

## OPEB Funding Challenges: The U.S. Postal Service

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Long-term liabilities such as pensions and other postemployment benefits (OPEB) have become prominent public concerns, often making their way into political discourse. The largest OPEB option, retiree health care insurance coverage, constitutes multibillion-dollar obligations for many states. In addition, because few states prefund OPEB obligations like they do pension plans, these OPEB costs continue to grow. Prefunding can be beneficial but is often challenging, as highlighted by the troubles of the U.S. Postal Service (USPS) over the past decade. While no state government has faced the severity of USPS's funding struggles, many states are fighting to curb rising OPEB obligations, and an examination of USPS's attempts to meet mounting OPEB costs may provide valuable insights for states.

### The Burden of Unfunded Liabilities

OPEB liabilities have proven to be an enormous challenge for USPS. Over the past decade, the quasi-governmental agency has struggled with lagging revenues and rising expenditures, showing losses for many years in a row. Revenues from mail delivery are recovering, but USPS's balance sheets still show significant losses (U.S. Postal Service 2017). Much of this strain can be attributed to the Postal Service's unpaid OPEB contributions.

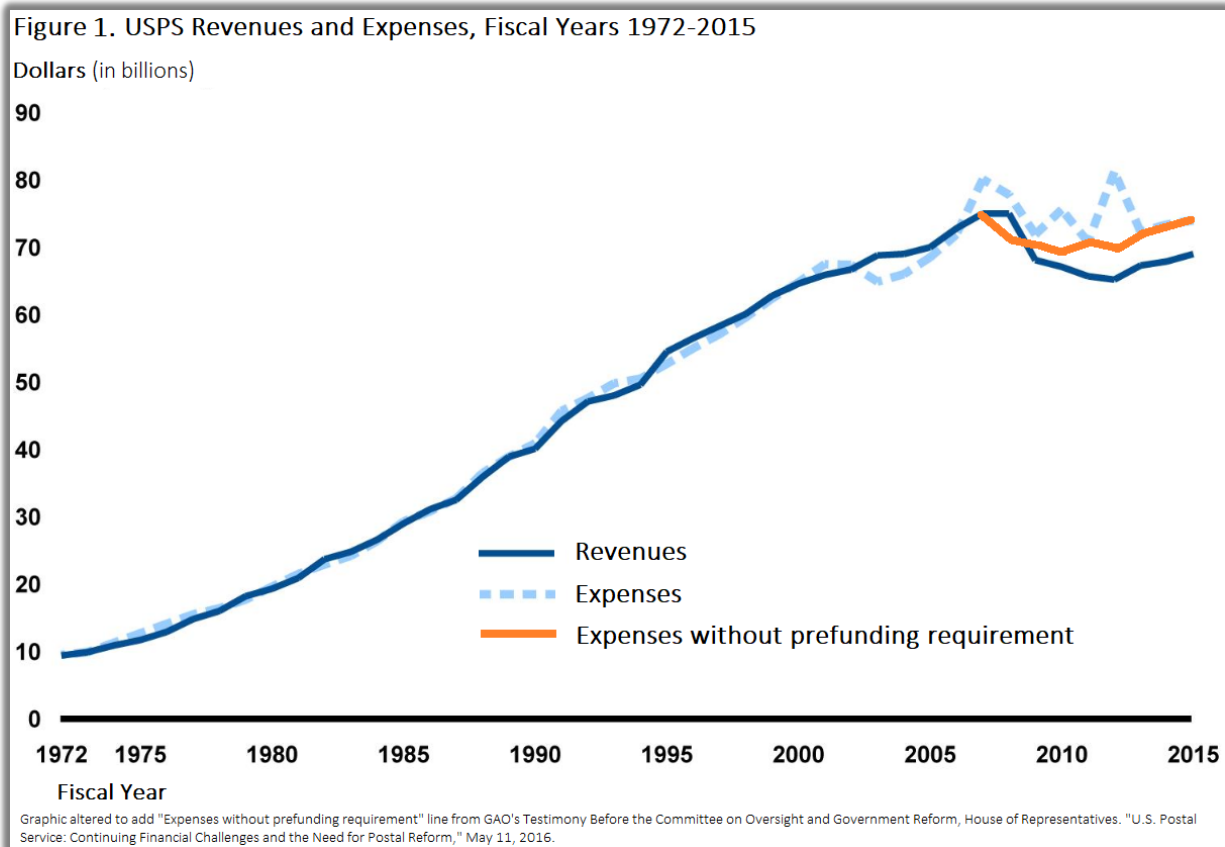
In the early 2000s, an evaluation of USPS's pensions found the system unexpectedly healthy, overfunded in fact (Schuyler 2016). With this good news, attention then shifted to the Postal Service's growing OPEB liabilities, which were strong commitments in line with its legally protected pensions. Retiree health care costs in particular had grown to nearly \$75 billion. Like most states and most of the federal government, USPS traditionally funded OPEB on a pay-as-you-go basis, paying expenses in the year incurred. This basis changed in 2006 when Congress passed the Postal Accountability and Enhancement Act—with the support of USPS—to address the growing OPEB liabilities.

