

CRS Report for Congress

Postal Reform

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Postal Reform

Summary

This report provides information on the postal reform initiative, which culminated in the enactment of P.L. 109-435, the Postal Accountability and Enhancement Act of 2006. The report provides background information on postal reform, analyzes the points of contention among postal stakeholders and the Administration, and describes both the proposed and enacted legislation. It will not be updated.

A number of factors encouraged the movement for postal reform. Perhaps foremost were the financial challenges of the U.S. Postal Service (USPS). Use of the mails is declining as alternatives such as e-mail, facsimiles, and on-line bill paying substitute for hard-copy letters. Yet costs — nearly 80% of which are labor — rise with the addition of 2 million addresses each year and mounting obligations for retiree health benefits.

Additionally, USPS, its board of governors, the Government Accountability Office, mailers' organizations, postal labor unions, and most recently a presidential commission have said that the Postal Reorganization Act of 1970 no longer provided a viable business model. The rate-setting process was criticized for preventing USPS from responding flexibly to an increasingly competitive marketplace. Critics have also argued that long-standing political and statutory restrictions impeded efforts to modernize the mail processing network and close unneeded facilities.

Passage of P.L. 108-18, the Postal Civil Service Retirement System Funding Reform Act of 2003, enabled USPS to pay off its \$11.9 billion debt to the Treasury and to defer rate increases through 2005. However, the law did impose costs. USPS was required to set aside future pension savings in an escrow fund, requiring a 5.4% increase in postal rates in 2006 with no operational benefit. USPS also was required to pay pension benefits for military service from the Treasury to USPS, costing ratepayers \$27 billion.

On July 31, 2003, a blue-ribbon commission appointed by President Bush issued a report that recommended changes, including controversial workforce changes. Congress eschewed the commission's labor proposals in drafting legislation.

In the 109th Congress, the House and Senate passed separate but very similar versions of H.R. 22. The bills proposed significant changes to the rate-making process and the powers of the Postal Service's regulator. The bills also proposed improving USPS's financial condition by transferring \$27 billion in obligations related to military service back to the U.S. Treasury and abolishing an escrow account that cost USPS over \$3 billion per year. Despite their similarities and wide bipartisan support, the bills appeared stalled to many observers.

In the waning days of the 109th Congress, H.R. 6407, a compromise bill was introduced. Congress approved the bill within two days, and on December 20, 2006, President George W. Bush signed the Postal Accountability and Enhancement Act of 2006.

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Postal Reform

Introduction

Bipartisan postal reform legislation was introduced in the 109th Congress in both chambers — H.R. 22 and S. 662. H.R. 22 passed the House by a 410-20 vote on July 26, 2005.¹ S. 662 passed the Senate by unanimous consent on February 9, 2006, re-designated as H.R. 22.

The bills were quite similar. They proposed significant changes to the rate-making process and the powers of the Postal Service's regulator. The bills also proposed improving USPS's financial condition by transferring \$27 billion in obligations related to military service back to the U.S. Treasury and abolishing an escrow account that cost USPS over \$3 billion per year. Despite their similarities, the bills appeared stalled to many observers.

In the waning days of the 109th Congress, H.R. 6407, a compromise bill was introduced. Congress approved the bill on voice votes within two days. On December 20, 2006, President George W. Bush signed the Postal Accountability and Enhancement Act of 2006 (P.L. 109-435) into law.

This report provides background information on the postal reform initiative, analyzes the points of contention among postal stakeholders and the Administration, and describes both the proposed and enacted legislation.

Background

Postal Service management, its board of governors, the Government Accountability Office (GAO), most stakeholders, and most lately a presidential commission have concluded that the Postal Reorganization Act of 1970 no longer provides a viable business model for a successful postal enterprise. That act had taken postal affairs out of the direct control of either Congress or the President. It made the U.S. Postal Service (USPS) an independent establishment of the executive branch, directed by a postmaster general selected by, and serving at the pleasure of, a part-time board of governors appointed by the President with the consent of the Senate. USPS was permitted to operate using business principles, and charged with generating enough revenues to support the costs of the service it provides by allocating those costs among the many users of the postal system. That allocation has

¹ This report originally was authored by Nye Stevens, who has retired from CRS. Since that time, it has been updated by Kevin R. Kosar, who may be contacted by readers with questions on postal issues.

been accomplished through periodic rate cases before the Postal Rate Commission (PRC), a five-member regulatory commission that considers cost data and the conflicting views of competitors, unions, and users of the many classes of mail in a 10-month adjudicative process leading to new rates and classifications.

The legal and regulatory framework established by the act served reasonably well for nearly three decades. Delivery service and customer satisfaction improved, USPS received no general appropriations after 1983, rising mail volumes covered the costs of adding new routes and delivery points each year, and prices rose generally in line with inflation. Postal issues came to be perceived as minor enough that postal service committees and eventually even subcommittees disappeared from the congressional organization chart. However, few who are familiar with postal affairs believe that Congress can ignore the current state of the enterprise. Comptroller General David Walker has called the institution's current course "unsustainable."² In 2003, the blue-ribbon President's Commission on the United States Postal Service came to the same conclusion.³

USPS faced a financial crisis in 2001, when both the House and the Senate held hearings on the deteriorating financial condition of the enterprise.⁴ GAO issued a number of reports that portrayed a steadily growing sense of urgency, and placed the transformation of the Postal Service on its list of High Risk programs. Among the indicators of an impending crisis were the following:

- Despite desperate cost-cutting measures, a freeze on facilities, and severe limits on productivity investments, revenues were falling faster than expenses. USPS suffered losses of more than \$2 billion in 2001 and 2002.
- Mailers warned of an "economic death spiral," as falling mail volume forced price increases to cover fixed costs, and the price increases led to further drops in volume as businesses seek more cost-effective alternatives.
- Liabilities continued to exceed and grow faster than assets, a condition that GAO said would mean bankruptcy if USPS were not a government entity.

