

# BACKGROUND

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## Postal Pension “Refund” Is a Disguised Taxpayer Bailout

David C. John

### Abstract

*Calls to refund “overpayments” by the U.S. Postal Service (USPS) to the retirement of postal workers are misguided. The estimates of overpayments are inflated by overly optimistic assumptions, as recent years have demonstrated. A refund would leave taxpayers on the hook for future shortfalls in USPS retirement funding. The better choice is to follow the private-sector practice of using the current surplus—whatever it is—to defray future retirement payments. Instead of giving the USPS a questionable refund, Congress should require it to make comprehensive reforms that recognize new realities and enable it to restructure its operations accordingly.*

This paper, in its entirety, can be found at <http://report.heritage.org/bg2699>

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**The Heritage Foundation**  
214 Massachusetts Avenue, NE  
Washington, DC 20002  
(202) 546-4400 | [heritage.org](http://heritage.org)

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With the U.S. Postal Service (USPS) nearly out of funds, a chorus of voices in Washington, including the USPS itself, are saying that the government-owned enterprise is owed a refund for the billions of dollars of supposed overpayments of its retirement obligations. Some even claim that these “accounting errors” are the primary cause of the USPS’s financial distress, rather than any fundamental change in the business of mail.

These arguments are fundamentally wrong. Providing refunds to the USPS would not only allow it to postpone vitally needed reforms, but leave taxpayers on the hook for future shortfalls in the USPS pension fund if it cannot meet its obligations.

### USPS Retirement Funding.

The debate over postal retirement funding involves three systems: the Civil Service Retirement System, the Federal Employees Retirement System, and the Retiree Health Benefits Fund. Each of these involves distinct issues:

- The USPS claims that it overfunded its share of the newer Federal Employees Retirement System (FERS) by \$11.4 billion. While some level of surplus exists, the estimate of \$11.4 billion is based

### TALKING POINTS

- A chorus of voices in Washington, including the U.S. Postal Service (USPS) itself, say that the USPS is owed billions of dollars as a refund for supposedly overpaying its retirement and retiree health obligations.
- Claims that the USPS overpaid the old Civil Service Retirement System by as much as \$75 billion are wrong and have been firmly (and correctly) rejected by both the Government Accountability Office and the Office of Personnel Management.
- Rather than refunding the Federal Employees Retirement System (FERS) surplus to the USPS, FERS should retain it and use it to offset future USPS payments.

on overly optimistic assumptions. Rather than refunding the amount, FERS should retain that surplus and use it to offset future USPS payments. If the USPS receives the refund it wants as provided by postal reform bills pending in Congress, the retirement plan would likely become seriously underfunded when economic conditions change, and taxpayers would be forced to make up the difference.

- Similarly, the USPS has advanced the myth that an unfair and incorrect pension funding formula has forced it to overpay the old Civil Service Retirement System (CSRS) by as much as \$75 billion. The USPS is wrong. The funding formula was set by law more than 40 years ago, and both the Government Accountability Office (GAO) and the Office of Personnel Management (OPM) have firmly rejected the USPS claims.
- Lastly, the USPS is disputing its contributions to the Retiree Health Benefits Fund. In 2006, Congress required the USPS to fully fund future retiree health benefits through a series of payments over 10 years on a pay-as-you-go basis. As with the other funds, prefunding these promised benefits is essential to protect taxpayers from the dangers of a shortfall.

### **The USPS Retirement System.**

When Congress created the USPS out of the old Post Office Department

in 1971, the federal employees of the Post Office became employees of an independent self-funding entity. By law, both those employees and all of those hired since the creation of the USPS have been part of the federal retirement system. USPS employees receive a pension that is calculated using the same formula that is used to calculate the pensions of federal employees, and they are paid by the same fund, the federal Civil Service Retirement and Disability Fund (CSRDF). This means that USPS retirees will receive a pension regardless of whether or not the USPS funds it. If the USPS fails to provide the funds, the taxpayers will pay for the pensions of USPS employees.

