

STATEMENT OF
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ON BEHALF OF POSTCOM
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT
INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
ON
THE FUTURE OF THE U.S. POSTAL SERVICE

May 5, 2010

I am Vincent Giuliano, and I am submitting this statement on behalf of the Association for Postal Commerce (PostCom), a national and international trade association that represents the interests of those who use or support the use of mail for business communication and commerce. PostCom's members are users of all classes of mail. I serve as Chairman of PostCom's Postal Policy Committee, and also as Senior Vice President of Government Relations for Valassis Direct Mail, Inc., a company that currently mails more than 3.5 billion pieces of advertising mail annually. I have been actively involved in postal affairs for over thirty years both on behalf of my company and through various industry trade associations.

I applaud the Subcommittee for creating a dialog on this most important topic. The purpose of my statement is to present a view of the current Postal Service crisis from the perspective of the mailing community, specifically postage rate payers, focusing on the enormous financial burden imposed on the Postal Service for funding of retiree health benefits. I also underscore the necessity to acknowledge and appropriately reconcile the \$75 billion USPS overfunding of its Civil Service Retirement System (CSRS) pension obligation, as identified by the Postal Service's Office of Inspector General (OIG).

I have been following the Postal Service's CSRS pension issue for nearly a decade, and am familiar with the OIG's January 2010 report on the CSRS overfunding as well as related Office of Personnel Management (OPM) materials. Attached to my statement is a more-detailed analysis of the historical background of this issue, including the original funding problems with the CSRS pension system and the 1974 law that has led to the overfunding identified by the OIG.

I. THE MASSIVE AND EXCESSIVE FEDERAL OBLIGATIONS ARE CREATING A CRISIS OF CONFIDENCE.

Mailers provide the sole source for the revenue that's needed to pay these obligations. The danger for America's postal system is that, in the face of rising postal rates, mailers will decide that the cost of using mail for communication and commerce is no longer justifiable from a business perspective. The expectation that businesses will continue to provide the revenue needed to keep our nation's postal system fiscally solvent will not be realized. Businesses will reduce their use of mail or will switch to other communication alternatives or, in some instances, simply go out of business. If that happens, these obligations will become "unfunded" by mailers, and the burden will fall on taxpayers.

You have already heard from the Postal Service and others about its financial crisis. Its distress is due to several factors, including a decline in mail volume. That, however, is not the most urgent problem. With the exception of the recession-induced decline last year, mailer volumes and postage over the last several years have been covering *current* postal costs. The Postal Service's financial hemorrhaging has instead been caused by the mammoth obligations imposed on it by the Postal Accountability and Enhancement Act (PAEA) for the funding of retiree benefits – a staggering \$7 billion annually. These, in turn, are the result of legacy costs inequitably imposed on the Postal Service and its mailers. For the users of the postal system, the resulting huge overfunding of retiree obligations is an unjustifiable tax that has undermined mail as a communications medium and brought the U.S. Postal Service to the brink of insolvency.

From the standpoint of the mailing community, the impact of these excessive payments reaches even deeper. The resulting "below the line" net financial losses, widely reported in the press, have led to an impression that the Postal Service is "going down the drain." This has created a lack of mailer confidence that it will be able to survive as an affordable and integral part of our nation's economic infrastructure. In particular, the specter of large rate increases needed to cover legislatively-mandated obligations is causing mailers nationwide to reassess their business models and seek out other communication and distribution channels, thus increasing the risk of a vicious downward spiral.

This "crisis of confidence" in the future viability of the postal system must be reversed if it is to remain a vital part of our nation's infrastructure. Congress's first order of business must be to "stop the bleeding" and place the Postal Service on a sound financial footing, starting with correction of the \$75 billion pension overpayment identified by the OIG. Merely rescheduling the PAEA-mandated retiree health payments by pushing them into future years is not a real solution, as it would only postpone the day of reckoning – at which time it might be too late to resuscitate the postal system.

Correction of these pension overpayments by proper estimation of the obligations and crediting to the Postal Service would result in full funding of both the pension and

retiree health benefit obligations, eliminating the need for the burdensome PAEA payments. That, in turn, would enable the Postal Service to stabilize its finances and reassure mailers of its continued viability as an affordable medium. Indeed, full credit for the overpayment would also provide the Postal Service with the capital it desperately needs to rationalize and efficiently restructure its system to meet the nation's communications needs into the future.

