CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Douglas Holtz-Eakin, Director

September 1, 2005

Honorable Judd Gregg
Chairman
Committee on the Budget
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Postal Accountability and Enhancement Act (S. 662), ordered reported by the Senate Committee on Homeland Security and Governmental Affairs on June 22, 2005, would make certain changes to the laws under which the United States Postal Service (USPS) operates. In response to your request of August 29, 2005, the attachment to this letter examines the long-term effects of the bill on USPS's financial condition and the bill's potential implications for taxpayers and postal ratepayers.

Extrapolating from current information, the Congressional Budget Office (CBO) finds that the overall effect of the bill on USPS's total costs would be small—a reduction of roughly 1 percent over the next 25 years. Two provisions of the bill would ease the Postal Service's budgetary pressures. One provision would shift from postal ratepayers to taxpayers the burden of paying for pension costs associated with the military service credits of certain postal employees. A second provision would relieve the agency of the requirement that it hold certain funds in escrow. However, CBO estimates that the savings from those provisions would be largely offset by a third provision—requiring USPS to switch to a system of recognizing and paying for the health care benefits of future retirees as those benefits are accrued by current employees—that would raise the agency's costs. Should current trends continue, that third provision could dominate the bill's effects in later years, yielding a net increase in the Postal Service's total costs starting in 2028.

Whether or not S. 662 is enacted into law, the Postal Service will face challenges in the years ahead in collecting enough revenues to cover its costs. The agency's costs are on a trend to increase in real terms (in part because of rising costs for health care), whereas its revenues are threatened by increasing competition from e-mail and other forms of electronic communication. CBO estimates that if revenues were to grow at 1 percent less than the rate of inflation, costs over the 2026-2030 period would exceed revenues by as much as one-third—less, if lower mail volumes resulted in some cost savings. For USPS to continue paying its bills, any such gap would have to be closed through some combination of improvements in productivity, reductions in service, increases in postage rates (which in turn could result in further reductions in mail volume), and federal support.

If you would like further information about this analysis, please feel free to contact me. The CBO staff contacts are Julia Christensen, Geoffrey Gerhardt, Mark Grabowicz, and Perry Beider.

Sincerely,

Douglas Holtz-Eakin
Director

Attachment

cc: Honorable Kent Conrad
Ranking Democratic Member

Honorable Susan M. Collins
Chairwoman
Committee on Homeland Security and Governmental Affairs

Honorable Joseph I. Lieberman
Ranking Minority Member

The Effects of S. 662 on the Long-Term Financial Outlook of the U.S. Postal Service

September 1, 2005

The Congress of the United States ■ Congressional Budget Office

Summary

The Postal Accountability and Enhancement Act, S. 662, would change certain laws that govern the operation of the United States Postal Service (USPS), particularly those regarding the financing of pensions and health care benefits of retired workers and the requirement that the agency hold certain funds in escrow.[1] At the request of the Senate Budget Committee, the Congressional Budget Office (CBO) has analyzed the effects of the bill on the distribution of those costs over time and between ratepayers (users of postal services) and taxpayers, and on the long-term budgetary pressures facing the Postal Service.

CBO's analysis leads to the following conclusions:

- The provisions of S. 662 would not directly change any real (inflation-adjusted) resource costs of operating the Postal Service. One provision would free up funds for the agency simply by eliminating the escrow requirement. Two other key provisions would reallocate the burden of paying for certain costs. Consistent with modern accounting practices, USPS would be required to "prefund" the estimated cost of health care benefits for future retirees—that is, to pay for those benefits in advance as current employees accrue them. That prefunding would shift the burden of paying for retirees' health benefits earlier in time, from future ratepayers to current ratepayers. The bill would also shift from current ratepayers to taxpayers the burden of paying for pension costs associated with the military service credits of employees covered under the Civil Service Retirement System (CSRS).

- Extrapolating from current information, CBO estimates that the shifts made by S. 662 would have offsetting effects on USPS's total costs in 2006; from 2007 through 2027, they would yield small reductions in total costs. Farther into the future, the net effect of the two shifts may be reversed, particularly if health care costs continue to rise rapidly.

