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before the

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

on

REFORM OF THE UNITED STATES POSTAL SERVICE

APRIL 14, 2005

Madam Chairman and Members of the Committee:

I am pleased to be here today to discus the issue of reform of the United States Postal Service. This Administration regards enactment of comprehensive legislation to reform the United States Postal Service in a principled manner as an essential goal. We appreciate this opportunity to work with you towards a solution that will enable the Postal Service to respond not only to today's known needs, but also to unforeseen future issues, in a responsible manner that is fair to taxpayers, ratepayers, and Postal Service employees.

Assistant Secretary Bitsberger's testimony today clearly states the Administration's overall approach to this matter. Thus, to avoid redundancy, I will limit my statement today to important benefit issues where additional clarity would be useful.

POSTAL RETIREMENT FUNDING BACKGROUND

The Postal Service has been treated differently than other Federal entities for more than three decades when it comes to retirement payments. Not only did it have to make payments not required from other agencies, there was a period of time when the Postal Service was actually overfunding its obligations under the Civil Service Retirement System (CSRS). Enactment of Public Law 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003, cured that problem. Under current law, the Postal Service is paying its actual retirement costs.

In order to understand where we are, it is important to understand how we arrived here. When the Postal Service was established as an independent entity within the Executive Branch in 1971, the Congress made the policy decision that postal employees would continue under the same benefit programs available to Government employees generally, including CSRS.

At that time, the Postal Service and its employees made the same payments to the Retirement Fund that were required of other agencies and employees. However, in 1974, the Congress enacted the first of a number of laws that provided for additional postal payments to the Retirement Fund, with obligations retroactive to 1971. Public Law 93-349 required the Postal Service to fund retirement costs resulting from wage increases pursuant to negotiated agreements.

Postal retirement funding remained unchanged until 1989, when, in the first of a series of bills, the Congress required the Postal Service to pay for cost-of-living adjustments for its annuitants, enacting Public Law 101-239. In 1990, the Congress revisited the issue of postal funding, by requiring payments for employees who separated or died at any time after the Postal Service was created. Congress again amended the law in 1991 to require the Postal Service to make payments for pre-1991 cost-of-living adjustments to annuities. The final of the series of laws increasing postal payments was enacted in 1993 obligating the Postal Service to pay into the Fund a total of $693,000,000 through Fiscal Year 1998.

In 2002, the General Accounting Office (GAO) conducted a review of Postal Service finances. As a part of that review, GAO asked OPM to review the Postal Service's CSRS financing as if a separate retirement account had been established for income and benefit payments since 1971. We undertook that analysis, during which OPM actuaries projected that due to a number of factors, but primarily higher than expected yields on pension investments, future payments required under then-current legislation would have overfunded the Postal Service estimated CSRS liability by almost $78 billion.

Because of that potential overfunding, we developed the legislative proposal that was the basis of section 2 of Public Law 108-18. That provision reduced Postal Service payments to the Retirement Fund and ensured that the Postal Service meets its pension obligations for its current and retired CSRS employees.

MILITARY SERVICE

Madame Chairman, you will remember that I testified before you last year to explain why we oppose funding CSRS benefits relating to military service of Postal Service retirees from the Treasury. Today, I would like to reemphasize the Administration's strong objection to such funding, which would amount to a taxpayer subsidy of Postal operations.

Postal Service payment of $27 billion of the cost of military service for Postal retirees, as required under the Postal CSRS Funding Reform Act, is justified for many reasons. This obligation is fair and equitable because the Postal CSRS Funding Reform Act effectively converted the Postal Service's CSRS to the funding system utilized for the Federal Employee Retirement System (FERS), which requires each agency (rather than the Treasury) to cover the military service retirement costs of its retirees. The Postal CSRS Funding Reform reduced the Postal Service's pension obligations by $78 billion. In our view, the Postal Service should not benefit from the dynamic valuation of its pension fund without assuming responsibilities that come with dynamic funding.[1] To do otherwise would mean that we endorse selectively implementing portions of dynamic funding, thus creating a hybrid that has both CSRS and FERS-like qualities. We do not support this approach.

The military service credit is a component of the government's overall benefits package. The government, as well as private sector employers, offers a variety of benefits tailored to meet their individual recruitment and retention needs.

The Federal government's retirement benefit, which includes the military service credit, is a valuable component of the government's overall compensation package. Since the Postal Service uses and receives the benefits of this human capital tool in the form of recruitment and retention of its own employees, it should pay for its full cost. There is no basis for the taxpayers to subsidize any element of the Postal Service's compensation package.