Some will undoubtedly be concerned about the "budget impact" of crediting the Postal Service for overpayment of its pension obligations. But the cost of doing this correction now will be far less than if Congress delays until the postal ship has sunk, along with much of the 8.4 million jobs and over \$1 trillion in revenues associated with the mailing industry.¹ By acting now to make the Postal Service financially viable, confidence in postal distribution as an effective and affordable medium will be restored.

II. THE RATIONALE FOR EXPANDING THE USPS'S SHARE OF THE CSRS PENSION OBLIGATION IN P.L. 93-349 IS INCONSISTENT WITH THE REQUIREMENTS AND LIMITATIONS CONGRESS IMPOSED ON THE POSTAL SERVICE IN THE POSTAL REORGANIZATION ACT.

When Congress in 1970 enacted the Postal Reorganization Act (the PRA), it intended to give the Postal Service a fresh start as a financially self-sufficient, business-like, independent entity within the federal government. Forcing the Postal Service to cover obligations of the old Post Office Department (POD) – as OPM claims P.L. 93-349 (1974) requires – is inconsistent with that intent by imposing a cost on the USPS and mailers that they did not cause.² There may be (and is) disagreement over the intent of the precise wording of the 1974, 2003, and 2006 laws (P.L. 93-349, P.L. 108-18, and the PAEA) regarding the Postal Service's CSRS obligations, but it is clear that the OPM method of calculating them is not only inequitable and inconsistent with Postal Reorganization but also extremely damaging to the entire postal industry and its contribution to the national economy.

OPM does not deny that its approach – which absolves the federal government of any responsibility for pension obligations due to post-1971 salary increases of former POD employees – imposes old POD obligations on the Postal Service. It cites as justification the enactment of P.L. 93-349 in 1974. Yet despite the repeal of that law in 2003 by P.L. 108-18, and our expectations that a new, more reasonable approach would be forthcoming, OPM continues to rely on the old law as the rationale for its approach, citing the 1973 House Report 93-120 that accompanied the old law. That

¹ See "EMA Foundation for Paper-Based Communications Institute for Postal Studies Releases 2008 Economic Jobs Study," Envelope Manufacturers Association, June 17, 2008.

² To avoid imposing old POD burdens on the new USPS and its mailers, for example, Congress actually authorized transitional appropriations to cover the POD liabilities to the employees' compensation fund and to postal employees for earned and unused annual leave as of June 30, 1971. (P.L. 91-375, Chap. 20, Section 2004).

report rationalized shifting the full burden for salary increases onto the Postal Service on the ground that, because of postal reorganization, “the Congress *now has no control – no oversight whatsoever* – with respect to the pay machinery in the Postal Service.” (emphasis added).

That Congressional rationale is contradicted by the very nature of the requirements and restrictions Congress imposed on the Postal Service in the 1970 PRA relating to employment, compensation, and benefits that directly impact the growth of the CSRS obligations but are beyond the USPS ability to manage. Chief among these was the general postal policy laid out in section 101(c) of the PRA that the Postal Service “shall achieve and maintain compensation for its officers and employees *comparable to the rates and types of compensation paid in the private sector of the economy*” and that it “shall place particular emphasis upon *opportunities for career advancements*” of all employees.

Thus, Congress in 1970 clearly anticipated *and expected* that the Postal Service would increase wages and promote employees over time, in accordance with this Congressional policy. This expectation should have been recognized and reflected in the calculation of the Federal government’s share of the pension obligation for former POD employees.

In addition to this general policy, Congress in the PRA also imposed a number of other specific requirements and restrictions on the Postal Service relating to employee compensation and benefits. These included:

- Mandatory CSRS Pension Coverage. By section 1005(d) of the PRA, Congress required that all Postal Service employees be covered by the CSRS pension program. The Postal Service was forbidden from setting up its own retirement program.
- Congressional Control. The features and benefits of the mandatory CSRS program – including eligibility and vesting rules, contribution levels, pension benefit calculations and levels – are set by Congress.
- Private-Sector Pay Comparability. Congress did not give the Postal Service freedom to set employee compensation and benefits as it saw fit. Instead, by PRA §1003(a), Congress required the Postal Service “to maintain compensation and benefits of all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy.”
- Collective Bargaining and Binding Arbitration. Congress also imposed constraints on the manner by which postal wages were set. In PRA §§1203 and 1207, it required that the Postal Service honor existing labor agreements and that wages be set through collective bargaining and binding arbitration.