This act laid out a 10-year payment plan for USPS to prefund most of its OPEB liabilities, with annual contributions of approximately \$5.5 billion. Given the healthy state of USPS's pension funds and a history of stable revenues, prefunding OPEB obligations seemed a feasible goal. Unfortunately, the Great Recession and sluggish revenues afterward severely weakened the Postal Service's ability to make payments while remaining solvent. After making full contributions through 2010, USPS defaulted on all subsequent payments (Schuyler 2016).

Figure 1 shows USPS's revenues and expenses from 1972 to 2015. Notably, revenues and expenses were relatively stable from 1972 to 2006. After the prefunding requirement mandate in 2006, expenses became volatile and regularly exceeded revenues. Figure 3 also illustrates USPS's expenses without the prefunding requirement. Although expenses would have been lower and less volatile without the prefunding contributions, they would still exceed revenues for the years after 2008.

The Postal Accountability and Enhancement Act left little room for USPS to alter the frontloaded prefunding schedule, but USPS offered several proposals to reduce its OPEB liabilities. One proposal shifts the insurance burden to Medicare, requiring all eligible retirees to join the public insurer (U.S. Postal Service, OIG 2017b). Another proposal argues that its employees are fundamentally different from other federal employees, and its liabilities should be projected using USPS-specific demographic assumptions instead of overall federal employee assumptions. In addition, USPS has proposed increasing the rate of return on invested assets and recalculating assets using the Postal Service's current real estate holdings at fair market value, a move that essentially wipes away any unfunded liabilities (U.S. Postal Service, OIG 2015b).

OPEB liabilities remain a daunting challenge for USPS. Legislation has been introduced to aid USPS in recent years, but nothing has been adopted. The initial 10-year prefunding plan ended in federal fiscal year (FY) 2016, at which point any remaining unfunded liabilities were to be



amortized over a much longer time frame. The federal Office of Personnel Management estimates that USPS would “need to contribute between \$2.8 billion and \$3.7 billion annually from FY 2017 through FY 2021” to address the current unfunded liability (U.S. Postal Service, OIG 2017a).

## What Can States Learn from USPS?

Although USPS supported the 2006 legislation that established prefunding requirements, in recent years it has questioned why it must prefund OPEB, particularly when the majority of other federal government agencies do not (U.S. Postal Service, OIG 2015a). While most states and the federal government do not prefund, they may nonetheless find themselves in a similar funding crisis in coming years because they do not currently address rising OPEB liabilities.

Several points from USPS’s experience are potentially useful for states. Most important, perhaps, is the value of prefunding legacy costs. For all its troubles, USPS’s OPEB funded ratio at the end of FY 2016 was 50 percent, well above the vast majority of state OPEB funded ratios (U.S. Postal Service, OIG 2017b; S&P Global 2017). Prefunding reduces issues of intergenerational equity, can reduce budgetary pressure, and can provide more flexibility during economic downturns. However, with this flexibility comes the risk that the funding policies become too malleable, thereby endangering the whole concept of prefunding. Using a prefunding mechanism, investment returns can offset the state’s OPEB costs, freeing up funds for other budget priorities. USPS has stated it has been unable to invest in other budget priorities such as research and development because of its OPEB costs (U.S. Postal Service, OIG 2015b). Of course, Congress instituted a strict and frontloaded prefunding schedule, but it was selected because of the enormous unfunded OPEB liabilities USPS faced, the health of its pensions, and the historical stability of its revenues. For the 30 years prior to the Great Recession, USPS’s finances stayed relatively balanced, but the Postal Service’s recovery after the Great Recession has been slow; many states are in a similar situation. Another

economic downturn like the Great Recession could leave many states finding it difficult to meet even the annual cost of OPEB liabilities.

In some proposed solutions, USPS addressed changing the underlying assumptions to liabilities and asset calculations. Small changes in investment rates of return can result in multibillion dollar shifts in assets. As mentioned previously, USPS has suggested changing the demographic assumptions that underlie liability projections. USPS representatives claim that Postal Service employees are substantially different from the rest of the federal workforce because USPS employees reach pay ceilings within 12 or 13 years, much faster than other federal employees who often receive pay increases throughout their careers (U.S. Postal Service, OIG 2015b). This difference would decrease future liabilities that incorporate employee earnings into benefit calculations. USPS also estimated that its unfunded liability would mostly disappear by including the fair market value of its real estate holdings.

These proposals highlight the uncertainty and variability inherent in long-term projections, furthering the importance of prefunding OPEB. Having assets in place helps to tame volatility in unfunded liability calculations and helps stabilize annual contributions, which can fluctuate from year to year based on updates to actuarial valuation studies. Having sufficient assets can be especially helpful because states conform to balanced budget requirements, and budget pressure can often lead policymakers to push off future costs.

## Conclusions

USPS’s OPEB difficulties have made national news for nearly a decade. Although USPS suggested numerous strategies to reduce its liabilities, the agency is still struggling to control its OPEB costs. With OPEB, particularly retiree health care costs, occupying a growing share of state budgets, many states may also struggle to curb long-term liabilities without strong prefunding mechanisms or substantive reforms to benefit coverage.

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## About the Author

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