- Under either current law or S. 662, USPS will face challenges in continuing to be self-financing; those challenges appear relatively modest in the short term but are likely to grow over time. Costs are likely to increase in real terms (again, in part because of health care costs); revenues are threatened by substitution of first-class mail by the internet and other electronic forms of communication and thus may have trouble keeping pace. As a result, unless USPS's managers can find ways to control costs through ongoing increases in productivity, the Congress may ultimately face choices among accepting significant increases in postage rates, allowing major cutbacks in postal services, or providing significant federal aid to the Postal Service.

1. The Postal Civil Service Retirement Funding Reform Act of 2003 (Public Law 108-18) reduced the total payments the Postal Service must make each year toward its pension obligations for employees covered under the Civil Service Retirement System but also specified that the agency place an amount equal to the reduction into escrow beginning with fiscal year 2006.

- In particular, if revenues kept up with inflation, by the 2026-2030 period, costs would exceed revenues by about 7 percent, CBO estimates. If that gap was closed through proportional increases in all postage rates, a first-class stamp in those years would cost about 40 cents (in today's currency). If the stream of gaps over the 25 years was closed through annual payments (funded by taxpayers, ratepayers, or both) into an interest-bearing fund, the required payment would be about $2.5 billion per year.

- Alternatively, if revenues grew at a rate 1 percent below inflation, costs over the 2026-2030 period could exceed revenues by as much as 33 percent—less, if lower mail volumes resulted in some cost savings. Closing a gap of that size through proportional increases in postage rates would require that a first-class stamp increase in price to nearly 50 cents (in today's currency), or higher if advertisers and other large mailers reduced their use of mail services in response to such an increase. To close the gaps over the entire 2006-2030 period, the annual payment into an interest-bearing fund would need to be as much as $11 billion (again, less if lower mail volumes were partly offset by cost savings).

Long-term analyses of this nature are inherently uncertain. For example, CBO cannot accurately predict the evolution of the competition between mail and electronic communication over the next 25 years, nor whether or how effectively USPS might use the savings it realized under S. 662 to increase its investments in productivity. Thus, the analysis is essentially an extrapolation of current information, and less weight should be placed on the specific numerical estimates than on the broad qualitative findings.

In keeping with the scope of the request from the Senate Budget Committee, this report focuses on the implications of S. 662 for the budget of the Postal Service. Information on its implications for the federal budget as a whole over the 2006-2015 period is available in CBO's cost estimate.[2] That document reports, for example, CBO's estimates that the bill would have a net cost of $3.9 billion to the unified budget over the period, reflecting on-budget savings of $37.7 billion and off-budget costs of $41.6 billion.

Background on the Postal Service

Established as an independent agency in 1971, the Postal Service has a mandate to offer a "fundamental service" on a "fair and equitable basis." It has a legal monopoly on the delivery of first-class mail, "standard mail" (mostly advertising), and periodicals; but it competes with private firms in providing other services, notably with United Parcel Service and Federal Express in delivering packages. USPS delivers to 142 million households and post office boxes, using a network of more than 37,000 post

2. Congressional Budget Office, *Cost Estimate for S. 662, the Postal Accountability and Enforcement Act* (July 1, 2005), available at www.cbo.gov.

Table 1.

The Postal Service's Revenues and Volumes of Mail in Selected Years

	1995	2000	2001	2002	2003	2004
Cash Revenues (Millions of dollars)	54,944	64,848	65,532	68,066	69,467	69,635
Mail Volume (Millions of pieces)						
First Class	96,296	103,526	103,656	102,379	99,059	97,926
Standard	72,048	90,057	89,938	87,231	90,492	95,564
Other	12,390	14,299	13,869	13,212	12,634	12,616
Total	**180,734**	**207,882**	**207,463**	**202,822**	**202,185**	**206,106**

Source: Congressional Budget Office based on Department of the Treasury, *Monthly Treasury Statement* (various issues), and U.S. Postal Service, *Annual Report* (various years).

Note: Revenues are measured on a cash-accounting basis.

offices and other facilities. It is the largest federal employer of civilians, with a workforce that includes more than 700,000 career employees.[3]

Table 1 presents revenues (on a cash-accounting basis) and mail volumes for the Postal Service for selected fiscal years.[4] The revenues shown reflect rate increases in 2001 and 2002, which (among other things) raised the price of a first-class stamp to 34 cents and then 37 cents. Revenue growth in 2003 and 2004 slowed as first-class mail volume declined in those years (as it did in 2002). However, total mail volume increased in 2004 as standard-mail volume increased significantly.