- Promotion Opportunities. Congress required the Postal Service to establish procedures to “assure its officers and employees meaningful opportunities for promotion and career development” (§1001) and to “provide a maximum degree of career promotion opportunities for officers and employees (§1006).
- Cross-Impact of Policies. Significantly, the collective bargaining and arbitration process excludes consideration of changes to features of employee pension plans which are established by Congress. Moreover, in considering compensation issues, the negotiating parties as well as the arbitrators must take into account the Congressional policy directive of private-sector pay comparability.

Although Congress gave up *direct* control to set postal wages itself, the policies, constraints, and mechanisms it imposed on the new Postal Service in the PRA *inevitably led to wage and pension increases in the future that it could not avoid*. Yet by then enacting P.L. 93-349, Congress evaded its share of the responsibility for the impact of those increases on the Postal Service’s pension liability for employees on the payroll as of the effective date of the PRA.

Having imposed on the Postal Service mandatory CSRS pension coverage with benefits set by Congress, plus pay-comparability and promotion policies, Congress’s action in later shifting the POD pension-financing burden for such wage increases from the federal government to the Postal Service is a tax on the Postal Service – and on mailers – for complying with Congressional policies. These Congressionally-imposed mechanisms and restrictions inevitably led to compensation and pension-obligation increases that were as much (or more) the responsibility of Congress and the Federal government as the Postal Service.

The unfairness of OPM’s approach for allocating the federal government’s share of pension obligations for POD employees who continued employment with the USPS after its creation in 1971 is readily apparent. It essentially assumes that such employees retired at the point of the Reorganization, resulting in the Federal government bearing no responsibility for pension obligations resulting from pay increases after June 30, 1971 – whether related to cost of living, step increases, promotions, or general increases as a result of collective bargaining. Thus, a not-so-hypothetical POD postal clerk who later rose to an executive position with the USPS was treated as though he or she had retired at their 1971 salary and position, with the Postal Service responsible for the grossly-disproportionate remainder of that employee’s actual pension based on salary-level-at-retirement.

No other postal competitor must face these management constraints or face payment of such a huge obligation not of its own making. The CSRS inequity can be rectified by adopting the OIG’s approach which allocates pension responsibility based on the ratio of “years of service” – properly reflecting that such increases were expected

of the Postal Service under the Reorganization policies prescribed by Congress. It is simply the right and necessary thing to do.

III. OPM Analogy to Private-Sector Spin-Offs Is Inapt.

Despite the repeal of P.L. 93-349 in 2003, OPM's defense of its methodology remains primarily legalistic: "the law made us do it." Missing is any explanation of the equitable merits of its approach to allocating the CSRS obligation between the USPS and the federal government. The closest OPM comes is its contention that this comports with the treatment of corporate "spinoffs" in the private sector. That analogy is wholly inappropriate. In the private sector, a company that is spun off from its parent is, thereafter, wholly independent of the control of its former parent. In particular, the former parent cannot:

- prohibit the spun-off company from later modifying or eliminating its pension plan either unilaterally or through collective bargaining as permitted by law (in the private sector, pension benefits are "on the negotiating table");
- impose "pay comparability" standards that will, over time, cause the spun-off company's pension liability to grow;
- dictate employment policies, such as rules on collective bargaining and binding arbitration.

Moreover, in the private sector, market forces – including the stock market and competition – provide an element of discipline and disincentive against overloading a spin-off company with excessive obligations that may impair its ability to thrive or survive. Furthermore, even if the parent overreaches by imposing an unaffordable pension liability burden on the spin-off company, that company still has potential remedies to manage and control its obligation regardless of the pension accounting arrangement – including not just modifying or renegotiating its pension plan but also, in the worst case, declaring bankruptcy and restructuring its debts and employee obligations, just as General Motors and Chrysler have recently done. Or, in the very worst case, the spun-off company will simply go out of business.

By contrast, the Postal Service has been placed in an untenable and wholly unmanageable position by the skewed methodology dictated in P.L. 93-349, a methodology that *despite the repeal of that law in 2003* is still being employed by the OPM. As a result, the Postal Service – although effectively "bankrupt" in an ordinary business sense – must still shoulder massive inequitable obligations that it simply cannot afford to pay. It cannot alter its pension plan or benefits. It cannot declare bankruptcy, and then negotiate with its creditors to pay 20¢-on-the-dollar for its debt, because the Postal Service's creditor is the federal government, requiring an act of Congress to restructure.

For its mailers, this means they must pay inefficiently high postal rates that will increasingly become unaffordable, forcing them to curtail their mailings to fit their budgets and to look for other lower-cost non-postal alternatives. The entire postal industry and its contribution to the national economy is at risk and may not recover without swift action to address this issue.

