

FINANCING POSTAL OPERATIONS:

ALTERNATIVE **APPROACHES**

AND THEIR BUDGETARY IMPLICATIONS

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PREFACE

Financing Postal Operations: Alternative Approaches and Their Budgetary Implications provides background information and analysis on the issue of postal finances. This paper provides documentation supporting the material on postal operations in **CBO's** report, Budget Options for Fiscal Year 1977. The paper was prepared by Edward H. Chase and Donald G. Deloney of **CBO's** Management Programs Division under the direction of Howard M. Messner and Seymour D. Greenstone. The long-range projections included in the paper were prepared by the **U.S.** Postal Service based on assumptions provided by the Congressional Budget Office.

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Director

March 25, 1976

SUMMARY

Background

The United States Postal Service was created as an "independent establishment" of the executive branch by the Postal Reorganization Act of 1970. The intent of the legislation was to provide a "business-like" environment for postal operations in which postal officials could improve the quality and scope of service while achieving financial self-sufficiency over a period of years.

Financial History of the U.S. Postal Service

The financial ledger of the Postal Service has shown an operating deficit in each of its five years of operation; i.e., expenses exceeded income (revenues and other income and appropriations). The amount of the deficit has grown rapidly, increasing from \$175 million in fiscal year 1972, its first year of operation, to an estimated \$1.3 billion in fiscal year 1976. The accumulated deficit at the end of 1976 will be almost \$3 billion. During this period Congressional appropriations have averaged \$1.5 billion a year.

Basically, this situation is the result of a rapid growth in operating costs during a time when anticipated growth in mail volume and revenue did not materialize. If the current system for financing postal operations provided by the Postal Reorganization Act remains unchanged, the Postal Service projects increases in the first class postage rate to 21 cents by 1981.

Financing Options and Their Budgetary Implications

It is difficult to discuss financing alternatives without examining the differing policy positions that became manifest before Congress enacted the Postal Reorganization Act of 1970. Debate still continues on the "public service" vis-a-vis the "business" aspects of postal operations and alternative cost allocations between taxpayers and mailers. Each of the following options depicts both the budgetary implications and the cost of first class postage for a different financial approach:

<u>Option</u>	<u>Appropriations^a</u> (Billions of dollars, fiscal years)						<u>1st Class Postage</u> (Cents, fiscal years)				
						Total					
	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1977-81</u>	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
A. The current system	1.7	1.6	1.5	1.3	1.2	7.3	17	17	19	19	21
B. Alternative 1-- eliminate the accumulated deficit with Congressional appropriations	Same levels as above plus \$3.4 billion to eliminate projected deficit at end of the transition quarter					10.7	16	16	18	20	21
C. Alternative 2-- increase dependence on Congressional appropriations ^b	2.6	3.5	4.4	5.1	6.2	21.8	Held to 13				

Source: Cost data for the options were provided by the U.S. Postal Service.

a. Appropriations for nonfunded liabilities are not included.

b. The appropriation levels do not include any amounts to reduce or eliminate the accumulated deficit.

Option A: The Current System--Continue Present Financing Arrangements

This option would continue the financing arrangements provided by the Postal Reorganization Act of 1970, and would include recovery of the current accumulated deficit through rate increases.

Option B: Eliminate the Deficit with Congressional Appropriation

One possible alternative would be a variation of the current financing approach. It would involve "wiping the slate clean" by a one-time appropriation to eliminate the present accumulated deficit. This alternative would preclude the need for an allowance in future postage rates to recover the present deficit. The subsidy appropriations would continue as presently provided.

Option C: Increase Dependence on Congressional Appropriations

This alternative would require a basic change in policy under which Congress would shift a larger proportion of the cost burden of postal operations from the mailers to the general taxpayers. The increased appropriations would permit stabilization of first class and other postage rates at their current levels.