USPS employees first hired before 1984, including any transferred from the Post Office Department, are also part of the Civil Service Retirement System (CSRS). This pension system pays a traditional defined benefit<sup>1</sup> based on the worker's highest three years of earnings. The formula is graduated so that, the longer the individual is employed, the higher the proportion of income that is used to calculate their pensions. In general, CSRS employees do not pay Social Security taxes or receive Social Security benefits.

Since 1984, both federal and USPS employees have been part of the Federal Employees Retirement System (FERS), a three-part plan that includes Social Security, a retirement savings system similar to a private 401(k) plan, and a fairly small defined-benefit pension. In addition to the USPS contributions

to the CSRDF for the defined-benefit pension, it also matches employees' retirement savings up to a set maximum.

The USPS funds the defined-benefit portions of both pension plans with an annual contribution equal to the amount of additional benefits its employees earned that year. These contributions are invested in special issue treasury bonds that pay interest. The USPS uses a formula developed by CSRDF actuaries to calculate the size of its contribution. If the USPS were to delay its payment, it would still be financially responsible for both the initial payment and any interest earnings lost because of the delay. In short, delay would only increase the USPS's pension costs.

### **The FERS "Overpayment."**

Two postal reform bills are pending in Congress. S. 1789 would transfer approximately \$11.4 billion from the CSRDF to the USPS during fiscal year 2012 as a refund of "overpayments" that the USPS has made on its FERS funding obligations.<sup>2</sup> As reported by the House Oversight and Government Reform Committee, H.R. 2309 also calls for a refund of FERS contributions. The USPS cites OPM figures to claim that it owes \$75.9 billion for future FERS pension benefits, but has a balance in the trust fund of \$87.3 billion.<sup>3</sup>

While this surplus appears to exist, it should be retained in the trust fund and used to offset future USPS funding requirements. This is how the private sector handles temporary surpluses in defined-benefit funding. The OPM estimates that the USPS will owe the CSRDF

1. A defined-benefit pension pays a monthly benefit for life based on a formula that includes both years of service and some measure of annual income.  
2. 21st Century Postal Service Act of 2011, S. 1789, 112th Cong, 2nd Sess., January 26, 2012.  
3. U.S. Postal Regulatory Commission, "Annual Report of the United States Postal Service (Postal Service) on Form 10-K 2011," November 15, 2011, p. 27, <http://about.usps.com/who-we-are/financials/10k-reports/fy2011.pdf> (accessed May 25, 2012).

approximately \$3 billion annually and given the USPS's uncertain financial prospects, retaining the surplus would protect both its employees and the taxpayers. As long as the surplus remains, USPS would have lower expenses.

However, that surplus may not last. It is based on estimates of earned interest and the eventual cost of promised benefits. As private-sector employers that sponsor defined-benefit pensions for their employees have discovered, both estimates can be volatile, and today's surplus can become tomorrow's deficit very quickly.

The CSRDF is composed of special issue treasury bonds with maturities of up to 15 years, which pay the appropriate interest rate when they were issued. Currently, interest rates are near record lows and have been since the 2008 financial crisis. This is reflected by lower earnings than predicted. For instance, the CSRDF actuaries predicted interest earnings of 6.25 percent for the FERS fund in 2009, but the actual figure was 5.18 percent. For 2010, the prediction was 5.75 percent, but actual earnings were only 4.77 percent. The earnings for 2011 were also projected at 5.75 percent, but actual earnings are unlikely to be better. In short, the estimated USPS surplus is based on overly optimistic assumptions. When estimates are adjusted to show actual earnings, the expected surplus will likely shrink. Given this, refunding the entire surplus is extremely irresponsible.