By law, the Postal Service is required to generate enough revenues to cover its costs.[5] Judged according to its current definition of costs, the agency did so over the 10-year period from 1996 through 2005, with spending and revenues nearly identical. On a cash basis, CBO anticipates that the Postal Service will have raised $648 billion in total revenues over the decade, mostly from postage and user fees, and spent a total of $641 billion. Specifically, in 2004, the Postal Service generated $69.6 billion in collections and had $65.5 billion in expenses, for a net cash surplus of $4.1 billion. CBO estimates that the USPS will end 2005 with a cash surplus of $2.6 billion. (As discussed below, however, the agency's current definition of costs does not include future retirees' health benefits as they are accrued by existing workers.)

3. More background information is available in United States Postal Service, *2004 Annual Report*; and Nye Stevens, *Postal Reform*, CRS Issue Brief IB10104 (Congressional Research Service, June 23, 2005).

4. The Postal Service reports its financial data on an accrual basis. Thus, the revenue figures calculated by CBO on a cash basis do not match those in USPS reports.

5. Stevens, *Postal Reform*, p. 3.

Notwithstanding that recent experience, the Postal Service's ability to continue operating in the black is far from certain. Of primary concern is the substitution of electronic forms of communication for hard-copy mail, and particularly for such first-class mail as bills, account statements, and payments. Given the current structure of postage rates, a shift in the mix of mail away from first class and to standard mail makes it harder for USPS to cover its overhead costs. Although standard mail costs 6 cents less to deliver (the agency estimates that its marginal cost in 2004 for standard mail was 10.9 cents, compared with 16.9 cents for first-class mail), the average revenue per piece is 18 cents lower (19.0 cents versus 37.1 cents); thus, the net revenue left to contribute to overhead after subtracting the marginal cost is only 40 percent as large (8.1 cents versus 20.2 cents).[6]

USPS's Costs Under Current Law and S. 662

The proposals in S. 662 would not directly affect USPS's costs for personnel compensation (wages)—the single largest item in the agency's analysis of its expenses in 2004, accounting for $37.9 billion out of the total of $66.0 billion, or 57 percent.[7] The bill would, however, make several changes affecting the costs that the agency faced for two major components of personnel benefits—retirement expenses and health care benefits for retirees—though it would not change the benefits individuals receive. In total, personnel benefits represented 22 percent of USPS's costs in 2004.

Retirement Obligations

The Postal Service's spending on contributions toward its pension obligations totaled over $4.2 billion in 2004: $1.7 billion in contributions to the Civil Service Retirement System, $240 million toward supplemental liabilities for CSRS,[8] and $2.3 billion in contributions to the Federal Employees' Retirement System (FERS). Both CSRS and FERS provide defined-benefit pensions that give eligible retirees annuities based on their final pay and the number of years they worked. Except for workers who chose to switch from CSRS to FERS during designated periods, workers first hired prior to January 1, 1984, are covered by CSRS, whereas those first hired after that date participate in FERS. In 2004, about 25 percent of the Postal Service's workforce was covered by CSRS, and the rest were under FERS; the CSRS share will continue to fall as more-tenured workers retire.

6. United States Postal Service, *2004 Annual Report*, p. 23; and *Cost and Revenue Analysis, Fiscal Year 2004*, p. 1.

7. United States Postal Service, *2004 Comprehensive Statement on Postal Operations*, p. 65. As noted earlier, USPS reports its costs on an accrual basis. The dollar figures and percentages could be somewhat different on the cash basis that CBO uses elsewhere in this analysis.

8. Supplemental liabilities represent the excess of the actuarial value of future CSRS benefits over the actual present value of plan assets, future contributions, earnings, and other actuarial factors related to postal participants in CSRS.

The Postal Service and its employees each make payroll contributions to the civilian retirement system. Prior to enactment of Public Law 108-18, the Postal Service contributed 7 percent of basic pay for most of its CSRS workers and 10.7 percent for most FERS employees.[9] Unlike most other agencies, the Postal Service was also required to make annual lump-sum payments designed to amortize the cost of certain unfunded pension liabilities incurred since 1971 by its CSRS workforce. In 2002, those lump-sum payments totaled $3.9 billion.