² Testimony of David M. Walker in U.S. Congress, Senate Committee on Governmental Affairs, *The Postal Service in the 21st Century: the USPS Transformation Plan*, hearings, 107th Cong., 2nd sess., May 13, 2002, S.Hrg. 107-551 (Washington: GPO, 2003).

³ President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service*, (Washington: GPO, July 31, 2003), pp. 125-126. The report is available at [<http://www.treas.gov/offices/domestic-finance/usps/>].

⁴ The following section is a summary of information and analysis in CRS Report RL31069, *Postal Service Financial Problems and Stakeholder Proposals*, by Nye Stevens. The report has not been maintained since 2002, but it provides a full account of the USPS financial crisis and its causes.

Causes of the Financial Crisis

While there are differences among the stakeholders in emphasis, the following factors have been identified as being in part responsible for the financial crisis of 2001-2002, and the present precarious state of the enterprise:

- The economic slowdown that began in early 2001 cut into USPS revenues from the dominant business segment, and (temporarily, as it turned out) reduced advertising mail, which now accounts for most mail volume. Costs continue to rise, however, since nearly 2 million delivery points are added each year, built-in wage and cost-of-living increases add \$2 billion per year even with declining employment rolls, and USPS is particularly vulnerable to energy price spikes.
- The rate determination process is cumbersome and rigid, preventing USPS from aligning its offerings with the variable needs of its customers. Preparations for a rate case begin many months before a filing with the Postal Rate Commission (PRC) and USPS must estimate costs and demand nearly two years into the future. The adversarial process of contesting proposed rates and classes goes on for 10 months, with exchanges of tons of paperwork and hundreds of hours of testimony. USPS competitors are very active participants. The emphasis is on allocating stated costs among mail classes rather than reducing costs or encouraging demand. USPS complains that the process gives it no opportunity to respond to competition, to vary rates with periods of low usage, to lower rates for big mailers, or to set prices in accordance with demand, rather than costs.
- Three rate increases in an 18-month period drove some mailers to curtail volume in order to stay within set budgets, and made the comparative cost of alternatives more attractive.
- Competition from other providers and other media had begun to marginalize some of the services that USPS provides. E-mail, facsimiles, and cell phones have become substitutes for written correspondence. The Internet is a growing alternative for financial billing and payment, which sustained USPS volume and revenue growth through the 1990s. USPS is already a secondary player in the overnight express and package delivery markets, except for the most difficult and costly routes to service in Alaska and Hawaii.
- Labor costs of its more than 700,000 employees accounted for 79% of USPS expenses,⁵ not much less than was the case decades ago. In contrast, labor costs are 56% of United Parcel Service's expenses, and 42% of costs at FedEx, where only the pilots are unionized. Lagging productivity growth (11% in 30 years), a backlog of

⁵ Congressional Budget Office, *The Effects of S. 662 on the Long-Term Financial Outlook of the U. S. Postal Service*, Sept. 1, 2005, p. 4.

146,000 pending or appealed labor grievances that are pursued “on the clock,” and binding arbitration of disputes keep labor costs high. Costly government annual and sick leave, early retirement, and health benefits are set in law and can only be enhanced, not diminished, in contract negotiations.

- Facilities are not optimally located for efficient distribution, since USPS has been unable to close existing facilities and consolidate operations in new locations. USPS maintains that over half its 38,000 facilities do not generate enough revenues to cover their costs, and complains that political considerations prevent it from modernizing its retail and distribution system.
- The use of mail to deliver agents of bio-terror (anthrax, followed by ricin) imposed major new mail security and operational costs on USPS, only some of which have been met by appropriations.

The American Postal Workers Union (APWU) has been a vocal proponent of another ascribed cause for the postal financial predicament. It blames the financial crisis on the \$12 billion in discounts that USPS gives annually to major mailers for pre-sorting their mail. “The discounts provided to big mailers significantly exceed the costs the Postal Service avoids by accepting pre-sorted mail. These subsidies rob the Postal Service of billions of dollars a year,” revenue that could be recovered if the work were brought back in-house, according to the APWU.⁶

The USPS Transformation Plan

When GAO placed the long-term outlook for USPS on its High Risk List in the spring of 2001, the Senate Governmental Affairs Committee asked USPS to prepare a comprehensive plan to address its financial, operational, and workforce challenges. USPS responded in April 2002 with an ambitious “Transformation Plan” that had two major thrusts. One was a concerted effort to improve operational efficiency, freeze spending on facilities, and cut its cost base by \$5 billion over the next five years within USPS’s existing statutory authorities. This aspect of the plan has succeeded to an impressive degree. In September 2005, USPS reported cumulative cost reductions of \$13 billion and a reduction in its career workforce of 68,000.⁷

The second thrust of the plan was to seek congressional approval of new statutory authorities that would allow USPS to change its business model. The plan suggested the need for authority to close retail post offices and processing centers, negotiate service agreements and discounts with large mailers, revamp contract talks

⁶ APWU press release, “Huge Subsidies for Mailing Industry are Real Cause of USPS Financial Mess,” May 13, 2002. See also, testimony of William Burrus in U.S. Congress, Senate Committee on Governmental Affairs, *Preserving a Strong United States Postal Service: Workforce Issues*, hearings, 108th Cong., 2nd sess., Feb. 24, 2004, S.Hrg. 108-439 (Washington: GPO, 2004), pp. 58-63.

