CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 14, 2003

H.R. 735
Postal Civil Service Retirement System Funding Reform Act of 2003

As ordered reported by the House Committee on Government Reform on March 6, 2003

SUMMARY

Enacting H.R. 735 would permanently reduce payments by the United States Postal Service (USPS) to the Civil Service Retirement and Disability Fund (CSRDF) starting in 2003. CBO estimates that enacting the bill would result in net outlays of $7.1 billion over the 2003-2008 period. (Over the 2003-2013 period, total costs would be about $7.2 billion.) That estimate is the total budgetary impact of the proposal, combining both on-budget and off-budget effects. (USPS cash flows are considered off-budget.)

Under the bill, the Postal Service would see its required payments to the CSRDF reduced by $3 billion to $5 billion a year. The legislation specifies that the Postal Service and the Department of the Treasury should determine how to apply the savings that would result over the 2003-2005 period. CBO expects the Postal Service would use those savings to repay debt, delay future rate increases, and invest in capital projects or other activities to increase productivity. For fiscal years after 2005, the bill would require that savings resulting from reduced payments to the CSRDF be held in escrow and remain unavailable for obligation unless authorized by subsequent legislation.

By reducing USPS payments to the retirement fund, CBO estimates the bill would reduce the agency's costs (off-budget) by about $12 billion over the 2003-2008 period. We also estimate that enacting H.R. 735 would increase on-budget costs by about $19 billion over the same period. Thus the net effect of this legislation on the unified federal budget would be a cost of about $7.1 billion over the 2003-2008 period largely because on-budget offsetting receipts—representing payments from the Postal Service to the CSRDF—would be reduced. Over the 2003-2013 period, enacting H.R. 735 would combine off-budget savings of about $34 billion with on-budget costs of around $41 billion to produce a net cost of about $7.2 billion.

H.R. 735 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 735 is shown in the following table. The costs of this legislation fall within budget functions 370 (commerce and housing credit), 900 (net interest), and 950 (undistributed offsetting receipts).

	By Fiscal Year, in Billions of Dollars										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
CHANGES IN DIRECT SPENDING											
On-Budget Effects—CSRDF											
Estimated Budget Authority	3.5	2.7	3.0	3.0	3.2	3.6	3.8	4.2	4.6	4.8	5.2
Estimated Outlays	3.5	2.7	3.0	3.0	3.2	3.6	3.8	4.2	4.6	4.8	5.2
Off-Budget Effects—Postal Service											
Estimated Budget Authority	-2.5	-0.6	0.8	-3.0	-3.2	-3.5	-3.8	-4.1	-4.5	-4.8	-5.2
Estimated Outlays	-2.5	-0.6	0.8	-3.0	-3.2	-3.5	-3.8	-4.1	-4.5	-4.8	-5.2
Total Budget Effects											
Estimated Budget Authority	1.0	2.1	3.8	0.1	0.1	0.1	0.1	0.1	0.1	*	*
Estimated Outlays	1.0	2.1	3.8	0.1	0.1	0.1	0.1	0.1	0.1	*	*

NOTES: * = less than $50 million.
Components may not add to totals because of rounding.

BASIS OF ESTIMATE

For this estimate, CBO assumes that H.R. 735 will be enacted in the spring of 2003. CBO estimates that reducing the Postal Service's payments to the retirement fund would reduce the agency's off-budget costs by about $12 billion over the 2003-2008 period, but enacting H.R. 735 would increase on-budget costs by about $19 billion over the same period. The net effect of this legislation on the unified federal budget would be a cost of about $7.1 billion over those six years. Over the 2003-2013 period, enacting H.R. 735 would combine off-budget savings of about $34 billion with on-budget costs of around $41 billion to produce a net cost of $7.2 billion.

Background

Although the Postal Service is a federal agency, its financial operations are classified as being off-budget. Despite this treatment, federal budget documents present the net income of the agency in the budgetary totals. The Postal Service is required by law to set postage rates to cover its full costs. In fiscal year 2002, the Postal Service generated $68.1 billion in collections, mostly from postage and user fees, and had $67.4 billion in expenses. The agency has the authority to borrow up to $15 billion from the Treasury; at the end of fiscal year 2002, its outstanding debt with the Treasury stood at $11.9 billion.

Postal employees participate in the federal government's two main defined benefit pension programs. Those workers first hired prior to 1984 are covered by the Civil Service Retirement System (CSRS) while those first hired after 1983, as well as former CSRS workers who elected to change coverage, participate in the Federal Employees' Retirement System (FERS). In 2002, about 30 percent of the USPS workforce was covered by CSRS, and the rest were under FERS.

The Postal Service and its employees each make payroll contributions toward both CSRS and FERS. For CSRS workers, both the standard agency and employee contribution rates are 7 percent. For FERS employees, the agency contribution rate for most employees is 10.7 percent, while the employee rate is 0.8 percent. Although CSRS provides more generous benefits than FERS, unlike FERS, CSRS is not a fully funded pension system, meaning that agency and employee contributions alone are not enough to finance the program's benefits. In an effort to make up the shortfall between contributions and benefits for its current and former employees, the Postal Service makes lump-sum payments to the retirement system each year. In 2002, those payments amounted to about $3.9 billion.

