Pre-funding of future retiree health benefits

The U.S. Postal Service has its roots in the United States Constitution (Article I, Section 8, Clause 7). For decades, it has entirely supported itself by the sale of stamps and other postal services—not with taxpayer dollars. The costs associated with the health benefits of USPS’ retirees are also covered by these proceeds.

In December 2006, a lame-duck Congress passed the Postal Accountability and Enhancement Act (PAEA), a postal reform measure that included a mandate on the Postal Service to “pre-fund” 75 years’ worth of health benefits for future retirees. Hard-wired into the law without regard to economic conditions was an inflexible payment schedule that required USPS to pay about $5.6 billion per year over a 10-year period.

This pre-funding mandate did not appear to be an immediate problem when the law was enacted, as postal revenues at the time were increasing and USPS was debt-free. But in 2007, the nation’s economy began to fall apart, and the more than $12 billion in pre-funding payments the Postal Service made from 2007 to 2009 have since helped turn USPS’ healthy income statement a deep shade of red.

Here are some facts about pre-funding:

• **It’s the primary cause of red ink:** The pre-funding burden has drained the Postal Service’s cash reserves and caused it to reach its $15 billion borrowing limit with the U.S. Treasury. Even though USPS has been unable to make pre-funding payments since 2010, the payment obligations still show up on postal financial statements as expenses and liabilities, accounting for more than 80 percent of the losses USPS has reported in recent years.

But USPS and the country as a whole continue to recover from the effects of the Great Recession of 2007-2009. The Postal Service has been experiencing a steady financial recovery on the strength of rising revenues, even as mail volume has declined modestly, thanks to an e-commerce boom and growing letter mail revenues. In fact, excluding the pre-funding requirement, USPS had an operating profit of $1.4 billion in Fiscal Year 2014, and it has been operationally profitable since October 2012.

• **Postal retiree health benefits are well-funded:** The Postal Service has already paid for more than half of its retiree health benefits liability—more than $49.1 billion. This is a far higher rate than called for by private-sector best practices, for the small percentage of companies that voluntarily pre-fund.

• **USPS stands alone:** No other public agency or private enterprise in America is required to take on such a financially crippling burden as the pre-funding of future retiree health benefits. In fact, nearly two-thirds of Fortune 1000 companies do not pre-fund at all. Of those companies that do pre-fund, most do so on a flexible and voluntary schedule, in line with generally acceptable accounting principles and in such a way that prevents them from putting their businesses at risk financially.

• **It prevents USPS from investing in itself:** Because Congress has failed, as yet, to reform the pre-funding mandate (or to reduce its burden), the Postal Service has turned to a doomed cost- and service-cutting strategy that has the potential to drive business away. Pre-funding also prevents USPS from investing in its infrastructure—for example, developing cutting-edge customer service technology or buying more fuel-efficient and environmentally friendly postal vehicles.

• **It puts services at risk:** No business can cut its way to prosperity, but USPS is continuing this exact approach, placing at risk vital USPS services such as six-day delivery, door delivery and local mail processing services on which American homes and businesses have come to rely. Continuing to cut services will only exacerbate the Postal Service’s financial problems, not solve them.

• **Smarter investment needed to decrease liabilities:** Currently, the retiree health benefit (RHB) fund is invested solely in low-yield Treasury securities. No private-sector business would invest its assets so conservatively, especially since the annual cash requirement for the RHB fund of $3 billion per year is a fraction of the fund’s nearly $50 billion in assets.

In an ideal world, the RHB fund would be held on USPS’ books, invested in a properly diversified portfolio of stocks, bonds and real estate, and overseen by a professional investment manager. But given the potential for scoring problems that such a strategy would raise, Congress could instead grant the RHB fund permission to be invested in the index funds offered by the Thrift Savings Plan, paving the way for the fund to earn higher, private sector-based returns without shifting the RHB from one set of books to another. Such a plan would have the added advantage of helping to reduce the federal deficit.

The Federal Retirement Thrift Investment Board already invests a pool of nearly $300 billion of federal and postal employee retirement savings in these TSP index funds, so investing the RHB fund in such a way would not be unprecedented. And the TSP’s Lifecycle 2040 fund has earned an annual return of 5 percent since its inception in 2006, much greater than the 2 to 3 percent returns paid in recent years on Treasury bonds. Modernizing how the RHB fund is invested and bringing those investments in line with private-sector business and investment practices would help relieve the pre-funding burden while increasing returns.

**NALC encourages Congress to reform the Postal Service’s burdensome pre-funding requirement and enact sensible investment reforms for its retiree health fund.**