P.L. 108-18 increased the agency's contribution rate for postal workers participating in CSRS from 7 percent to 17.4 percent. The new rate is determined by the Office of Personnel Management (OPM) and is subject to change as needed to reflect the actuarial cost of providing CSRS benefits, whereas the old rate was set in statute. The law also greatly reduced the annual lump-sum payments required from the Postal Service. CBO estimates that the legislation reduced postal contributions for CSRS pension benefits by $2.7 billion in 2004. Starting in 2006, the legislation specifies that the Postal Service must deposit any net reduction in CSRS contributions resulting from the enactment of P.L. 108-18 into an escrow account, treating those escrow deposits as expenditures. CBO estimates that the Postal Service will pay between $3 billion and $6 billion into escrow in each of the next 10 years, for a total of $43 billion over the 2006-2015 period.

S. 662 would make further changes to the Postal Service's pension obligations. The bill would eliminate the requirement that the Postal Service deposit net reductions in CSRS contributions in an escrow account. It would also transfer to the Department of the Treasury costs associated with military service credits for the Postal Service's CSRS workforce, effectively shifting those costs from ratepayers to taxpayers.[10] According to OPM, the latter change would reduce USPS's obligations for CSRS pension benefits below the amount USPS has already contributed toward them. Specifically, OPM estimates that USPS would have spent approximately $20.3 billion more than was necessary by the end of 2005. Consequently, the Postal Service would no longer be obligated to make any future contributions toward those benefits.

Health Care Obligations for Retirees

Proposals in S. 662 also would change the way the Postal Service finances its share of the cost of providing health care to its retirees. Under current law, the Postal Service

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9. The employee contribution rate is 7 percent for most CSRS workers and 0.8 percent for most FERS workers; those rates were not altered by P.L. 108-18. Workers in CSRS receive generally higher benefits than those in FERS, but unlike FERS, those in CSRS do not participate in Social Security and do not receive agency contributions to the Thrift Savings Plan.

10. Those who served in the armed forces or military reserves may credit any time served toward their CSRS benefits, provided the credits are not being used for a military pension. Up until the enactment of P.L. 108-18, the costs associated with those credits for the Postal Service's CSRS workforce were charged to the Department of the Treasury. P.L. 108-18 transferred responsibility for much of the costs for military service credits within CSRS to the Postal Service.

pays a portion of health care premiums for retired USPS employees who participate in the Federal Employees Health Benefits (FEHB) program. Over 400,000 Postal Service retirees participate in that program. On average, the Postal Service currently pays about 45 percent of the health care premiums for its retirees. Retirees pay about 30 percent of their FEHB premiums, and the Treasury's general revenues pay the remaining amount (roughly 25 percent).[11] In 2004, the Postal Service's payment for its portion of retirees' FEHB premiums was $1.3 billion.

Under S. 662, USPS would no longer directly pay a portion of the health care premiums incurred by current retirees each year. Instead, it would begin paying in advance for the estimated cost of health care benefits of future retirees as such benefits were accrued by current workers.[12] Starting in 2006, its annual payment would equal the increase in the future benefits accrued during the year by those current workers. Those payments would be deposited into a new on-budget account, the Postal Service Retiree Health Benefits Fund (PSRHBF), which would earn interest at the same rate as the Civil Service Retirement and Disability Fund (CSRDF). The Postal Service's share of health care premiums for current retirees would be paid out of the PSRHBF as soon as adequate funds were available in the account to do so.

Another provision of S. 662 specifies that any overfunding toward CSRS liabilities (after financial responsibility for military service credits reverted to the Treasury) would be transferred from the CSRDF to the PSRHBF by June 30, 2006. On the basis of information provided by OPM, CBO anticipates that the transfer to the new fund would total $21.2 billion and would occur in June 2006.[13]

Under the bill, the Postal Service would also make annual amortization payments toward the unfunded liabilities for health care costs of both current and future retirees. The unfunded liability would be the difference between the assets held in the PSRHBF and the net present value of accrued liabilities projected for retirees' health care. On the basis of information provided by OPM and CBO's current projections of

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11. The percentage paid by general revenues reflects retirees' health benefits attributable to service prior to the reorganization of the Postal Service in 1971. As the number of the Postal Service's annuitants with service before that point falls to zero, so to will the payments from the general fund. Provisions of S. 662 would not affect those payments.