⁷ U.S. Postal Service, *Strategic Transformation Plan, 2006-2010*, pp. 1, 53.

with the unions to escape binding arbitration, cut back on delivery days, and most significantly, expanded freedom to use its assets for entering related markets and developing new products without skeptical scrutiny from the PRC. While postal reform has been under active consideration by the last three Congresses, agreement has not been reached on the specifics of a new law. The success at USPS in cutting costs, with help from Congress as discussed in the next section, may have made postal reform more difficult by lessening the sense of crisis early in the decade.

Recalculation of USPS Retirement Obligation

Postal reform has become intimately bound up with controversies over the huge retirement obligations the Postal Service has for former employees and their spouses.⁸ On April 23, 2003, President Bush signed into law the Postal Civil Service Retirement System Funding Reform Act of 2003, P.L. 108-18. The law was quickly passed without dissent in either chamber in response to a surprise finding by the Office of Personnel Management (OPM) that future payments under current legislation would overfund USPS liability to the Civil Service Retirement Fund by at least \$71 billion. A principal reason is that interest earnings on past contributions by USPS on behalf of its employees have been credited at a statutory rate of 5%, when in fact the average rate of return on the bonds held by the trust fund has been substantially higher.

The act authorized USPS to reduce its annual payments by \$3.5 billion in FY2003 and \$2.7 billion in FY2004 and in FY2005. The savings (plus rate increases) allowed USPS to eliminate its \$11.9 billion debt to the Treasury in 2005 and keep postage rates stable until 2006. While this development (coupled with cost-cutting successes achieved by USPS under its Transformation Plan) granted financial breathing room, Postmaster General John Potter said that it does “not in any way obviate the fundamental flaws in the Postal Service business model” and urged undiminished attention to postal reform.⁹

The act also did not (as was recognized by its authors) permanently settle questions about responsibility for postal retirement obligations. Three major points remain at issue. First is the use of future savings from the retirement funding reduction. USPS pointed out that “savings” is really a misnomer for the “potential amount of overfunding of Civil Service Retirement System (CSRS) pension costs in any given year had corrective action not been enacted.”¹⁰ The law requires that they continue to be collected through postage rates and kept unused in an escrow account until Congress decides on their use in the future. The amounts are considerable,

⁸ This subject is treated more extensively in CRS Report RL32346, *Pension Issues Cloud Postal Reform Debate*, by Kevin R. Kosar.

⁹ U.S. Postal Service, “USPS Retirement Determined to be Almost Fully Funded, Provides Opportunity to Stabilize Postage Rates to 2006,” press release #02-083, Nov. 5, 2002.

¹⁰ U.S. Postal Service, *Postal Service Proposal: Use of Savings For Fiscal Years After 2005, P.L. 108-18*, undated.

estimated by CBO at \$43.2 billion over the 2006-2015 period.¹¹ The rub arises from the fact that either not collecting the funds, or using them for operational expenses, would have the effect of reducing revenues in the unified federal budget, thus increasing the deficit by that amount. USPS and mailers' organizations naturally object to the collection of funds that cannot be used. The Bush Administration agreed that the escrow requirement has no operational value, but said that any change to the requirement must be made in a budget-neutral manner.

The second issue concerned a provision of P.L. 108-18 that transferred from the Treasury to USPS the obligation to cover military retirement costs of postal employees in the Civil Service Retirement System, a \$27 billion obligation. If this amount had not been subtracted from the USPS overpayment to the Civil Service Retirement Fund, the overfunding would have amounted to more than \$100 billion. USPS pointed out that more than 90% of the financial obligation is the result of military service performed before the Postal Service was created, that no other agency has to bear these costs for its veterans, and that it conflicted with the veterans preference requirement. The President's Commission on the United States Postal Service (see next section) recommended that the costs be returned to the Treasury because they are a national obligation and none of USPS's competitors have to pay for retirement benefits earned while the retiree was employed by another employer.

The Administration was firm in opposing return of the obligation to the Treasury (and the taxpayer), though its rationale evolved over time. Its original report suggested that USPS should bear the costs because the retirement credits based on military service would have no value if the employees had not joined USPS, and thus were a consequence of USPS hiring decisions. Later, its rationale stressed the fact that all agencies bear the costs of military retirement in their contributions to the Federal Employees Retirement System (FERS — to which all federal employees hired since 1984 belong), without complaint, and that the underlying principle of P.L. 108-18 was to apply FERS-like principles to USPS. GAO, whose original report said this was a policy matter for Congress to decide, seemed to side with USPS in an April 14, 2005 hearing, saying that costs of military service should be borne by beneficiaries of the service, or taxpayers, rather than postal ratepayers.

The third issue was the USPS unfunded liability for health care costs of its retirees, estimated by CBO at \$76.8 billion over the 10-year period 2006-2015. USPS proposes that a fund be created in the Treasury to hold money for this obligation, funded initially with a \$20 billion credit from returning military retirement obligations to the Treasury. The Administration counter-proposed that all of the collections from retaining the escrow requirement be put into the new fund, which would have the effect of making removal of the escrow requirement budget neutral because postage rates would not be diminished.

¹¹ See Congressional Budget Office, *Cost Estimate, H.R. 22, Postal Accountability and Enhancement Act*, April 25, 2005, p. 5.

The President's Commission on the United States Postal Service

A number of postal observers have believed for some time that political power is so thoroughly dispersed among stakeholders that only an independent blue-ribbon commission, rather than the legislative process, could devise a contemporary solution to today's postal crisis. There is a notable precedent. In 1967, President Johnson appointed Frederick R. Kappel (the chief executive of AT&T) to chair a Commission on Postal Organization that eventually devised the framework for the Postal Reorganization Act of 1970.

On December 11, 2002, President Bush issued Executive Order 13278 creating a Commission on the United States Postal Service, forestalling congressional initiatives to create such a commission by statute. The co-chairmen of the commission were James Johnson, former CEO of Fannie Mae, and Harry Pearce, board chairman of Hughes Electronics. The other seven members included no one with close ties to postal stakeholders.