The Office of Personal Management projects that, under current law, the Postal Service will eventually overfund pension obligations for its workers by as much as $71 billion. The projected overfunding is due primarily to higher-than-expected returns on assets held in the CSRDF.

On-Budget Effects

H.R. 735 would change the way the Postal Service finances retirement benefits for many of its current and former employees. The proposal would replace two amortization payments the Postal Service now makes to CSRDF—amounting to a combined $4 billion in 2003 and expected to grow to nearly $6 billion in 2013—with a new annual payment of $434 million over the next 40 years that would amortize the agency's estimated unfunded liability of about $5 billion. The net effect is to reduce Postal Service payments to the CSRDF by $4 billion in 2003, $19.5 billion over the 2004-2008 period, and $43.5 billion over the 2004-2013 period.

The legislation also would replace the fixed contribution rate, which the Postal Service currently makes for its approximately 225,000 employees covered by the CSRS, with a rate intended to pay the full normal cost of CSRS benefits (including military service credits). This change would effectively increase the Postal Service's contribution rate for most covered employees from 7 percent to 17.4 percent of payroll. In 2004, the first full year of contributions at the higher rate, CBO estimates that this would increase the agency's retirement contributions by nearly $1 billion, but that increase would gradually decline as the CSRS covered workers retire. Employee contribution rates for those in CSRS, as well as agency and employee contributions for those in the Federal Employees' Retirement System, would be unaffected by the legislation.

The Postal Service is an off-budget entity and contributions and payments that it makes to the retirement trust fund are considered offsetting receipts. Reducing overall payments the Postal Service makes to the CSRDF would result in a reduction of on-budget receipts to the government. To the extent that the Postal Service uses its savings to reduce its debt to the Federal Financing Bank, on-budget interest receipts would also be lower. Assuming the changes made by H.R. 735 are effective in April 2003, CBO projects the net on-budget effect of the bill would be a cost of $3.5 billion in 2003 and approximately $19 billion over the 2003-2008 period.

Off-Budget Effects

CBO estimates that enactment of H.R. 735 would reduce net expenditures of the USPS by $12 billion over the 2003-2008 period. After 2005, the bill would direct the agency to continue to charge its ratepayers for the estimated cost of its current contribution to the CSRDF. However, the legislation would require that those collections be held in escrow and unavailable for obligation until a subsequent act of the Congress specifies how the collections should be used.

Estimated Effects on Postal Outlays for Fiscal Years 2003-2005. The Postal Service's response to the change in its pension payments is uncertain, but CBO anticipates that the agency will use the savings from H.R. 735 to:

- Repay $2 billion of its outstanding debt in fiscal year 2003,

- Invest $1 billion in fiscal year 2003 and $2 billion in 2004 in additional capital projects or other activities aimed at improving productivity, and

- Delay the next postal rate increase—anticipated late in fiscal year 2004, until fiscal year 2006.

CBO expects that the Postal Service would repay $2 billion of its outstanding debt to the Treasury in 2003. That action would reduce the agency's interest expenses by about $60 million annually, beginning in fiscal year 2004. Although the bill would require that all of the USPS's savings be used for debt redemption over the 2003-2004 period, the legislation would not effectively constrain the agency's ability to use its line of credit with the Treasury to ensure that net outstanding debt is reduced in those years. Because the USPS pays an average interest rate on that debt of only 3 percent, CBO expects the agency would seek to make capital investments with much of the savings that could more effectively contribute to lowering its operating costs and thus contribute to a postponement of its next rate increase. By fiscal year 2005, CBO estimates such investments would lead to operational savings of about $300 million per year.

In July 2002, the Postal Service raised the price of a first-class stamp from $0.34 to $0.37 and raised rates for other classes of mail. Based on information from the Postal Service and on postal revenues to date in 2003, CBO estimates that this rate increase will raise over $3 billion in additional revenue a year. The CBO baseline assumes a similar rate increase late in fiscal year 2004, including a price of $0.40 for a first-class stamp.

We estimate that delaying the next rate increase would result in a small loss of revenue in fiscal year 2004 and a loss of roughly $3.5 billion in fiscal year 2005. A delay in the rate increase also would increase operating expenses because the Postal Service would have to deliver higher volumes of mail than otherwise expected. (When rates go up, mail volume goes down.) Based on information from the Postal Service about the relationship between price increases, mail volumes, and operating costs, we expect that this increase in expenses would be just over half a billion dollars in 2005.

CBO estimates that those changes in postal revenues and expenses would result in lower net outlays of $2.5 billion in fiscal year 2003 and $600 million in 2004, with a net increase in outlays of $800 million in 2005.

Estimated Effects on Postal Outlays for Fiscal Years 2006-2008. For fiscal years after 2005, savings resulting from enactment of the bill would not be available for spending unless authorized by subsequent legislation. In addition, H.R. 735 would direct any savings to be considered operating expenses of the Postal Service. Thus, the agency's gross costs for rate-setting purposes would remain nearly identical to what those costs would be under current law even though the agency's actual expenditures would decline by the amounts that the bill would require to be placed in escrow. As a result, net off-budget outlays of the Postal Service would decline by the same amount as the savings from lower pension payments, beginning in fiscal year 2006.

INTERGOVERNMENTAL AND PRIVATE-SECTOR IMPACT

H.R. 735 contains no intergovernmental or private-sector mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

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