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Understanding the Post Office's Benefits Mess

By Josh Barro - Aug 2, 2012

Yesterday, the United States [Postal Service](#) admitted that it will miss a legally required \$5.5 billion payment toward pre-funding its promised health-care benefits for retirees. But is this even a cost the USPS should have to cover? The answer, unfortunately, is "sort of." Here's why -- and what we should do about it.

Imagine you have a company with only one employee, Steve. If Steve earns a salary of \$50,000 and receives no benefits, you have to pay him cash in the current period and reflect the whole \$50,000 as an expense.

Now imagine that instead you pay Steve \$45,000 a year and promise to pay for his health care in retirement, assuming that he works for a certain number of years. The present value of the health care benefits that Steve will accrue this year is \$5,000.

Your employment expenses are still \$50,000 a year, even though you had only \$45,000 in actual cash outflows to Steve. Whether or not you set aside money to cover Steve's future health-care costs, you incurred a debt to him, and that's an expense.

Unfortunately, most government entities do not treat the accrual of retiree health-care liabilities as a cost (though they do report the size of the liability). Private firms do treat these accruals as costs. These firms are not legally obligated to pre-fund health-care benefits, but [about a quarter do so](#).

Now imagine that Steve is nearing retirement, and all along you had been promising him health benefits but hadn't set aside any money. In order to reach full funding by the time Steve retires, you would now have to set aside \$15,000 per year: \$5,000 for the benefits he accrues and \$10,000 to build up the fund you never created.

Your extra \$10,000 payment amortizes a debt you had accrued in past years; it's not an expense any more than paying off principal on a loan is an expense.

Now let's look at how this example applies to the Postal Service. Until 2006, the USPS handled its retiree health benefits on a "pay as you go" basis. They weren't pre-funded; the service simply paid retirees' health bills as they arose, reporting only those expenses. Because the cost of actually providing health care to retirees in a given year is less than the value of benefits current workers are accruing, that meant the post office was understating the cost of retiree health care.

Then in 2006, Congress forced the post office to start prefunding its benefits for retiree health care on a schedule designed to reach full funding in 10 years. Now, the Postal Service is supposed to put [about \\$8 billion a year](#) toward retiree health care.

But the so-called "normal cost" of health benefits -- the value of the benefits current postal employees are accruing this year, the equivalent of Steve's \$5,000 -- is only about \$3 billion. To the extent the post office pays the other \$5 billion, that shouldn't be counted as an expense; it is going to pay off the Postal Service's debts.

As it happens, even while missing the \$5.5 billion payment that's in the news this week, the Postal Service will pay about \$2.5 billion this year to provide health benefits to its existing retired workers. So, the service will be short of covering the accrual-basis cost of retiree health care this year, but only by about \$500 million.

Going forward, the Postal Service should be expected to cover the normal cost of retiree health care, paying a little bit more than it is right now, but far less than what Congress has obligated it to pay.

That will take care of the cost of retiree health benefits that are earned in the future. But what should we do about the \$46 billion in accrued but unfunded benefits? All the plausible options involve taxpayers covering that bill.

For example, we could privatize the Postal Service and make the buyer take on the retiree health-care obligation. But that would simply reduce the sale price of the post office by \$46 billion -- meaning that taxpayers pay.

Or, we could keep the Postal Service in public hands, restructure it so it produces profits and use those profits to gradually amortize the liability. Basically, this is what the 2006 law was supposed to do, though Congress didn't actually give USPS enough flexibility to restructure. This option costs taxpayers, too -- postal profits that would otherwise go to the government would instead be diverted to pay off the retiree health care liability.

Or, Congress could directly subsidize the post office to fund its retiree health-care costs. Obviously, that would put the cost on the backs of taxpayers.

The only way to avoid having taxpayers bail out the USPS is to default on the benefits -- tell current and retired workers that they won't get the benefits they thought they had earned. Stockton, [California](#), is proposing to do this as part of its bankruptcy filing. But that would be a bad option for several reasons -- unlike Stockton, the federal government is not insolvent and therefore ought to keep its promises, even if they were unwise.

It was a big, boneheaded mistake to let the post office run up such big debts -- and therefore understate its losses -- for decades. But trying to squeeze repayment of those debts out of future postal profits is

like getting blood from a stone.

The best way forward is to cut our losses, deregulate the post office and sell it -- as has been done all over [Europe](#). Regardless of how the retiree health issue is handled, declining mail volumes mean that the USPS will eventually become insolvent if it is not reformed; the only question is when. Relieving the post office of the obligation to pay the \$5.5 billion this year would give us breathing room to get that necessary restructuring done.

And going forward, we should require government entities to pre-fund their health benefits, just as the USPS should have been doing all along. Retiree health benefits are non-trivial costs, and if governments are required to pre-fund, they will be less likely to make irresponsible promises of the sort that sank Stockton and that have helped to undermine the Postal Service.

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