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HERITAGE'S RUINOUS RECOMMENDATIONS FOR THE U.S. POSTAL SERVICE

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The new Heritage Foundation background paper (Gattuso 2013) on the future of the U.S. Postal Service (USPS) is a self-contradictory, poorly analyzed review of the Postal Service's finances that concludes with recommendations that would, with one partial exception, be disastrous. This policy memo will discuss the flaws in the Heritage report and make a very different set of recommendations.

In summary, Heritage's *Can the Postal Service Have a Future?* has the following flaws:

- It fails to recognize the damage Congress has inflicted on Postal Service finances.
- It wrongly supports a disastrous, congressionally imposed prefunding requirement for retiree health benefits.
- It fails to recognize that the Postal Service's revenues are recovering from the Great Recession, and that its cost-cutting has been effective.
- It recommends elimination of the traditional letter-mail monopoly, which would effectively end universal access to mail delivery—the Postal Service's core purpose.
- It pretends to support competitive freedom for USPS but would add new restraints.

Congress can quickly restore USPS to health by doing the following:

- Ending the arbitrary, congressionally imposed requirement that USPS prefund retiree health benefits
- More fairly allocating pre-1971 pension obligations between USPS and the Office of Personnel Management

- Freeing USPS from restraints on its pricing
- Removing restrictions that currently prevent USPS from offering nonpostal services

The Heritage analysis is seriously flawed

Heritage analyst James Gattuso overstates the severity and misdiagnoses the cause of USPS's current financial problems. According to Gattuso (2013, 1), USPS is "virtually bankrupt, losing $45 billion since 2007." He cites a year-old projection that USPS deficits will hit $20 billion a year by 2016, but fails to note that USPS has aggressive plans to reduce costs and that more recent financial projections are more positive.[1]

USPS has in fact been pursuing aggressive cost-cutting, which Gattuso acknowledges only much later in his report. The non-legislative cost-saving initiatives in its five-year business plan grow each year between now and 2016 and are estimated to save $8.6 billion in 2016, which would reduce USPS's projected operational loss in that year to less than $3 billion (USPS 2013a).

Gattuso also presents a highly misleading analysis of USPS's retiree health benefit obligations, which are a principal cause of the Postal Service's current financial problems. He does this in at least three ways. First, he calls the retiree health prefunding a "pension benefit funding requirement," even though it has nothing to do with employee pensions. He then declares that the payment required by Congress—an annual $5 billion-plus prefunding of retiree health benefits that will not be paid out for decades—is "perfectly appropriate." This is highly inaccurate.

As an independent establishment of the federal government that is structured as a corporation, USPS should be treated to the maximum extent possible like a private company. However, the Postal Accountability and Enhancement Act of 2006 imposed a burden on USPS that is imposed on no other corporation (and no other federal government agency): a financially disastrous obligation to prefund its retiree health benefits on a 10-year schedule. Over the past six years, beginning in 2007 and through September 30, 2012, USPS has had to set aside $46 billion to pay for future retiree health benefits (United States Postal Regulatory Commission 2013, 42)—money that would otherwise have been available to invest in training or new equipment, new technologies, better marketing, or just to meet the bottom line.

Third, Gattuso characterizes the Postal Service's inability to make scheduled prefunding payments in recent years as "defaulting on $16 billion owed to the U.S. Treasury." This is simply not true; the Postal Service did not miss any payments to the Treasury. Rather, it missed unrealistically onerous payments mandated by Congress to a trust fund held by the Office of Personnel Management (OPM), the Postal Service Retiree Health Benefits Fund, which was established to cover the Postal Service's share of future retiree health insurance premiums. Gattuso's use of the term "default"—as in a failure to honor a debt or pay off a bond—is highly misleading in this case. Failing to pay off a bond is a sign of insolvency; failing to prefund insurance premiums not payable for 30 or 40 years in the future is a sign of misguided congressional policy.

Gattuso describes this congressional imposition as "sensible" and misleadingly states that "many private sector firms prefund such liabilities." However, he gives no examples of such firms, and the truth is that few, if any, private-sector firms fully prefund retiree health benefits. According to Towers Watson (2012, 19), a leading international benefits consulting firm, "the vast majority of plan sponsors are still choosing not to fund their OPEB [other post-employment benefit] plans." Of the minority that do *any* prefunding, the median funded status of postretirement benefits "have remained in the 23-37% range" since 1999. United Parcel Service, the biggest competitor for USPS's package delivery business, has only funded 10 percent of its retiree healthcare obligation, versus 51 percent for USPS. In a 2012 report, the financial consulting firm Lazard condemned the congressional prefunding requirement in strong terms, writing, "[T]he current legislative requirement that the Postal Service pre-fund its retiree health obligations is both financially punitive and entirely inconsistent with accepted practices in the private sector."