12. In general, the Financial Accounting Standards Board requires private-sector companies that offer single-employer health plans to recognize the cost of retirees' health benefits as they are accrued by current workers. Companies that participate in multiemployer plans are exempt. United Parcel Service and Federal Express offer both single-employer and multiemployer health plans for their retirees and therefore use a mix of accrual and cash accounting. See Congressional Budget Office, *The Proposal to Reduce Payments by the Postal Service to the Civil Service Retirement System* (letter attachment to Honorable Jim Nussle, Chairman, House Budget Committee, January 27, 2003), p. 11 and the appendix.

13. This amount reflects the $20.3 billion in estimated CSRS overfunding plus interest that would accrue between the end of the valuation period in September 2005 and when CBO assumes the asset transfer would take place in June 2006.

long-term interest rates, CBO anticipates that the net present value of the unfunded liability for the health care costs of retirees would total about $70 billion at the end of 2005. The bill would direct OPM to compute the required prefunding and amortization payments consistent with assumptions and methodologies for financial reporting used by OPM under current law. CBO estimates that the Postal Service's total costs for retirees' health care would amount to $6.9 billion in 2007 (the first full year the bill would be in effect) and $80.2 billion over the 2006-2015 period, compared with $2 billion in 2007 and $30.7 billion over the 2006-2015 period under current law.[14]

Projected Total Costs, 2006-2030

To project USPS's total spending through 2030 under current law and S. 662, CBO had to extend the above analysis in two ways. Estimates of pension costs, retirees' health care costs, and current-law deposits to the escrow account were extended another 15 years by applying the same methods used for the 2006-2015 period. Spending in all other categories, which is not directly affected by the provisions of S. 662, was assumed in both cases to grow from its 2005 level at the rate of inflation—specifically, at the rate CBO projects for the consumer price index for all urban consumers—thus staying constant in real terms.

For the short term, CBO estimates that USPS's costs in 2006 will total $73.0 billion, under either current law or S. 662. Looking at the entire 25-year period, CBO estimates that total costs in nominal dollars will grow from $384 billion over the 2006-2010 period to $629 billion over the 2026-2030 period under current law, and from $383 billion to $630 billion under S. 662. (See Figure 1, which includes observed costs from the 1996-2000 and 2001-2005 periods for comparison.) Costs under the bill are lower in four of the five five-year intervals shown; however, the largest difference in any of the intervals is just $7 billion, or 1.4 percent (in the 2016-2020 period). The net effect of the bill through 2030 is small for two reasons. First, the requirements for pensions, retirees' health care, and escrow payments affected by the bill represent a relatively small share of current-law costs—less than 18 percent of estimated total costs over the 25 years. Second, the changes resulting from the bill tend to offset each other during the period. Shifting responsibility for the military service credits of workers in CSRS from ratepayers to taxpayers and eliminating the escrow requirement reduces USPS's costs, but the savings are nearly offset by the increase in contributions resulting from the earlier recognition of retirees' health costs.

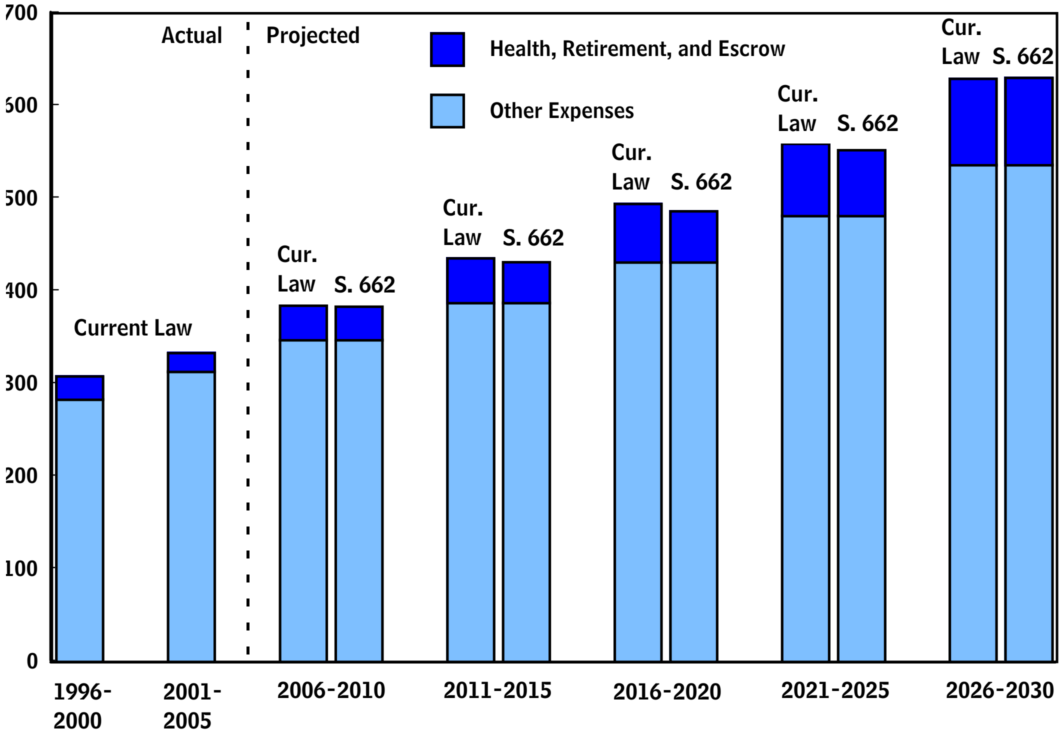
For the final five-year period shown in Figure 1, CBO projects that the net effect of S. 662 on the Postal Service's costs would be a small increase, rather than a decrease. The savings from the bill's pension and escrow provisions diminish over time as the numbers of workers and retirees covered under CSRS fall. In contrast, the projected