The value of this benefit was demonstrated by our recently completed 2004 OPM Benefits Survey. We are completing our final analysis of the results of that survey in which we queried over 2400 new hires and tenured employees throughout Government. Our preliminary analysis of the submissions by the nearly 900 respondents indicates that they consider our retirement package to be the employee benefit that is most important to them.

The law requires the Postal Service to manage its finances to ensure that its revenues cover its costs, unlike virtually all other Federal agencies. The parallels between departments such as Defense, Education, Housing and Urban Development, Health and Human Services, Treasury, Homeland Security, Justice, et al, and the Postal Service simply do not exist. For other agencies, the cost of the military service credit under the CSRS is borne by taxpayers regardless of whether they are charged to the General Fund of the Treasury or charged to agency budgets. By contrast, Postal Service costs are paid through postage revenues rather than funded by the Treasury.

I would also point out that last year, Congress enacted legislation according similar pension treatment to the Patent and Trademark Office ("PTO"). Pursuant to that legislation, PTO, which is also a self-funded agency, is required to pay the full costs of CSRS benefits, including those associated with military service. The President's 2006 budget proposes this practice be continued at the PTO.

Some small entities have also been required to pay the full costs of CSRS benefits, which include the military service credit, on a prospective basis. At the time these organizations were carved out of the Federal Government, their Federal employees' retirement coverage was "grandfathered" under the condition that the full cost was paid.

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[1] Under "static" funding assumptions, computations are not made under real world conditions, because it is assumed that inflation and pay increases do not occur, and the interest rate assumption is thus also set lower than actual expectations. Under "dynamic" funding assumptions, computations yield results that are consistent with actual expectations, because the best possible estimates are included with regard to inflation, pay increases, and interest rates.

When the Metropolitan Washington Airports Authority ("MWAA") was created by Public Law 99-500 in 1987, former Department of Transportation employees were permitted to retain their Federal retirement benefits. At that time, MWAA was required to prepay the difference between employer and employee contributions, and the actual cost of CSRS benefits, which included the military service credit.

In 1996, Public Law 104-134 spun-off the United States Enrichment Corporation ("USEC") from the Department of Energy as a private entity, and former Department of Energy employees were permitted to retain their Federal retirement benefits. For its CSRS employees, USEC, like the Postal Service, is required to pay the dynamic normal cost[2] less employee deductions, which includes the cost of military service credit.

While these are small organizations, we regard their situations as being analogous to that of the Postal Service. In each case, there was a mandate that full retirement costs be paid by the entity. And in each case, the cost of service credit for military service was included in the payments required to be made.

In addition, past Presidents' Budgets have proposed to change CSRS funding for all agencies by requiring payment of the full costs of CSRS. I would emphasize that full funding of CSRS is not a partisan issue, and that both this and a prior administration did in fact submit proposals to the Congress that would have required service in a manner similar to that under FERS.[3] Under these proposals, agencies would pay the costs of military service in their accrued liability payments. The appropriate, "good-government" response to the under-funding issue is to require all agencies to pay the full cost of CSRS, not to give the Postal Service a discount from the real cost.

Finally, I note that the taxpayers already fund approximately $21 billion in military service retirement credits under the current CSRS methodology for Postal funding. The $21 billion that the taxpayer has paid is the CSRS military service cost attributable to pre-1971 civilian Post Office employment for Postal retirees who retired after 1971. In other words, this represents the pro-rata share of the cost that is allocated to Treasury based on the portion of the retiree's civilian service that was performed before 1971. Thus, even though a Postal Service employee retires under the Postal Service, Treasury will continue to assume a portion of the retirement cost for military service if the retiree had some civilian service under the old Post Office Department. This is fair, because the obligation was created prior to the existence of the Postal Service.

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[2]While the technical definition is more detailed and complex, in essence the "normal cost percentage" is the percentage of salary that must be contributed at the time service is performed in order to pay the full cost of retirement benefits, assuming that the contributions begin at first creditable employment, and that the system will continue. The normal cost percentages change from time to time based upon changes in the underlying economic assumptions. To fully fund the retirement system, the normal cost percentage of basic pay must be paid into the Retirement Fund at the time service is performed.

[3]The "Federal Retirement Accrual Accounting Amendments of 1995" was submitted in the 104th Congress, and the "Managerial Flexibility Act of 2001" in the 107th Congress.

