281.pdf. The GAO report also summarizes the arguments of the Administration and the Postal Service. For the Presidential Commission's discussion, see President's Commission, *op. cit*, pp. 125-126.

11. The Postal Service has already promised current employees higher pensions if they served in the military, and it should honor that promise. It would be equitable and efficient, however, if Congress allowed this fringe benefit to be subject to collective bargaining for future employees, rather than mandated by statute.

12. Michael Schuyler, "Should the Postal Service Be Able To Withhold Some Of Its Financial Results From The Public?" *IRET Congressional Advisory*, No. 184, March 16, 2005, available on the Internet at ftp://ftp.iret.org/pub/ADVS-184.PDF.

13. For an earlier paper in this series discussing those studies, see Michael Schuyler, "The Postal Wage Premium: No Wonder The Postal Service Loses Money," *IRET Congressional Advisory*, No. 131, July 24, 2002, available on the Internet at ftp://ftp.iret.org/pub/ADVS-131.PDF.

14. The Administration would ideally like broader reform of the Workers' Compensation System for all federal employees.

15. Administration Policy Statement, *op. cit.*

16. See, for example, John E. Potter, Postmaster General, U.S. Postal Service, Testimony Before the Committee on Homeland Security And Governmental Affairs, April 14, 2005, esp. p. 8, accessed on the Internet at http://www.usps.com/communications/news/speeches/2005/sp05_0414pmg.pdf.

17. For a fuller discussion, see Michael Schuyler, "Empire Building At The Postal Service," *IRET Policy Bulletin*, No. 87, May 19, 2003, available on the Internet at ftp://ftp.iret.org/pub/BLTN-87.PDF.

18. Don Soifer, "Congressional Postal Reform: What's In It For consumers?" *Marshfield News-Herald* (Marshfield, Wisconsin), August 13, 2005, accessed on the Internet at http://www.wisinfo.com/newsherald/mnhopinion/283992626572413.shtml. A previous paper in the IRET series provided a slightly different perspective on why revamped rate regulation would not be a panacea for the troubled government-owned mail service. See Michael Schuyler, "Rate-Cap Regulation Will Not Deliver Real Postal Service Reform," *IRET Congressional Advisory*, No. 188, June 20, 2005, available on the Internet at ftp://ftp.iret.org/pub/ADVS-188.PDF. Soifer also observed, on a more optimistic note, that almost half of the reforms advocated by the bipartisan Presidential Commission On The U.S. Postal Service could be implemented without new legislation and that the Service is currently led by very capable and effective individuals, Postmaster General John Potter and Chairman of the Board Jim Miller. The Service could undertake many worthwhile improvements on its own initiative if it is willing.