14. The estimate of $80.2 billion for retirees' health costs includes $78.8 billion in prefunding and amortization payments required under the bill, plus $1.3 billion paid through June 2006 under the current-law system in which USPS pays directly to the FEHB program a portion of the health premiums of current retirees.

Figure 1.

Projected Expenditures of the Postal Service Under Current Law and S. 662

(Billions of dollars)



Source: Congressional Budget Office.

increase in costs associated with the prefunding and amortization requirement grows over time, given the assumptions of the analysis that USPS's workforce remains constant and that the rate of growth in medical costs continues to outpace the rate of return the agency earns by investing its prefunding contributions (7 percent versus 5.75 percent, respectively).

If the assumptions underlying CBO's estimate of future health costs remain valid beyond 2030, the gap between the agency's costs under S. 662 and current law would widen over time. The combined cost of prefunding health care benefits and amortizing the unfunded liability associated with retirees' health care costs could continue to be larger than premium payments under current law, while the savings associated with changes to CSRS and the escrow fund are guaranteed to keep falling.

Future Costs Versus Revenues

CBO's projections indicate that USPS's costs are on a trend to rise somewhat faster than general inflation—if only because health care costs are expected to grow in real terms. Thus, for the agency to keep paying its bills, it will need some combination of higher revenues, lower expenses (from either cuts in services or greater productivity), and federal support. The traditional answer might be to increase revenues by raising postage rates—but that may be harder to do in light of the growing competition from e-mail, cell phones, and other means of electronic communication.

The financial pressures that USPS could face are illustrated in Figure 2, which provides the same estimates of costs included in Figure 1 and adds two alternative trajectories for revenues over the 2006-2030 period. The upper line shows revenues growing at 2.2 percent annually, the rate of inflation assumed in the analysis, from $381 billion over the 2006-2010 period to $589 billion over the 2026-2030 period. Those revenues could arise through many different combinations of postage rates and mail volumes—but in particular, the trajectory shown is consistent with rates keeping pace with inflation (as they have tended to do since 1970) and revenue-weighted volume remaining constant.[15] The lower line shows revenues growing at 1.2 percent annually, from $374 billion over the first five years of the analysis to $475 billion over the final five years. That trajectory could represent, for example, rates continuing to keep pace with inflation and revenue-weighted volume falling by 1 percent per year.

Under either current law or S. 662, the estimated gap between costs and revenues over the 2026-2030 period is about $40 billion if real revenues stay constant and about $150 billion if they shrink by 1 percent annually. (Both estimates are in nominal dollars, not corrected for inflation.) However, the latter figure may be an overestimate: it is likely that a steady reduction in mail volume would allow some reduction in USPS's costs that would partly offset the lost revenues. For example, if all costs not related to requirements for pensions, retirees' health care, or escrow payments grew 0.5 percent slower than inflation, the gap over the 2026-2030 period relative to revenues growing 1 percent less than inflation would be roughly $100 billion.