The commission's report, issued on July 31, 2003, confirmed that universal mail service at affordable rates is at risk, and made 35 recommendations, 18 of which would require some action by Congress.¹² In many ways, the commission's approach is in the mainstream of postal reform discussions that have been underway among stakeholders since the mid-1990s. For example, the commission endorsed the basic structure of the 1970 Postal Reorganization Act, recommending that USPS "should continue to operate as an independent establishment within the executive branch with a unique mandate to operate as a self-sustaining commercial enterprise" and rejecting the alternative of privatization that many other countries have adopted. While keeping the basic government corporation model, the commission pressed in many of its recommendations that USPS should adopt the "best practices of similarly-sized private-sector corporations." These included an independent corporate-style board of directors that would perpetuate itself, greater financial transparency, expanded outsourcing for services, aggressive real estate asset management, and use of commercial purchasing practices. A core recommendation was that USPS should not enter new lines of business, but adjust to a steadily declining demand for its services by becoming smaller and more productive.

The commission's recommendations with regard to regulatory controls were similar to proposals under consideration by Congress for several years. The Postal Rate Commission would be transformed into a new Postal Regulatory Board that would have authority to refine the scope of the universal service obligation and the postal monopoly, to establish broad parameters within which USPS could set rates

¹² President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service: Report of the President's Commission on the United States Postal Service*, (Washington: GPO, July 31, 2003). The report is available at [<http://www.treas.gov/offices/domestic-finance/usps/>]. The 18 recommendations to Congress are discussed in CRS Report RS21640, *The Legislative Recommendations of the President's Commission on the United States Postal Service: An Overview*, by Kevin R. Kosar.

and negotiate service arrangements, to redefine pay comparability, and to assure that competitive products are not cross-subsidized by revenues from products protected by the monopoly.

While recommending that Congress eliminate current statutory restrictions on closing post offices for economic reasons, the commission did not press for an aggressive program of closing local post offices, pointing out that even some “low activity” post offices are needed to meet the universal service obligation. It placed much more emphasis on consolidating the 446 large processing facilities, recommending a Postal Network Optimization Commission to identify facilities to be closed with a fast-track congressional approval process comparable to the defense base closing process.

The most controversial of the commission’s recommendations were four proposals relating to workforce compensation, a subject that recent bills in Congress have conspicuously avoided. Referring to “persuasive testimony” that a postal compensation premium may exist, the commission (with the one labor member dissenting) recommended major revisions to the current practice of binding arbitration of wage bargaining disputes, including the value of fringe benefits such as health care and early government retirement in bargaining over compensation, a redefinition of pay comparability to be made by the Postal Regulatory Board, and introducing some form of pay for performance into the compensation package. The American Postal Workers Union denounced the recommendations as “fundamentally dishonest” and “a disaster,” and said the APWU would use every tool at its disposal to assure that none of them becomes law.¹³

Should the Postal Service Compete?

USPS itself (in its Transformation Plan), its unions, and many mailers’ organizations believe that the survival of the Postal Service depends on the institution’s ability to compete in active or developing markets, because the services it provides under its statutory monopoly are a declining business. Another school of thought, however, rejects the notion that USPS should compete with private sector companies who are able to provide services within the market economy.

There are several components to the argument.¹⁴ One relates to fairness. USPS has many advantages stemming from its governmental status. It pays no federal, state, or local taxes on its income, sales, purchases, or property. Unlike private sector companies, it is immune from most forms of regulation, such as zoning, land use restrictions, motor vehicle registration, parking tickets, and antitrust. It is also able to borrow money at the lowest possible rate because it does so through the U.S. Treasury. Companies facing competition from USPS argue that these factors put

¹³ APWU News Service Bulletin, July 23, 2003, available at [<http://www.apwu.org/news/nsb/2003/nsb14-072303.htm>].

¹⁴ The Institute for Research in the Economics of Taxation [<http://www.iret.org>] has a number of publications exploring these themes.

them at a great disadvantage (though they tend to ignore the statutory constraints and regulation by the PRC that USPS faces).

A second argument is based on concepts of economic efficiency. Because of its indirect subsidies such as freedom from taxation and regulation, and because its goal is to break even rather than earn a competitive rate of return, USPS has less incentive than private sector entities to use capital and labor resources efficiently. Subsidies make government products and service seem artificially inexpensive, resulting in an over-allocation of resources that could be used to produce greater benefits elsewhere in the economy. Economic theory maintains that such a misallocation reduces national economic welfare below that achieved by a competitive market. When private sector companies produce and sell a product or service, there is some benefit to society from the taxes that result, a benefit not gained when the government produces the same product or service.

Finally, there is substantial evidence that USPS is not a very adept competitor. GAO has issued several reports of failed commercial ventures by USPS. In 1997, for example, USPS had discontinued or was losing money on 15 of 19 new products, resulting in a net loss of \$85 million.¹⁵ UPS and FedEx have both established profitable delivery networks in markets where USPS tries to compete but is now a relatively minor player.

One policy prescription leading from this diagnosis is that USPS should stick to its monopoly business and not seek to grow at the expense of private sector competitors. Indeed, some would like to see the postal monopoly reduced to “the last mile” of delivery, opening up collection, sorting, and transportation to market competition.