The prefunding requirement is the financial equivalent of filling someone's pockets with lead before forcing him to swim against a strong current. The requirement took effect in 2007, just before the onset of the Great Recession. As the economy crashed, postal business dried up, and revenues fell, USPS was saddled with $5 billion-plus per year in payments that no other corporation would have undertaken in these circumstances. The result was huge losses, which Gattuso sugarcoats with the observation that "the Postal Service would still have lost billions." There is a world of difference, however, between losing $41 billion (as USPS did over 2007–2012) and $9 billion (which would have been the accumulated losses over 2007–2012 but for the prefunding requirement).[2] For one thing, USPS's current cash flow problems would never have arisen in the context of the smaller loss. To make matters worse, USPS has no authority to raise postal rates to cover the increased cost of prefunding and can only suffer losses or make damaging cuts in service. In its entire history, USPS has never suffered a more damaging blow to its finances—one made all the more painful because it is so utterly unnecessary.

These pernicious prefunding requirements might not matter if USPS were in a death spiral, with net operating revenues falling faster and faster—a picture Gattuso attempts to paint with his declaration that USPS "is virtually bankrupt." But USPS is not bankrupt. Its fiscal position is improving—and would improve even faster if prefunding were eliminated.

The Postal Service's assets and liabilities are in rough balance, and as the economy recovers, so will mail revenue. The key to USPS's future prospects is package delivery, which Heritage admits has been a bright spot: "As e-commerce grows, the number of packages delivered has grown. From 2009-2012, the total number of packages delivered by USPS has grown by over 7 percent" (Gattuso 2013, 8). Revenue from shipping and packages over the last four quarters has grown even more strongly, increasingly nearly 8 percent (USPS 2013b). If USPS were freed from current constraints that, for example, prohibit it from offering volume discounts, revenue from shipping and packages could drive it back to financial health.

Although Gattuso grudgingly offers that the end of the Postal Service "is still some time off," he cites a 2011 GAO estimate that overall volume, which includes packages and mail, "could fall to 127 billion pieces by 2020," as well as a more positive projection by the Boston Consulting Group of 150 billion pieces. As noted, package volume is increasing; any overall losses, then, will come from mail. But even there, the trend is improving. Year-over-year first class and standard mail revenue fell almost 10 percent in 2009; by 2012 the loss had been cut to 4 percent, and so far in 2013, first class mail and standard mail revenues are down less than 0.5 percent from the year before (USPS 2013d). In fact, the most recent quarterly result for mail revenue is actually encouraging: First class and standard mail revenue increased on a year-over-year basis in the third quarter of 2013 (USPS 2013b, 1).

The Heritage report assumes that customers will abandon everything having to do with paper, including financial records and bills, but the "evidence" is just speculation. Gattuso claims, "Just as most people no longer feel the need to print an e-mail in order to save it, the paper statement, along with the postage stamp necessary to mail it, will become dispensable." Few people ever printed and saved their e-mail, so the analogy is a poor one. Beyond that, Gattuso's ability to predict consumer preferences should not be taken for granted. Cookbooks were supposed to disappear, too, as the Internet, e-books, and YouTube provided paperless ways to find recipes and visualize dishes. But the opposite has been happening: Print cookbook sales have been climbing (Finz 2011) and are higher now than five years ago (Orr 2012).

In short, Heritage and Gattuso are too quick to pronounce the imminent death of transactional mail.

Heritage's recommendations are worse than doing nothing

Gattuso correctly observes, "If the Postal Service is to survive … Congress must abandon its politics-as-usual attitude and give postal officials the ability to make the significant changes that are needed."

Gattuso calls for "fundamental changes," but his recommendations are less radical than they are ideological, ill-designed, and counterproductive. Instead of freeing USPS from constraints that no other corporation in America is forced to contend with—including the onerous requirement to prefund health benefits and unreasonable controls on its pricing, such as prohibitions against volume discounts and the imposition of price caps on "market dominant"[3] products such as first class mail—Heritage prefers to weaken service standards and eliminate the first class mail monopoly and the Postal Service's exclusive right to mailboxes and letter slots.

Doing away with the letter mail monopoly would do two damaging things: undercut the financial health of USPS—the very thing Heritage claims it wants to bolster—and end universal access to mail delivery, the Postal Service's core purpose. The only way the Postal Service (or anyone else) can afford to make a physical delivery to every home and business in America—six days a week, no matter how remote or dangerous the location—is to have a large and guaranteed base of less-expensive customers. It is a fantasy that decimating its customer base "could itself help the Postal Service improve," as Heritage claims.

Heritage suggests USPS "could use its existing assets to shift into entirely new fields, such as real estate, internet services, or even banking." It is difficult to imagine the public purpose that would be served by USPS acting as a real estate broker, or to see how it could provide Internet access that is as universal in scope as is its mail delivery. But making fuller use of its post offices by providing ATMs or banking services that are otherwise unavailable to some of its customers could be a reasonable alternative to closing them.

Recommendations to ensure a sustainable Postal Service

To make a real difference in the Postal Service's financial health and survival, Congress must do much more than allow USPS to sell private advertising on its trucks or to deliver alcoholic beverages (two other recommendations offered by Heritage), though USPS should certainly be free to do both. Congress must deal with the big-ticket items that will give USPS the breathing room and capital to invest in and grow its parcel delivery business. The two most important items are repeal of health benefits prefunding, which would save the Postal Service more than $17 billion over the next three years (USPS 2013a, 7), and adjustment to its Civil Service Retirement System liabilities, for which OPM has overcharged USPS by $50–75 billion (Office of Inspector General 2010).