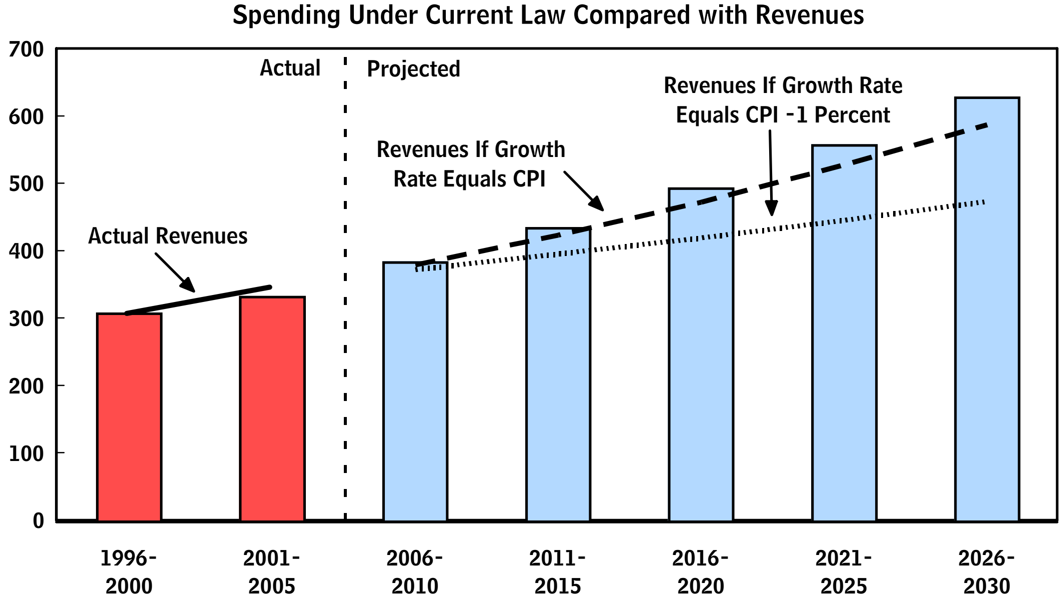
One way to put those apparent "deficits" into context is to calculate the postage rates that would be required to eliminate them through proportional increases in all rates and fees. For example, in the case of constant real revenues, the deficit shown for the 2026-2030 period represents about 7 percent of revenues during those years. Raising all postage rates by 7 percent would yield a first-class stamp priced at 40 cents (in today's currency). In the case of declining real revenues, the relative gap over the 2026-2030 period would be as much as 33 percent if there were no cost savings associated with lower mail volumes; alternatively, the gap would be 20 percent with the cost savings specified above. Closing those gaps through increased postage rates implies that a first-class stamp in those years would have to cost about 49 cents or 45 cents (in today's currency), respectively, assuming that the higher rates did not reduce volume further still. Of course, the larger the increase in rates, the greater the extent to which mailers would be likely to reduce their use of postal services.

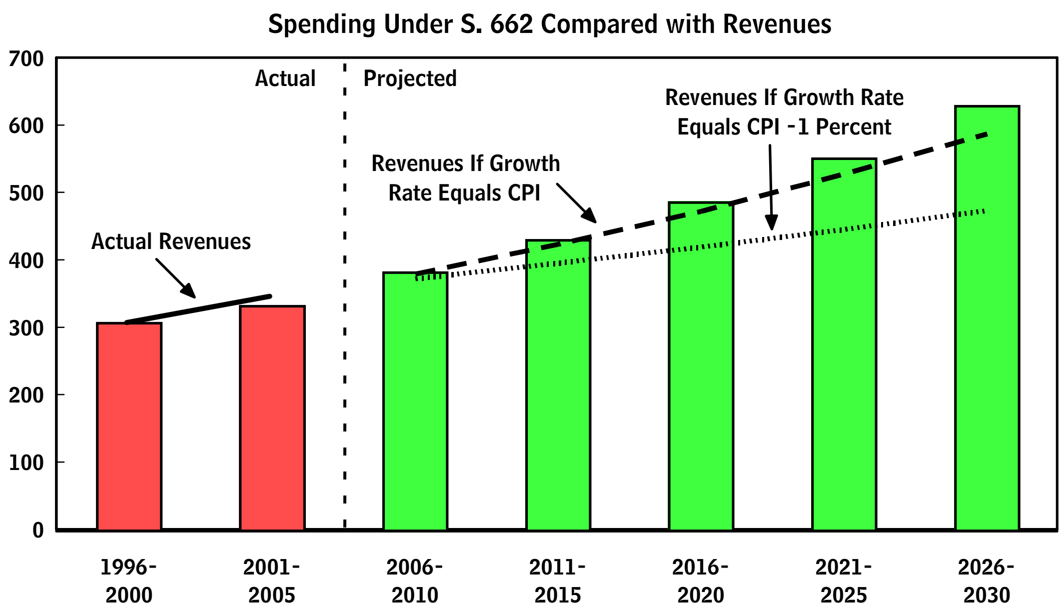
15. Again, at current postage rates, first-class mail yields roughly twice as much revenue per piece as standard mail, on average; thus, each piece of the former counts for roughly twice as much in calculating revenue-weighted volume.