### **The CSRS "Overpayment."**

When the USPS was created, it was allowed to set its own wage scale and determine appropriate pay increases based on competitive pressures, unrestricted by the federal pay system. For that reason, in 1974, Congress required the USPS to pay the full costs of any pensions that were based on its pay scale while the taxpayers would pay any pension benefits earned when postal workers were federal employees. The 1974 law also specified the division of funding responsibilities.

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### **THE CSRDF ACTUARIES PREDICTED INTEREST EARNINGS OF 6.25 PERCENT FOR THE FERS FUND IN 2009, BUT THE ACTUAL FIGURE WAS 5.18 PERCENT.**

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However, both the USPS Office of the Inspector General and the Postal Regulatory Commission, an independent agency that oversees USPS activities, have issued reports claiming that the methodology for dividing CSRS funding responsibility is flawed and that the USPS overpaid its share of pension costs by as much as \$75 billion. The USPS believes that these "overpayments" should be repaid.<sup>4</sup>

Congress asked the GAO to review these claims, and in a report that is strikingly direct, the GAO bluntly rejected these claims, pointing out that despite minor changes in 2003 and 2006, the 1974 division of responsibilities remains valid. The

GAO pointed out, "The key impacts of transferring assets out of the CSRS fund to USPS based on the current proposals would be to increase the federal government's current and future unfunded pension liability by an estimated \$56 billion to \$85 billion."<sup>5</sup>

In addition, the U.S. Office of Personnel Management's Office of the Inspector General came to the same conclusion in a similar study in February 2011. According to the report, "The proposals would create a dangerous precedent whereby the trust funds' assets are used for purposes other than the payment of benefits." In addition, OPM said, "They do not actually remedy any alleged inequities in the Federal retirement program. Instead, they serve only to provide the USPS with operating capital, which would potentially shift costs from USPS ratepayers to the taxpayers."<sup>6</sup>

**Fully Funding Retiree Health Care Benefits.** A third funding issue involves health care benefits for postal retirees. In 2006, Congress required the USPS to fully prefund this benefit. Critics argue that this is unfair, pointing out that other federal agencies do not prefund their health benefit obligations and that not all private firms do so. However, unlike other federal entities, the USPS was created as a self-sustaining organization. Thus, it has a unique obligation to pay for its own liabilities rather than pass that expense onto the taxpayers. Similarly, while private companies are not always

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4. Ibid., pp. 24-27.

5. U.S. Government Accountability Office, *U.S. Postal Service: Allocation of Responsibility for Pension Benefits between the Postal Service and the Federal Government*, October 2011, <http://www.gao.gov/assets/590/585739.pdf> (accessed May 25, 2012).

6. U.S. Office of Personnel Management, Office of the Inspector General, "A Study of the Risks and Consequences of the USPS OIG's Proposals to Change USPS's Funding of Retiree Benefits," February 28, 2011, p. ii, [http://www.opm.gov/oig/OPM\\_OIG\\_Study\\_of\\_USPS\\_OIG\\_Proposals%20Feb%2028%202011.pdf](http://www.opm.gov/oig/OPM_OIG_Study_of_USPS_OIG_Proposals%20Feb%2028%202011.pdf) (accessed May 25, 2012).

required to prefund such obligations, they do not enjoy the USPS's federal guarantees, and the law does not require taxpayers to cover their debts.

**Reduced Contributions Today, Higher Costs Tomorrow.** The USPS is attempting to use some extremely creative accounting to finance its day-to-day operations and to avoid paying some of its employee

pension costs. If Congress allows the USPS to get away with these machinations, taxpayers will pay a much higher cost. The USPS needs to face the reality that people are sending many fewer letters and using e-mail more and that private carriers can deliver packages just as well as the USPS can. Rather than allow the USPS to pass its pension costs on to the taxpayer, Congress should

require it to make comprehensive reforms that recognize new realities and enable it to restructure its operations accordingly.

*—David C. John is Senior Research Fellow in Retirement Security and Financial Institutions in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*