A Word About Cost Reductions

While significant savings could be realized by major cost reductions in postal **operations**, such savings would not be sufficient by themselves to eliminate the need for rate increases. However, these cost reductions could help lessen the financial burden on postal operations. Institution of some of them would be highly unpopular; others would require change in law, union contract, or regulation. Four possible areas for cost reduction could produce as much as \$810 million annually in **savings**: (1) reduce delivery service in remote areas from six to two days per week (\$400 million); (2) eliminate Saturday deliveries (\$250 million); (3) close small post offices (\$130 million); and (4) consolidate or close some larger post offices (\$30 million).

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CHAPTER I INTRODUCTION

The United States Postal Service was created as an "independent establishment" of the executive branch by the Postal Reorganization Act of 1970 (Public Law **91-375**). The intent of the legislation was to provide a "business-like" environment for postal operations in which postal officials could improve the quality and scope of service while achieving financial **self-sufficiency** over a period of years.

The events leading to the reorganization establishing the Postal Service can be traced to late 1966 when an unprecedented log-jam of mail occurred within the postal system. The situation took months to untangle. Top management concluded that substantial corrective action was needed to prevent repetition of such breakdowns which could potentially cripple mail service nationwide and bring extreme hardship to businesses and individuals dependent upon the mails. In April, 1967, Postmaster General Lawrence F. **O'Brien** suggested reorganization of the Post Office Department into a government corporation to permit it to improve management capability, modernize antiquated facilities, and allow postal rates to keep pace with cost increases.

Shortly after Postmaster General **O'Brien** made his recommendation, President Johnson appointed a commission, headed by Frederick R. **Kappel**, former board chairman of American Telephone and Telegraph Company, to develop recommendations for improving the operation of the Post Office Department. In June, 1968, the commission issued its report strongly recommending that the Post Office be reorganized to allow for a more business-like operation. Although it was to be two years before postal reform legislation was enacted, most of the **commission's** recommendations were adopted.

The goal of financial **self-sufficiency** was set forth in Section 3621 of the Postal Reorganization Act of 1970: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service." The act also established the formula for determining the amount of subsidy (appropriation) that was to be provided the Postal Service, and authorized certain activities allowing the Postal Service to operate in a business-like manner. These included collective bargaining and the authority to borrow money and

issue and sell obligations. These obligations could be used for both capital investment and operating expenses.

This status report will provide a brief review of the financial operations of the Postal Service. It will focus on:

- some salient characteristics of postal finance in the United States;
- operation of the Postal Service since the 1970 reorganization;
- the outlook for the future; and
- various alternatives for financing postal operations and their budgetary **implications.**

CHAPTER II
THE NATURE OF POSTAL FINANCES

Postal Revenue and Expenses

The Postal Service currently handles approximately 90 billion pieces of mail per year, or 418 pieces for every person in the United States. Approximately three-quarters of the mail is originated by businesses. Almost 84 percent of the Postal **Service's** total revenue comes from postage and certain other fees. Appropriations constitute 15 percent of total revenue, with investment income providing the remainder. First class and air mail represent more than half of the mail volume and almost half of the total revenue.

Table I
Revenue and Mail Volume by Class of Mail
(Fiscal Year 1974)

<u>Source of Revenue</u>	<u>Percent of Mail Volume</u>	<u>Portion of Revenue Dollar (Cents)</u>
1st Class and Air Mail	58.8	48.9
3rd Class Mail	25.0	11.3
4th Class Mail	1.0	6.7
Government Mail	3.5	4.4
Priority Mail	.2	3.7
International Mail	1.0	3.2
2nd Class Mail	9.8	1.9
Controlled Circulation Mail	.7	.4
Special Services and Other Income	—	<u>3.3</u>
Total Mail Receipts	(100.0)	(83.8)
Appropriations	---	15.3
Investment Income	—	<u>.9</u>
Total	100.0	100.0

Source: U.S. Postal Service; testimony before Postal Rate Commission (1975).

Personnel compensation and benefits totaled \$11.2 billion in fiscal year 1975, representing approximately 88 percent of the Postal **Service's** total operating expenses. The next largest expense was transportation costs, amounting to almost \$1 billion in fiscal year 1975, or over 7 percent of total operating expenses.