Activity in the 107th Congress

Although Congress became increasingly concerned about deterioration in USPS’s finances, legislative activity was confined to the subcommittee level until late in the 107th Congress. The House Postal Service Subcommittee was not reconstituted in the 107th Congress. Representative John McHugh, who had chaired the Postal Subcommittee through six years of hearings largely devoted to postal reform, was term-limited as chairman. In a House Government Reform Committee hearing on April 4, 2001, Chairman Dan Burton and ranking minority member Henry Waxman invited postal stakeholders to participate in a broad range of discussions aimed at the development of a bipartisan consensus bill, and these discussions proceeded for more than a year. A bipartisan bill (H.R. 4970) was eventually introduced on June 20, 2002, proposing changes in the regulatory process. However, H.R. 4970 fell victim to legislative backlogs as the 107th Congress drew to a close, and it did not emerge from committee.

¹⁵ U.S. General Accounting Office (now the Government Accountability Office), *U.S. Postal Service: Development and Inventory of New Products*, GAO Report GGD-99-15, Nov. 24, 1998, p. 4.

Activity in the 108th Congress

Both the House Government Reform and the Senate Governmental Affairs Committees geared up for concentrated attention to postal issues in the 108th Congress. Congress did act swiftly on the USPS request to change the formula for its contributions to the Civil Service Retirement Fund. By April 23, 2003, the Postal Civil Service Retirement System Funding Reform Act of 2003 had been enacted as P.L. 108-18. Its proponents said that the act would provide some much-needed financial breathing room but warned that it would be a serious mistake to let that relief forestall consideration of long-range reforms. They also recognized that Congress would need to revisit provisions of the act that put “savings” to the Postal Service in an escrow fund that could not be used for regular operations and obligations, and that transferred the obligation to pay retirement benefits based on military service from the Treasury to the Postal Service.

The Senate Governmental Affairs Committee held eight hearings on the report of the President’s Commission on the United States Postal Service, the House Government Reform Special Panel held three, and there was also a joint hearing of the two bodies on March 23, 2004. Following the hearings, both committees drafted and unanimously reported legislation on a bipartisan basis — H.R. 4341 in the House and S. 2468 in the Senate. However, neither bill was brought to the floor in the 108th Congress.

Activity in the 109th Congress

The fact that two similar postal reform bills in the 108th Congress had been reported by unanimous votes in both the House and Senate Committee was a hopeful sign to some observers that the way was clear for early passage in the 109th Congress. Representative McHugh reintroduced the House version of postal reform legislation with no significant modifications on the first day of the 109th Congress, for himself, Government Reform Committee Chairman Tom Davis, Ranking Minority Member Waxman, and Representative Danny Davis. H.R. 22 was marked up by the Committee on Government Reform on April 13, 2005, and reported on a roll call vote of 39-0. The House debated H.R. 22 on July 26, 2005, and passed it by a vote of 410-20, even though OMB issued a Statement of Administration Policy on the day of the vote threatening a veto.¹⁶ One of three rejected amendments, offered by Representative Hensarling, would have met the Bush Administration’s demand that the bill be “budget neutral.”

Progress of bipartisan postal reform legislation in the Senate has been much slower. Senator Collins, with Senator Carper and Senator Voinovich, introduced the Senate version of the postal reform bill on March 17, 2005, as S. 662, and it was referred to the Committee on Homeland Security and Governmental Affairs. S. 662

¹⁶ Available at [<http://www.whitehouse.gov/omb/legislative/sap/109-1/hr22sap-h.pdf>].

was reported by a 15-1 vote of the Committee on June 22, 2005.¹⁷ Action on the bill then slowed down as the Senate's attention was devoted to the Supreme Court, Hurricane Katrina, and budget issues, and several Senators voiced concerns about specific provisions. Both the Postal Service and the Administration voiced opposition to the bill. Nevertheless, on February 9, 2006, the Senate added three amendments, substituted the language of S. 662 for the House language in H.R. 22, and passed H.R. 22 by unanimous consent.

Since then, the Senate has named conferees but the House has not. Fairly extensive "pre-conference" negotiations have taken place behind the scenes in a search for resolution to issues among stakeholders and with the Administration.

Elements of Postal Reform in H.R. 22

The basic elements of H.R. 22 have been under consideration and debate for more than a decade. The legislation was first introduced by Representative McHugh in the 104th Congress on June 25, 1996, as H.R. 3717, and reintroduced in the 105th Congress as H.R. 22. Today, after dozens of hearings and years of making modifications and additions to respond to the interests and concerns of postal stakeholders, the key reforms embodied in H.R. 22 can be distilled into these elements:

- **Separation of Businesses.** The Postal Service remains a government entity but would be reorganized into two separate lines of business with separate funding and regulation principles. The traditional monopoly products like letters, periodicals, and advertising mail would be called "market-dominant" products. Those in which USPS shares the market with other enterprises — such as Express Mail, Priority Mail, and international mail — would be called "competitive" products.
- **Flexible Rate Regulation.** Replacing complex rate cases based on apportioning costs among mail classes with two separate schemes in which market-dominant product prices rise with the consumer price index (CPI) and competitive products are priced based on market mechanisms — while imputing taxes to level the playing field with competitors — subject only to after-the-fact reviews of fairness.
- **Financial Incentives.** USPS would no longer be subject to a break-even mandate, but would be allowed to retain earnings and improve compensation for top employees by raising current limits.
- **Limitations on Postal Monopoly and Products.** Requires USPS to offer only postal services and for the first time defines exactly

¹⁷ Senator Coburn, in dissent, objected to the budget cost of the bill and its lack of authority to deal with health care costs of postal employees, whose benefits are greater than those of other federal workers.

what constitutes “postal services.” The bill also would revise the authority of USPS to regulate competitors.

- **Reform of International Mail Regulation.** Clarifies the authority of the State Department to set international policy, applying customs laws equally to postal and private shipments.
- **Strengthening of the Commission.** Grants the Postal Rate Commission subpoena power and a broader scope for regulation, auditing, investigation of rate and service complaints, and oversight, renaming it the “Postal Regulatory Commission.”
- **Increase Transparency.** H.R. 22 requires more detailed disclosure of USPS financing and service measures, rate-setting data and determinations, and justifications for work-sharing discounts. USPS would be subject to Securities and Exchange Commission, and certain Sarbanes-Oxley Act requirements.