In conclusion, I would urge Congress to redress this problem promptly by adopting the methodology and fix recommended in the OIG's report. In the olden days of robust demand for postal products, the impact of this pension overfunding was every bit as inequitable but it was masked, as the costs could be spread over ever-growing mail volumes. That is no longer true. The cash cow is dry and the postal system is in great jeopardy. The simple fact is that neither the Postal Service nor mail users can afford these costs. However, even within this increasingly competitive environment, relief from these unfair burdens will go a long way toward ensuring the success of the Postal Service effort to restructure and become financially stable.

Background Of The CSRS Issue

A. The Original CSRS Design Flaw

The Civil Service Retirement System (CSRS) is a defined benefit plan that provides a pension based on the years that an employee serves and the average of his three highest salary years. Thus, as an employee's salary increases for whatever reason – whether due to promotions, pay-scale or grade increases, or inflation increases – his pension benefit also increases. And, the longer an employee serves, the larger the percentage of average salary used to calculate his pension. Moreover, after a retiree starts receiving a pension, he also receives annual inflation adjustments to his pension (retiree COLA).

From an efficient, dynamic actuarial point of view, the present value of a pension benefit for each year of employment (i.e., each year's dynamic "normal" pension cost) should be determined and funded on the basis of the estimated years of service, the estimated high-three average salary at retirement, and the expected cost-of-living adjustments (COLAs) on that pension.³ For each year, this efficiently matches the total estimated pension cost generated by that year's employment with the revenue earned that year. By law, private companies are required to fund their pension programs dynamically.

Unfortunately, due to a serious design flaw in the CSRS, federal agency plus employee contributions to CSRS each year did not cover all dynamic pension benefit costs (pension obligations) associated with their annual employment. While the contributions reflected expected employee years of service, they did not include the costs of expected future benefits associated with pay scale/grade, promotion, and inflation increases. These latter costs should have been estimated and funded each year because the pension benefit for each year of employment is based on that high-three average salary and the expected annual retiree COLAs. Instead, these particular costs were largely ignored and allowed to become a growing unfunded obligation attributed to the Federal Treasury.⁴ In the 1980s, the CSRS plan was discontinued for all new employees because of this design flaw and its consequent growing unfunded obligation. Its replacement, the Federal Employees Retirement System (FERS), was designed to cover all dynamic benefit costs and avoid unfunded pension obligations.

³ See, e.g., "Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans." The Pension Committee of the American Academy of Actuaries, July 2004, http://www.actuary.org/pdf/pension/fundamentals_0704.pdf

⁴ For an enlightening discussion of this flaw, see General Accounting Office, "Federal Retirement System Financing," June 28, 1995, GAO-T-GGD-95-197.

When the Postal Reorganization Act (PRA) abolished the old Post Office Department and created the Postal Service on July 1, 1971, there remained a large unfunded POD obligation caused by the CSRS design flaw. This unfunded portion of the obligation should have been estimated and permanently attributed to the federal government in 1971 because it was caused by POD employment prior to establishment of the USPS.

The PRA required that all USPS employees be able to participate in CSRS. Initially, the USPS and its employees, like the vast majority of federal agencies, paid only CSRS “normal” contributions which did not fund all the dynamic costs of their CSRS obligations. For the Postal Service, this began to change in 1974.

B. The 1974 Correction And The USPS Overfunding It Caused

In 1974, Congress passed P.L. 93-349 to correct the CSRS underfunding associated with salary increases the Postal Service negotiated with its employees. Based on the concept of USPS self-sufficiency, a correction was required so that the Postal Service paid, over time, the CSRS costs that *its* operations caused.⁵ As USPS salaries increased (for whatever reason) annually, the associated CSRS unfunded obligation for all postal employment also increased.

Unfortunately, the wording of the 1974 law was interpreted by the Civil Service Commission (now the Office of Personnel Management) to allocate to the USPS not only the increased pension obligation correctly associated with employment in USPS operations but also the increase in the *unfunded POD obligation* for POD employees that continued their employment with the USPS. In essence, for purposes of calculating the federal government’s share of pension liability for those “crossover” POD employees, OPM’s method assumes that they retired at their 1971 pay levels. That, of course, is the antithesis of a dynamic estimation of the federal government’s share of the obligation.