Congressional Appropriations

The Postal Service receives subsidies to support its operation through Congressional **appropriations**. Two principal types of subsidies currently are appropriated: reimbursements for "public service" costs and reimbursement for "revenue lost or **foregone**." In addition, the Postal Service is authorized transitional **appropriations**, which have been requested to meet the liabilities of the former Post Office Department to the **employees'** compensation fund and to postal employees for earned and unused annual leave as of June 30, 1971.

Public Service Reimbursements

This subsidy is for operating post offices which are not **self-sustaining**, primarily in small or rural communities. The amount of the "public service" subsidy is established in the Postal Reorganization Act as a percentage of the sum appropriated to the predecessor Post Office Department in fiscal year 1971. For fiscal years 1972 through 1979, it is 10 percent of the fiscal year 1971 appropriation (\$920 million); for fiscal years 1980 through 1984 the subsidy decreases by one percentage point each year. The subsidy runs through fiscal year 1984, at which time the act requires a determination by the Postal Service regarding further reduction in the subsidy.

Revenue Lost or Foregone Reimbursements

Under the provisions of the Postal Reorganization Act, rate increases applicable to certain classes of mailers will be "phased" over a number of years to minimize the economic impact of the increases. Mailers covered by these provisions include newspaper and magazine publishers; shippers of books, **records**, and certain other fourth class mailers; and nonprofit **organizations**. Phasing will be continued until 1981 (1987 for nonprofit **organizations**, in-county **publications**, and certain other types of mail). The act also provides for free mail for some mailers, such as blind or handicapped **persons**.

The appropriation reimburses the Postal Service for revenue lost as a result of providing service at the free or reduced rates. The amount of the appropriation is the difference between the revenue received at the free or reduced rates and that which would have been received at the

full rate.¹ The total appropriation for this category was \$613 million in fiscal year 1975.

Borrowing Authority

The Postal Reorganization Act authorizes the Postal Service to borrow money and issue and sell obligations. The act sets a limit of \$10 billion on the aggregate amount of such obligations. It also limits the net annual increase in the amount of obligations outstanding to \$1.5 billion for capital improvements and \$500 million for operating expenses.

1. Under the provisions of the act, the mail subsidy for blind and handicapped persons will continue in perpetuity. It will also continue for that portion of the subsidy for in-county **publications**, library and classroom material, and nonprofit organizations which covers their share of the Postal Service's "institutional" costs.

CHAPTER III OPERATION OF THE POSTAL SERVICE SINCE REORGANIZATION

The financial ledger of the Postal Service has shown an operating deficit in each of its five years of operation. The amount of the deficit has grown rapidly, increasing from \$175 million in fiscal year 1972, its first year of operation, to an estimated \$1.3 billion in fiscal year 1976. The accumulated deficit at the end of fiscal year 1976 will be \$2.9 billion. Basically, this situation is the result of a rapid growth in operating costs during a time when anticipated growth in mail volume and revenue did not materialize.

Table II
FINANCIAL HISTORY OF THE U.S. POSTAL SERVICE, FISCAL YEARS 1972-1976
(Millions of dollars, unless otherwise indicated; fiscal years)

	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976 (Est.)</u> (Billions)
Expenses	9,530	9,853	11,215	12,671	14.2
Less: Revenue and Other Income	7,993	8,463	9,140	10,149	11.3
Accrued Net Expenses	1,537	1,390	2,075	2,522	2.9
Less: Appropriations ^a	1,361	1,377	1,637	1,533	1.6
Net Income or Loss	-175	-13	-438	-989	-1.3
Accumulated Deficit	-175	-188	-627	-1,616	-2.9

Source: U.S. Postal Service.

a. Does not include appropriation for nonfunded liabilities.

Increased Costs

As previously indicated, personnel compensation and benefits constitute the major element of the Postal Service's operating budget. Under the 1970 Postal Reorganization Act, compensation and benefits are to be maintained "on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy." The collective bargaining process is used for most employees.

During the period from fiscal year 1971 to fiscal year 1975, personnel compensation (including benefits) increased \$3.8 billion, from \$7.4 billion to \$11.2 billion (51.4 percent). The cost per manyear during this four-year period increased 46 percent compared to a 32 percent increase in the Consumer Price Index (CPI) during the same period.