Notably, the legislation did not include any of the workforce cost-reduction measures recommended by the President’s Commission, such as major changes to collective bargaining, pay comparability, or fringe benefits, all of which were strongly opposed by postal unions; nor does the legislation deal with the sensitive problem of allowing USPS to rationalize its outdated facilities network.

The one new element common to both versions of H.R. 22 is that the bills would have provided USPS with relief from pension obligations imposed by P.L. 108-18. They would have repealed the escrow provision of P.L. 108-18 and returned responsibility for the military service cost of postal retirees to the Treasury Department, while also requiring USPS to begin funding its enormous liability for retiree health benefits. These provisions would have relieved USPS of \$27 billion in costs of military service retirement credits and freed up at least a portion of the \$73 billion that will eventually be collected from postal customers and placed in escrow under current law.¹⁸

Differences Between the House and Senate Bills

Although the House and Senate versions of H.R. 22 share a common origin in the work carried out by the House Subcommittee on the Postal Service in the 104th through the 106th Congresses, there were differences between the two bills that mattered to some stakeholders and that will need to be resolved in conference. Following is an explanation of the most significant of these differences.

¹⁸ According to OPM, the amount to be placed in escrow is \$3.3 billion in 2007, and \$3.6 billion in 2008, rising eventually to \$7.0 billion in 2024. For more extended discussion of the escrow and military retirement cost issues, see CRS Report RL32346, *Pension Issues Cloud Postal Reform*, by Kevin R. Kosar.

- **Single-piece Parcels.** The Senate version of H.R. 22 placed single-piece parcels in the market-dominant business category, while the House bill would have had USPS set prices on single-piece parcels as if they were part of the competitive segment. The latter approach would have resulted in USPS charging higher prices to deliver such parcels and charging sales taxes on them as well. Under the Senate approach, the cost of providing air service to remote areas of the United States, including Alaska, would be included in the rates as a cost of universal service and paid for by all mailers; under the House bill these costs would have needed to be recaptured in the rates charged specifically for the service. USPS said that if parcels are treated as a competitive product, it would have to raise prices dramatically — perhaps as much as 40% — and could be driven from the market altogether.¹⁹ An argument in favor of the House bill’s approach is that carrying single piece parcels is indeed a competitive product, in that there are lots of options, and USPS hardly dominates the market. Others in that market — specifically FedEx and UPS — supported the House version, while most shippers and the Postal Service itself favored the Senate’s version.²⁰
- **Exigency.** While both bills allowed the Postal Service to raise the rates charged for services in the market-dominant category as long as they stayed within the increase in the CPI, the Senate bill applied stiffer criteria for when a larger increase might be warranted: only under “unexpected and extraordinary circumstances.” The House language would have allowed a larger increase when the commission determined it was “reasonable and equitable and necessary.” Large mailers thought that the House standard could be too easily exceeded and rates could rise unpredictably. USPS opposed the “hard cap” in the Senate version, because it could foresee circumstances that would raise its costs above the rate of inflation, such as an arbitrator’s decision to allow a large wage increase. Postal unions argued that a hard cap could amount to a prior constraint on wage negotiations, since labor constitutes nearly 80% of costs, and would have to bear the brunt of any rate limit.
- **Unused Rate Authority.** The Senate bill had a provision, not included in the House bill, that would have allowed USPS to “bank,” or set aside for possible future use, at least a part of any unused difference between rates it sets and what it could have set if it had taken full account of a CPI increase. This would have allayed a

¹⁹ Ken Parmelee, “NRLCA Goes to Washington,” *The National Rural Letter Carrier*, July 2005, p. 394.

²⁰ Jessica Brady, “House Parcel Language Would Boost Competitors to USPS,” *Congress Daily*, May 15, 2006. The article quotes the Association of Priority Mail Users as saying that there had been “an enormous amount of private lobbying” and that the House provision “effectively accomplishes the agenda” of companies such as UPS. A UPS spokesman said that its position was “up front” and that customers would benefit from a level playing field.

tendency to “use it or lose it” that might promote greater-than-needed rate increases.

- **Transition Period.** The House bill allowed for a 24-month transition period before the new rate setting process would take effect, and the Senate bill allows 12 months. Mailers preferred the shorter period, though all recognized that USPS would certainly file at least one more rate case under the current law.
- **Labor Member of the Board.** The House, but not the Senate, would have required that the first vacancy in the Board of Governors shortly after enactment be filled by a person nominated with “unanimous concurrence” of the five postal unions. An amendment offered by Representative Pence to remove this provision failed by a vote of 82-345 on the floor of the House.²¹
- **Injury Compensation.** The Senate bill contained provisions revamping the way workers compensation claims for on-the-job injuries are paid, while the House bill did not. The Senate bill (in Title IX) would have carried out a recommendation of the President’s Commission on the United States Postal Service that USPS should be empowered to reduce its costs under the Federal Employees Compensation Act.²² The bill would amend 5 U.S.C. § 8117 so that a postal employee would not be entitled to compensation under FECA for the first three days of a temporary disability, but would be required to use sick leave or another form of leave. It also would have required that long-term disabled workers move to the retirement rolls at retirement age, as happens in other worker compensation programs, rather than stay on workers compensation benefits throughout their lives. Since the Postal Service has very high rates of claims for on-the-job injuries, its obligations under current law constitute a \$6.5 billion unfunded liability, and changing these provisions could have saved a great deal of money.²³ For that same reason, the changes were strongly opposed by postal unions, whose members are beneficiaries of the current arrangement.
- **The Use of the Escrow Account.** The Senate bill had a different schedule for USPS to begin paying into a Treasury account for financing retiree health benefits. It also would have required USPS to establish an amortization schedule to retire or liquidate any liability or surplus by 2045. (The House bill did not have this latter

²¹ *Congressional Record*, daily edition, vol. 151 (July 26, 2005), pp. H6538-H3541, H6547-H6548.