By the time it passed P.L. 93-349, Congress was well aware that USPS wages levels (including those for “crossover” employees) were likely to increase substantially in accordance with the promotion and wage comparability policies it

⁵ The 1974 law was retroactive and the USPS was required to pay for the additional obligation costs caused by salary increases starting from July 1, 1971. Each annual increase in the obligation was amortized over 30 years but the Postal Service was released from the amortization payments that would have been due prior to 1974. Subsequently, under the Omnibus Reconciliation Acts of the late 1980s and early 1990s, the Postal Service was required to pay for the CSRS impact due to annual retiree COLAs. These also were retroactive to July 1, 1971, and each annual increase in the obligation was amortized over 15 years.

imposed on the Postal Service in the 1970 Postal Reorganization Act. Beginning in the early 1970s, the American economy experienced high price and wage inflation that continued throughout the decade. The history of civil service pay increases enacted by Congress since 1971 is instructive. According to a recent report to Congress prepared by the Congressional Research Service (CRS), federal civil service pay scales increased by 86.2% during the first decade following enactment of the PRA.⁶ By the end of the second decade in 1991, civil service pay had increased by 176.4%. Of particular note, over the three years between creation of the USPS and enactment of P.L. 93-349, Congress increased civil service pay by 22.5%, thereby increasing the federal government's liabilities for CSRS pensions.⁷

Over those same periods, CRS estimated that wages in the private sector – the benchmark Congress prescribed for postal compensation – increased by 111.8% through 1981, and by 235.8% through 1991. And, consumer prices (CPI-W) increased by 124.5% and 230.0% over those periods.

Given Congress's control over federal civil service pay, and its policy directive in the PRA that the Postal Service "maintain compensation and benefits" for postal employees comparable to those paid in the private sector, Congress clearly intended and expected that the Postal Service would increase wages in line with its policy. The claim in 1974 that Congress "now has no control" over postal wage increases ignores its own directives in the PRA.⁸ Indeed, the civil service pay raises that Congress enacted over time undoubtedly served as a "floor" in postal collective bargaining and arbitration deliberations, under the Congressional pay standard of private sector comparability.

This highlights another irrationality of the purported rationale behind P.L. 93-349 as interpreted by OPM. Had the Postal Service not been created in 1971, those employees of the old POD would undoubtedly have continued to receive pay increases from Congress that, over time, would surely have tracked the pay increases that Congress granted to other federal civil service employees. Yet by virtue of P.L. 93-349, Congress abrogated *any* responsibility for the pension impact of USPS pay increases for former POD employees after 1971.

⁶ CRS Report, "Federal Employees: Pay and Pension Increases Since 1969," January 20, 2010, at 8 (comparing 1981 federal civil service pay to 1971). This report is available on the web in pdf format at: http://assets.opencrs.com/rpts/94-971_20100120.pdf.

⁷ See the CRS report cited above, January 8, 2008, at 8, comparing 1974 to 1971.

⁸ House Report 93-120 (April 11, 1973) issued by the House Committee on Post Office and Civil Service on the PL 93-349, at 4.

C. The OIG's Correction For The Overfunding

The inappropriate allocation to the USPS of those POD obligation increases must be corrected. From an economic efficiency perspective, the original obligation as well as any subsequent increases in that obligation were caused by POD operations and employment, and should have remained with the federal government. However, the Civil Service/OPM allocation methodology absolved the federal government of any responsibility for obligation increases for POD employees that continued their employment with the USPS. It did this by incorrectly assuming those POD employees retired in 1971 at their 1971 salary level and years of service when, in fact, those employees, by PRA mandate, continued to earn benefits by participating in the CSRS.

The more efficient and equitable approach should have been to estimate the federal government's share of the pension obligation based on dynamic actuarial assumptions for salary and inflation increases over an employee's estimated years of service. Under that approach, as those estimated assumptions are revised over time (based on more recent data), the estimate of the size of the obligation could change. But, the original responsibility for (the cause of) the obligation never changes.

The USPS payment for POD obligations it did not cause is the source of the \$75 billion overfunding identified by the OIG/Hay Report.⁹ That report's recommendation – that the share of the obligation should have been allocated between the USPS and the federal government on the basis of “years of service” – is sound and equitable, and in line with accepted dynamic principles for estimating and allocating pension obligations.¹⁰ Properly, that \$75 billion is the responsibility of the federal government, and a corresponding credit is owed to the Postal Service.

⁹ The \$75 billion represents a Postal Service overfunding of its entire CSRS obligation, including the obligation for retiree COLAs.

¹⁰ In fact, the OIG Report notes that “OPM uses a years-of-service methodology to allocate the cost of retiree *health care* premiums for retirees who split their careers between the Post Office Department and the Postal Service,” and that applying the same years-of-service approach to pension obligations would align it with the treatment of health care obligations. OIG Report Summary at 2.