Personnel costs will continue to increase during the period covered by the current labor agreement with the postal **unions**, which is effective from July 21, 1975, through July 20, 1978. This agreement provides for fixed-dollar increases each year (approximately 12 percent over the three-year period) plus a **cost-of-living** adjustment based on the **CPI**, an operating reality for the Postal Service for this period.

Mail Volume

Postal Service earnings are dependent on two factors--mail volume and postal rates. An increase in either should result in additional revenue. At the time of the 1968 Kappel Commission report, mail volume had been increasing at an annual average of 3 to 4 percent. Mail volume, however, is sensitive to economic conditions (**three-fourths** being originated by businesses) and, in the short run, to postal rate increases. In the 1970s the economic downturn and the rate increases slowed volume growth and made accurate volume forecasting more difficult.

During the year after the first Postal Service rate increase in May, 1971, volume increased only two-tenths of a percent. It increased 2.9 percent in fiscal year 1973, but experienced little growth during the next year when the rate was increased again. In fiscal year 1975 there was a decrease in mail volume. The significance of the situation is that revenue has been over-estimated when projecting postal rate requirements in each of the first four years of the Postal **Service's** existence. **Thus**, the Postal Service experienced a \$474 million shortfall in revenues during the **period**.

Table III

CHANGES IN MAIL VOLUME
Fiscal Years 1965-1975

<u>Year</u>	<u>Volume</u> (millions of pieces)	<u>Percentage Change</u>
1965	71,873	---
1966	75,607	5.2
1967	79,165	4.7
1968	79,800	0.8
1969	82,005	2.8
1970	84,882	3.5
1971	86,983	2.5
1972	87,156	0.2
1973	89,683	2.9
1974	90,098	0.5
1975	89,266	-0.9

Sources: Budget of the United States for fiscal years **1965-1974**.
United States Postal Service for fiscal year 1975.

CHAPTER IV OUTLOOK FOR THE FUTURE

The following table provides a summary of key postal data for fiscal years 1977-1981, as projected by the Postal Service.

Table IV
KEY POSTAL PROJECTIONS^a
(Fiscal Years)

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>
Expenses (dollars)	15.2	16.0	17.0	18.1	19.3
Less: Revenue and Other Income	14.0	14.8	16.3	16.6	18.4
Accrued Net Expenses	1.2	1.2	.7	1.5	.9
Less: Appropriations ^b	1.7	1.6	1.5	1.3	1.2
Net Income or Loss	.5	.4	.8	(.1)	.3
Accumulated Deficit ^c	2.9	2.6	1.8	1.9	1.5
Mail Volume (billions of pieces)	86.9	81.7	81.8	83.3	84.5
Man-years (in thousands)	664	652	648	648	650
Cost of 1st Class Stamp (cents)	17 (April)	17	19 (October)	19	21 (October)

a. Data are dollars in **billions**, unless otherwise specified.

b. **Does** not include appropriations for nonfunded liabilities.

c. Numbers may not add due to rounding. Accumulated deficit at the end of the **transition** quarter is \$3.4 billion.

These projections were based on the following assumptions:

- Appropriations will remain at the levels provided under current law.
- There will be no major changes in service levels.
- Personnel compensation for fiscal years 1977 and 1978 is based on the provisions of the current labor contract; for fiscal years 1979-1981 it increases at a rate equal to one percent greater than the projected increase in the **CPI**.
- The increase in the CPI will average 5.5 percent per year from fiscal years 1977-1981.

- There will be no major cost reduction or productivity **gains**.
- Postal rates will be set at a level that will recover the accumulated deficit by 1984.

CHAPTER V
FINANCING POSTAL OPERATIONS--
THE CURRENT SYSTEM AND SOME ALTERNATIVES

Basis for Developing Alternatives

It is difficult to discuss financing alternatives without examining the differing policy positions that became manifest before Congress enacted the Postal Reorganization Act of 1970. Debate still continues on the "public service" vis-a-vis the "business" aspects of postal operations and alternative cost allocations between taxpayers and mailers.