Regarding the latter reform, the Postal Service Office of Inspector General, The Postal Rate Commission, and the Economic Policy Institute (Clemente and Kiley 2010) have all called for a reallocation between USPS and the federal government of liabilities for annuity rights USPS employees earned while working for the pre-1971 Post Office Department. The sums involved are enormous: $50 billion to $75 billion would be returned to the Postal Service. The problem stems from the federal government's self-serving decision to shift pension liability from itself to USPS. Rather than crediting each year of service equally when allocating responsibility between USPS and its federal government predecessor, the Office of Personnel Management backloaded the liabilities and treated each year worked under USPS as more expensive than a year under the Post Office Department, saving the federal government money and transferring costs for past service to USPS. The U.S. Government Accountability Office (GAO 2011, 9) has said it would be actuarially reasonable for the retirement cost to be allocated equally to each year of service, and that the accounting choice is a policy decision for Congress. It is time for Congress to step up on behalf of the Postal Service, its customers, and its 617,000 employees and make the accounting choice that will restore the Postal Service to financial health.

The forced prefunding of health benefits is both disastrous and unnecessary. As explained previously, in 2006 Congress imposed a 10-year schedule for prefunding 100 percent of USPS retiree health benefit liability. No one has identified a single corporation anywhere that has undertaken such extensive prefunding, and USPS has already far exceeded the prefunding of its most important competitor, UPS. Locking up tens of billions of dollars in an account that can only invest in Treasury bonds with low interest rate returns at a time when USPS is desperate for capital is total financial malfeasance. The timing of the new requirement, coinciding with the Great Recession and a huge drop in postal volume, made prefunding doubly disastrous.

Congress might have had genuine concerns about the financial security of postal retirees, but it elevated them to an indefensible priority over sustaining and improving the Postal Service's current operations. In any event, now that USPS has funded half of the anticipated liabilities—far beyond what is normal even for the minority of corporations that do prefund these benefits—it is time to stop. Congress should suspend the requirement immediately and let USPS devote those funds to better marketing its products, to developing new services, to improving its vehicle fleet, and to meeting more urgent financial obligations. Over 2013–2017, this would improve the Postal Service's bottom line by a minimum of $22.8 billion (USPS 2013a, 7).

Congress should fix two other problems that burden the Postal Service—the various arcane restrictions on the products it may offer and the shackles placed on its product pricing. Heritage identifies two product restrictions: the prohibition on delivery of alcoholic beverages and the prohibition against carrying private advertising. Carrying private ads is something other businesses and even government entities like subway and bus systems are free to do and could mean substantial revenue, given the huge fleet of postal vehicles that could be involved.[4] Congress should also repeal the recently enacted prohibition against experimental products that would generate more than $10 million in revenue in a year. The idea that Congress would want to prevent meaningful, financially significant innovation in postal products is outrageous.

As for restrictions on product pricing, The Postal Accountability and Enhancement Act of 2006 imposed pricing restraints on the Postal Service that unfairly tie management's hands and tilt the competitive playing field against the Postal Service. McDonald's, Amazon, UPS, and other large businesses are free to decide that a product is important to the brand or competitive posture of the company and use revenues from other areas to subsidize it while sales build up or new efficiencies are found. McDonald's "Value Meal" is a well-known example, and Amazon, despite its market dominance, has yet to earn a corporate-wide profit, even as it offers new products and its sales and revenues continue to explode. Yet the 2006 act prohibits USPS from subsidizing any competitive products with revenue earned by market dominant products (those where USPS has enough market power to be able to set prices above costs or decrease quality or output without losing significant amounts of business to competitors). In addition, USPS is prohibited from raising rates on market dominant products by more than the annual change in the Consumer Price Index. While U.S. first class mail postage is just about the cheapest in the world, Congress has not properly balanced consumers' interest in low prices with their interest in having a Postal Service at all.

In the products where USPS is not dominant, it is required to include the Postal Service's institutional costs in the price charged to customers, in addition to the direct and indirect postal costs. And the Postal Service cannot appeal to customers by offering volume discounts on even hypercompetitive products, such as small package delivery, without first going through a public review process that allows competitors to counter its strategy. USPS competitors, by contrast, are not required to disclose their own pricing negotiations and need no one's approval to offer volume discounts.

The United States Postal Service reliably delivers mail to every home and business in America, providing an important public service without taxpayer subsidy. As an independent corporation, it should be free to manage that responsibility with more flexibility.

About the author

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Endnotes

1. The current projected deficit for 2016—assuming no cost reductions, which would lower the deficit—is $17.1 billion, but only $11.3 billion if the retiree health benefit prefunding requirement is suspended (USPS 2013a, 7).

2. These losses occurred during the worst U.S. economic recession and slowest recovery since the Great Depression.

3. The Postal Enhancement and Accountability Act of 2006 defines the market dominant category of products as "each product in the sale of which the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products."

4. USPS has 212,530 vehicles (USPS 2013c).

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