²² President’s Commission on the United States Postal Service, *Embracing the Future*, (Washington: GPO, 2003), p. 177.

²³ *Ibid.*, p. 133.

feature.) The Senate version of H.R. 22 would have devoted about three-quarters of the escrow savings to advance funding of retiree health costs, while the House bill would devote about two-thirds. For this reason, the CBO cost estimate for S. 662 carries a lower 10-year cost — \$3.9 billion — than does the House bill, at \$5.9 billion.²⁴ The Administration's position is that the bill must be budget neutral, which would preclude any use of the escrow fund for operations.

Postal Reform at an Impasse?

There were active discussions with the Administration over the summer, spurred by the threatened veto of the legislation. Observers in the postal industry speculated that a compromise was being developed to handle the apparent impasse over the issue of "budget neutrality." Reports of a compromise emerged. On the escrow provision, all of the "savings" would be set aside in a Treasury fund for the health care expenses of retirees, thereby offsetting the budget deficit impact. On military retirement costs, the compromise would relieve USPS of its obligation under P.L. 108-18 to pay retroactively for the military service credits of its employees in the past, but it would assume responsibility for future payments to CSRS retirees, beginning in FY2007. This would greatly reduce the financial impact on USPS, and put CSRS and FERS retirees on an equal footing.

Yet, the postal community voiced skepticism that the legislation would be sent to the President before the end of the 109th Congress. The Postal Service itself did not press for action, seeing the prospect for more harm than good. Its Board of Governors sent the committees a letter on September 13, 2005, raising basic questions about the value of the "reforms" in the legislation, especially if they are not accompanied by pension funding relief at the Administration's insistence that the bill be "budget neutral." The board (which includes the Postmaster General) primarily objected to the enhanced role given in the bill to the Postal Regulatory Commission. With the commission empowered to issue orders in response to complaints about any aspect of USPS performance, and armed with subpoena power, USPS thought it could lose basic management authority. The board also said that USPS could not accept a "hard" rate cap at the CPI level without "significantly greater ability to control its infrastructure and growing labor costs." The American Postal Workers Union followed a week later with a letter expressing some of the same reservations about the legislation, fearing that a hard rate cap would eventually result in pressure to keep wage levels down.

By mid-October of 2006, many observers were surprised when reports emerged that the quest for final legislation had broken down. Initially, one report asserted that UPS objected to the bill when it appeared that parcels would not be included in the

²⁴ See Congressional Budget Office, *Cost Estimate, H.R. 22, Postal Accountability and Enhancement Act*, April 25, 2005, p. 1; and *Cost Estimate, S. 662, Postal Accountability and Enhancement Act*, July 1, 2005, p. 1.

competitive products category.²⁵ Later reports suggested that the bill sponsors were blind-sided by a late-in-the-game complaint by the National Association of Letter Carriers (NALC).²⁶ The 300,000-member union objected to the disability provisions in S. 662, section 902.²⁷ It also was suggested that unions were antagonized by recent White House demands for labor cost reductions.²⁸ Another observer proffered that the demise of the postal reform legislation might be attributed to election year politics, that the possibility of a significant shift in the partisan composition of one or more of the Houses of Congress may have emboldened stakeholders who believe they can get legislation more to their liking under the 110th Congress.²⁹ By late autumn, few observers voiced the opinion that reform would be enacted.

Reform Enacted: The Postal Accountability and Enhancement Act of 2006

In the last days of the 109th Congress, a compromise postal bill (H.R. 6407) was introduced in the House (December 7, 2006). The House and Senate passed the bill by voice votes (December 8 and December 9, respectively). President George W. Bush signed the Postal Accountability and Enhancement Act of 2006 (P.L. 109-435) on December 20, 2006.

Major Provisions

The major provisions of the new postal law include the following:

- **Definition of the term “Postal Service.”** H.R. 6407, sec. 101, defines this term to mean “the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting,

²⁵ “Changing parcel pricing to the ‘competitive’ category rather than the ‘market dominant’ category in the reform legislation will effectively cripple the USPS. They [sic] would be forced to increase parcel post prices to cover overhead costs. And UPS could swoop in and capture most of the business.” Alliance of Nonprofit Mailers, *Alliance Report*, Sept. 29, 2006, p. 2.

²⁶ Section 902 would encourage injured workers of retirement age to retire rather than continue on disability leave. Under current law, an employee suffering total disability from a workplace injury is entitled to compensation of 66% of monthly pay. S. 662 would reduce this to 50%. On reports of NALC’s involvement, see Stephen Barr, “Fate of Post Office Overhaul Is Up for Debate,” *Washington Post*, Oct. 4, 2006, p. D4; and Stephen Barr, “Communication Breakdown Cited in Failed Postal Legislation,” *Washington Post*, p. D4.

²⁷ On NALC’s view of the matter, see available at NALC, *E-Activist Network* newsletter, Sept. 30, 2006 [http://www.unionvoice.org/nalc/notice-description.tcl?newsletter_id=1576837].

²⁸ Jessica Brady, “Senator Unsure of Postal Overhaul’s Lame Duck Prospects,” *GovExec.com*, Oct. 4, 2006, available at [<http://www.govexec.com/dailyfed/1006/100406cdpm2.htm>].