Under the Congressionally mandated goal of self-sufficiency, the Postal Service is required by law to operate with rates which will cover expenses in excess of subsidies. Other countries pay higher rates: West Germany has a 19 cent first class stamp; Sweden, a 20 cent; and the Netherlands, a 19 cent stamp. In the United States recent economic pressures, adversely affecting mailers, the Postal Service, and taxpayers, have resulted in renewed demands for Congress to hold down postage rates by increasing subsidies. Congress is being asked to reconsider the arguments on financing postal operations. The discussion of alternatives in this paper is limited to their budgetary implications and their impact on the first class postage rate.

The Current System--
Continue Present Financing Arrangements

If the basic system for financing postal operations provided by the Postal Reorganization Act remains unchanged, the Postal Service projects increases in the first class postage rate to 17 cents in fiscal year 1977, 19 cents in fiscal year 1979, and 21 cents in fiscal year 1981. These projections are based on the provisions of the current labor agreement and an average annual inflation rate of 5.5 percent. These rates also include an allowance for recovering the accumulated deficit. Congressional appropriations (as provided by current law) would be:

Fiscal Year 1977	\$1.7 billion
Fiscal Year 1978	\$1.6 billion
Fiscal Year 1979	\$1.5 billion
Fiscal Year 1980	\$1.3 billion
Fiscal Year 1981	\$1.2 billion

Alternative 1--
Eliminate the Deficit with Congressional Appropriation

One possible alternative is a variation of the current financing approach. It would involve "wiping the slate clean" by a one-time appropriation of \$3.4 billion to eliminate the accumulated deficit.

This alternative would preclude the need for an allowance in future postage rates to recover the accumulated deficit. Under this approach the cost of a first class stamp would reach 21 cents by fiscal year 1981, the same as the current system approach. However, the first class postage rates in effect during fiscal years 1977-1979 would be 1 cent lower than those which would occur under the current system. Appropriations required by current law would continue at approximately the same level **as** in the current system. This would be in addition to the \$3.4 billion needed to eliminate the accumulated deficit.

Under both the current system and Alternative 1, improvements in the rate-making process could be instituted that would reduce the time lags so that rates could reflect current economic conditions more accurately.

Alternative 2--
Increase Dependence on Congressional Appropriations

This alternative would require a basic change in policy, under which Congress would shift a larger proportion of the cost burden of postal operations from the mailers to the general taxpayers. Under this alternative the increased appropriations would permit stabilization of first class and other postage rates at their current levels. The Postal Service projects a modest increase in mail volume on the basis that the stabilized rates would become more competitive with alternative means of **communication**. The level of appropriations required to achieve rate stabilization are shown below. These appropriations do not include any amounts to reduce or eliminate the accumulated deficit.

<u>Fiscal Year</u>	<u>Revised Subsidy Levels</u> (Billions of dollars)	<u>Current System</u> (Billions of dollars)
1977	2.6	1.7
1978	3.5	1.6
1979	4.4	1.5
1980	5.1	1.3
1981	6.2	1.2

Partial Alternative--Cost Reductions

While major cost reductions in postal operations could be realized, such savings would not be sufficient by themselves to eliminate the need for rate increases. However, these cost reductions could help lessen the financial burden on postal operations. Institution of some of them would be highly unpopular; others would require change in law, union contract, or regulation. Following is an inventory of some of the major possibilities:

Table V
POSSIBLE COST REDUCTIONS IN POSTAL OPERATIONS

<u>Activity</u>	<u>Current Practice</u>	<u>Cost Reduction</u>	<u>Approximate Annual Savings</u> (Millions of dollars)
Delivery to remote places	Generally 6 days per week	Reduce to 2 days per week	400
All other delivery	6 days per week	Reduce to 5 days per week	250
Small post offices	12,220 3rd class 6,241 4th class	Reduce to 6,000 Eliminate	68 62
Larger post offices	Maintain	Close or consolidate 2,000 for economic reasons	<u>30</u>
Total Savings			810

Source: Comptroller General of the United States; letter to Honorable Edward J. Derwinski; B-114874 (October 9, 1974).