Figure 2.

Projected Spending and Revenues of the Postal Service

(Billions of dollars)





Source: Congressional Budget Office.

Note: CPI = consumer price index for all urban consumers.

Another way to put into perspective the streams of deficits shown in Figure 2 is to consider the annual amounts that would have to be put into a fund, like the proposed PSRHBF, to amortize them over the 25 years considered in this analysis. Assuming the same 5.75 percent rate of interest as was used for the PSRHBF, the required annual payment—from taxpayers, USPS ratepayers, or some combination of the two—would be about $2.5 billion if real revenues were constant, $11 billion if real revenues fell without any offsetting reductions in costs, and nearly $7 billion if real revenues declined with partly offsetting reductions in costs.[16]

Sensitivity of the Estimates

As noted earlier, projections of postal spending and revenues over the 2006-2030 period are dependent on several variables that are highly uncertain. Different assumptions could yield different results, as illustrated by the fact that USPS's estimates of the payments required each year to prefund retirees' health benefits before workers retire are significantly below CBO's. (The Postal Service has not developed overall 25-year projections that could be compared with those presented above.) S. 662 directs the Office of Personnel Management to make the final determination on the bill's required prefunding and amortization payments. If the bill was enacted and OPM ultimately calculated that the required payments were lower than those estimated by CBO, the net savings to USPS would be larger than those discussed above. In particular, USPS's total costs in 2006 could be measurably lower than under current law, in contrast to CBO's projection that total costs that year would be $73.0 billion in either case.

Several differences in assumptions and actuarial methods help explain USPS's and CBO's divergent estimates of prefunding costs. For example, the Postal Service generally has assumed that the long-run growth rate of health care costs is between 5 percent and 6 percent annually, compared with CBO's rate of 7 percent, and that the interest rate on prefunded contributions is 6.25 percent, rather than the 5.75 percent rate that CBO uses. Also, USPS's analysis does not uniformly follow OPM's actuarial methods, as CBO's does. In particular, the Postal Service incorporates in its analysis some information specific to the postal workforce, whereas OPM uses methods that reflect the characteristics of the federal workforce as a whole. USPS and OPM also measure differently the average periods during which benefits are accrued.

Although the focus of CBO's analysis is on USPS's future costs for pension and health benefits (the parts of the agency's financial picture that would be most directly affected by the enactment of S. 662), other costs are also subject to uncertainty over the long term. Again, USPS identified personnel compensation as its single largest expense in 2004, representing 57 percent of the total. Future compensation costs could differ significantly from those projected above—lower if, for example, productivity

16. The figures given in the text are approximate averages of the estimates for costs under current law and S. 662. They would be about $0.7 billion higher under current law than under S. 662.

improvements allowed reductions in the size of the workforce, or higher if, say, USPS wages rose faster than inflation.

Combining compensation with retirement and health benefits, total personnel costs accounted for 79 percent of the Postal Service's total 2004 expenses. The largest non-personnel cost was for transportation, representing 7.5 percent of total expenses. Future expenses in that category could be higher than those assumed in the above projections if fuel prices increased faster than inflation and were not offset by greater vehicle fuel efficiency or improvements in USPS's transportation network. Supplies and services, depreciation, building occupancy, interest expense, and miscellaneous other costs collectively accounted for about 13 percent of the agency's 2004 expenses. Those categories do not represent major sources of uncertainty in CBO's analysis of USPS's overall costs.