²⁹ Bill McAllister, “A Postmortem on Postal Reform,” *Postcomm*, Oct. 6, 2006, available at [<http://www.postcom.org/public/articles/2006articles/postmortem.htm>].

transportation, or other functions ancillary thereto.” This provision is significant because current law does not define “postal service,” an omission, critics have contended, which has permitted USPS to undertake nonpostal activities. However, H.R. 6407, sec. 102, permits USPS to “provide nonpostal services which were offered as of January 1, 2006.”

- **Repeal of the Escrow.** H.R. 6407, sec. 804, would abolish the escrow account established by P.L. 108-18, sec. 3 — “Savings accrued to the Postal Service as a result of enactment of Public Law 108-18 and attributable to fiscal year 2006 shall be transferred to the Postal Service Retiree Health Benefits Fund established under section 8909a of title 5, United States Code, as added by section 803 of this Act.”
- **Return of Military Obligations to the Treasury.** H.R. 6407, sec. 802, would require that “In the application of section 8348(g)(2) of title 5, United States Code, for the fiscal year 2007, the Office of Personnel Management shall include, in addition to the amount otherwise computed under that paragraph, the amounts that would have been included for the fiscal years 2003 through 2006 with respect to credit for military service of former employees of the United States Postal Service as though the Postal Civil Service Retirement System Funding Reform Act of 2003 (Public Law 108-18) had not been enacted, and the Secretary of the Treasury shall make the required transfer to the Civil Service Retirement and Disability Fund based on that amount.” This relieves USPS of a \$27 billion obligation.
- **Separation of Businesses.** H.R. 6407, Title II, would divide USPS products into “market-dominant” and “competitive” classes. Market-dominant products would include (1) first-class mail letters and sealed parcels, (2) first-class mail cards, (3) periodicals, (4) standard mail, (5) single-piece parcel post, (6) media mail, (7) bound printed matter, (8) library mail, (9) special services, and (10) single-piece international mail. Competitive products would include (1) priority mail, (2) expedited mail, (3) bulk parcel post, (4) bulk international mail, and (5) mailgrams.
- **New Rate Regulation.** H.R. 6407, Title II, would replace the current rate determination system with a bifurcated system. Prices of products in the market-dominant class prices may be increased by USPS with the Consumer Price Index for All Urban Consumers. Prices of products in the competitive class would be based on market mechanisms, including “costs attributable,” defined as “the direct and indirect postal costs attributable to such product through reliably identified causal relationships.” H.R. 6407 would require the new postal regulator to review the new regulatory scheme 10 years after enactment of the law. If the new system is not achieving the law’s

objectives for market-dominant products, the regulator may alter or replace the system.

- **A Stronger Regulator.** H.R. 6407, Title VI, would replace the Postal Rate Commission with the Postal Regulatory Commission. The new regulator would have subpoena power and a broader scope for regulation, auditing, investigation of rate and service complaints, and oversight.
- **Reform of International Mail Regulation.** H.R. 6407, sec. 407, would clarify the authority of the Secretary of State to set international postal policy, enter agreements, and would require him/her to apply customs laws equally to private shipments and “shipments of international mail that are competitive products.”
- **New Qualifications and Lengths of Terms in Office for Governors.** H.R. 6407, sec. 501, would require that governors “be chosen solely on the basis of their experience in the field of public service, law or accounting or on their demonstrated ability in managing organizations or corporations (in either the public or private sector) of substantial size.” Of the nine governors, at least four of the Governors would have to “be chosen solely on the basis of their demonstrated ability in managing organizations or corporations (in either the public or private sector) that employ at least 50,000 employees.” Governors’ terms would be reduced from nine to seven years.
- **Increased Transparency.** H.R. 6407, sec. 204, would mandate USPS to provide more details of USPS financing and service measures, rate-setting data and determinations, and justifications for work-sharing discounts. USPS would be subject to Securities and Exchange Commission, and certain Sarbanes-Oxley Act requirements.

Reconciliation of the Differences Between the House and Senate Bills

The above-described differences between the competing House and Senate bills were settled thus:

- **Single-piece Parcels.** Like the Senate version of H.R. 22, H.R. 6407 placed single-piece parcels in the market-dominant business category.
- **Exigency.** While both bills allowed the Postal Service to raise the rates charged for services in the market-dominant category as long as they stayed within the increase in the CPI, the Senate bill applied stiffer criteria for when a larger increase might be warranted: only under “unexpected and extraordinary circumstances.” H.R. 6407

kept this provision but also would require the Postal Regulatory Commission to allow proposed increases only after holding a public hearing and determining that the increases are “reasonable and equitable and necessary.”

- **Unused Rate Authority.** Like the Senate bill, H.R. 6407 permits the Postal Service to “bank,” or set aside for possible future use (within five years) a part of any unused difference between rates it sets and what it could have set if it had taken full account of a CPI increase.
- **Transition Period.** The House bill allowed for a 24-month transition period before the new rate setting process would take effect, and the Senate bill allows 12 months. H.R. 6407 would split the difference and allow an 18 month transition period.
- **Labor Member of Board.** H.R. 6407 does not include this provision.
- **Injury Compensation.** The Senate bill contained provisions revamping the way workers compensation claims for on-the-job injuries are paid, while the House bill did not. It would have required that long-term disabled workers move to the retirement rolls at retirement age and it would have amended 5 U.S.C. § 8117 so that a postal employee would not be entitled to compensation under FECA for the first three days of a temporary disability, but would be required to use sick leave or another form of leave. H.R. 6407 retains only the latter provision.
- **Use of Escrow Account.** H.R. 6407, Sec. 803, adopts much of the Senate bill’s language. It includes a specific schedule for payment into the Postal Service Retiree Health Benefits Fund from 2007 through 2016 (ranging between \$5.4 and \$5.8 billion per year). The bill would require USPS to establish and amortization schedule for any remaining unfunded obligations and retire them by 2056.