However, shifting further liabilities - that essentially fund Postal operations – to the taxpayer would be wrong.

In our view, CSRS military service credit associated with post-1971 Postal Service civilian employment should be accorded and funded in the same manner as other employee benefits. If we are to honestly maintain the policy that the Postal Service is to be financially self-sufficient, then the Postal Service must bear the cost of that benefit. Any transfer of those costs to the Treasury would constitute a taxpayer subsidy of postal operations and would violate the principle that the Postal Service should be self-funding.

PRE-FUNDING RETIREE HEALTH BENEFIT COSTS

The Administration supports the principle of prefunding health insurance and pensions. The Managerial Flexibility Act of 2001 introduced in the 107th Congress would have implemented this requirement for CSRS for all agencies, and would have also required all agencies to prefund their employees' retiree health benefits. Since 1987, all agencies have been required to prefund the full cost of their pension liabilities under FERS, which covers over 70 percent of current employees. Since 1997 all agencies have been required to recognize the accruing costs for both CSRS and post retirement health insurance liabilities on their annual financial statements. As a result of the 2003 Postal Pension Reform Act, the Postal Service is now required to prefund its CSRS pension costs, putting USPS closer to the true intent of the 1971 postal reorganization - - that the cost of postal operations be borne by the users of postal services.

However, Postal retiree health benefits are currently funded on a pay-as-you-go basis. That is to say, the Postal Service pays its portion of the Government share of retiree health insurance premiums on the same monthly basis as the retirees. However, the obligation for these future payments actually accrues when employees are actively serving. Thus, there is a substantial unfunded liability that has accrued because no money has been set aside when service is performed for this future obligation. We believe that responsible financing requires that this obligation be recognized and funded when it is created. Thus, the law should provide for funding of the accruing cost for active employees plus funding of the liability accrued to date.

We believe the Postal Service's health liability should be funded over forty years with limited Postal liability for ten years. This would cap the total Postal Service liability during the first ten years to the amount of the escrow plus the health premium payments the Postal Service would be obligated to make under current statute. Thereafter, the additional Postal liability is manageable. We believe that this provides the Postal Service with an appropriate transition period to reduce its cost structure and to plan for the inclusion of these additional liabilities.

S. 662

Madame Chairman, I would like to add a few comments on the benefit aspects of S. 662. Section 802 of the bill would transfer responsibility for the cost of CSRS military service credit from the Postal Service to the Treasury, resulting in a $27 billion benefit to the Postal Service.

The Postal Service would no longer have to make CSRS retirement contributions based upon a percentage of salary paid to employees. This amount would be transferred to reduce the unfunded liability for annuitant health benefit costs. Using these funds for that purpose is preferable to giving it directly to the Postal Service; however, we strongly object to the underlying proposal to shift liability for this benefit from the Postal Service.

Section 803 of the bill would establish a new Postal Service Retiree Health Benefit Fund, administered by OPM, and invested in the same manner as the Retirement Fund.
Future payments for the employer share of health benefits premiums for retired Postal employees will be made from the Fund.

In addition to the transfer payment from the Retirement Fund required by section 802, the new Fund will receive two forms of payment from the Postal Service. Under section 803, OPM will calculate the net present value of the unfunded liability for future payments required for the Government share of health benefits premiums for retired Postal employees. The Postal Service will make annual payments into the new Fund to amortize that unfunded liability over a period of 40 years. In addition, the Postal Service will pay the present value of the future Government share of the premium payments for Postal retiree health benefits attributable to the service of Postal Service employees during the current fiscal year.

We believe that the retiree health benefits funding mechanism provided for by S. 662 is a responsible plan, but for the provisions for the transfer from the Retirement Fund. We would support the full-funding concepts contained in section 803, provided that section 802 is deleted from the bill.

CONCLUSION

The Administration recognizes that we stand at a critical juncture in the history of how postal services will continue to be provided to this Nation. We are in agreement that the 35 year old legislative framework governing the Postal Service is in grave need of reform. But in moving forward, we must not violate bedrock principles such as self financing. Shifting retirement liabilities from the Postal Service, where they now properly rest, to the taxpayer runs counter to true reform. We deeply appreciate the opportunity to work with you in efforts to craft legislation that the Administration can endorse and support.

In conclusion, Madam Chairman, thank you for including me in today's panel. I will be glad to answer any questions you may have.