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THE WHITE HOUSE

WASHINGTON

April 27, 1976

ADMINISTRATIVELY CONFIDENTIAL

MEMORANDUM FOR:

JAMES T. LYNN

FROM:

JAMES E. CONNOR *JEK*

SUBJECT:

U. S. Postal Service Financial  
Problem

Confirming phone call to Jim Jura of your office earlier today, the President reviewed your memorandum on the above subject and approved the following option:

Option 2 - Continue our current position, providing assurances of continued borrowing rights for Postal Service and acknowledgement that some portion of the accumulated debt may have to be canceled. Support legislation to create a postal study commission to look into the postal situation. As a part of its charter, the commission would deal with the question of the disposition of the accumulated postal debt.

During the staffing of the above mentioned memorandum, the comment was made that the memo doesn't indicate "insofar as we can find what the present level of Federal subsidies is". The President underlined the quoted portion and made the notation "I agree".

Please follow-up with appropriate action.

cc.: Dick Cheney

THE WHITE HOUSE  
WASHINGTON

April 26, 1976

MR PRESIDENT:

U. S. Postal Service  
Financial Problem

Staffing of the attached memorandum resulted in the following:

Option 2 - Recommended by Messrs. Cannon, Friedersdorf, Marsh, Seidman and Greenspan.

Alan Greenspan comments further -- "We support Option 2 - we'll live with Option 1 but not with Option 3. Also we are a little concerned the memo doesn't indicate, insofar as we can find what the present level of Federal subsidies is." *2 agree*

Option 1 - Recommended by Phil Buchen who comments further "I believe that both the merits and the politics of this issue favor Option 1. Additionally, I would suggest that the President acknowledge that some portion of the debt may have to be canceled only if pressed on the question -- there would appear to be no immedicacy to this aspect of the problem. Finally, although the President would not veto legislation to create a postal study commission, I would hesitate to make this representation publicly -- such an approach appears indecisive and supportive of a system which appears, from the public's perspective to be totally inept."

Jim Connor

EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

ACTION

MEMORANDUM FOR: THE PRESIDENT  
FROM: James F. Lynn  
SUBJECT: U.S. Postal Service Financial Problem

BACKGROUND

Since the U.S. Postal Service commenced operations on July 1, 1971, it has failed to achieve one of the basic goals of postal reform, a balancing of costs with revenues. Through fiscal year 1975 the Postal Service has accumulated a deficit totaling over \$1.6 billion and it is now expected to sustain an additional \$1.4 billion loss this fiscal year. There are numerous factors which have contributed to the continuing yearly deficits in postal operations.

On the cost side, postal management's efforts to maintain high levels of service, coupled with a period of double digit inflation, lagging productivity and liberal wage settlements have driven up the costs of operating the Postal Service by nearly 50 per cent since reorganization. Labor costs, which account for 86 per cent of all postal costs, have gone up 42 per cent, representing the largest single item impacting postal expenses. The average postal employee is now making \$13,574 a year compared to the comparable GS-5, step 5, civil service salary of \$10,117.

On the revenue side, there has been a leveling off in mail volume, due in part to the recession, higher rates, and new forms of electronic communication. This has blunted the traditionally expected 6 per cent annual growth in postal income. The rate setting process has also proven to be slow and generally unresponsive to these problems. As a result, postal revenues have continued to lag about 10 per cent behind expenses.

The mounting deficit in postal operations has produced a complete erosion of the Service's initial equity position. As a result of this decline, postal management has begun to consider steps to control costs. For the most part, however, management has relied on its borrowing authority to maintain operations. Under the Reorganization Act the Postal Service can borrow up to \$1.5 billion annually for capital purposes and up to \$500 million to defray operating expenses. There is a \$10 billion statutory ceiling on the total amount of debt which the Postal Service can have outstanding. By the end of this fiscal year the Service will have accumulated \$3.0 billion in outstanding debt, one half of which will have gone to finance general postal operations. The other half has gone into capital expenditures, including a heavy investment of over \$1 billion in bulk mail facilities in an unsuccessful attempt to compete with United Parcel Service.

While the overall financial condition of the Postal Service has seriously weakened, there is no immediate danger that it will be unable to meet its current obligations. The Postal Service's own financial analysis confirms that there is no short term crisis. While the deficit is increasing, the projected quarterly balances of the Service show a positive cash position through the third quarter of fiscal year 1979. This projection assumes:

- . Stable revenues (no increase in rates);
- . No increase in the current level of Federal subsidies;
- . No appreciable change in mail volume;
- . Maximum utilization of the Service's borrowing authority; and
- . No change in the Service's planned capital investment program.

Implementation of cost reductions and a stretch out of the Postal Service's planned capital investment program would improve this projection. Without further rate increases or higher subsidies, however, the Postal Service's outstanding debt would increase to \$8.9 billion by the end of 1979.

The Postal Service's financial condition has raised Congressional concerns. Complaints of poor service, increasing rates, and the threat of major service reductions have further intensified those concerns and increased pressures on the Congress. The House passage of legislation last session, which would return control of all postal monies to Congress, evidenced the growing dissatisfaction with the current situation in general and postal management in particular. Thus far the Senate has taken no action, but Senator McGee has introduced legislation and held hearings on his bill which would increase Federal subsidies to the Postal Service by \$1.5 billion a year over the next three years, while a "study commission" explores the role of public service appropriations in supporting postal operations.

There is underlying sentiment of support in the House and Senate Post Office Committees for additional Federal subsidies for the Postal Service. The announcement of a series of "possible" cost saving measures which postal management is exploring has further strengthened that sentiment. Possible savings mentioned include the closing of some small rural post offices, reductions in residential and city deliveries, ending Saturday delivery and transferring excess employees to other offices. While these are legitimate areas for seeking savings, the proposed actions under consideration will contribute little to resolving the overall financial problems facing the Service. The announcements have, however, generated considerable pressure by the mailers and postal unions on Congress to appropriate additional funds. Thus far the House budget committee has not included any additional funds in its fiscal year 1977 planning figures, but the Senate budget committee has allowed about \$1 billion for additional direct appropriations to the Postal Service. There is some indication from congressional committees that they may be willing to compromise at about half that amount.

In addition to the immediate financial problems of the Service, it almost certainly will be facing serious long-term problems due to fundamental changes in forms of communications, such as increased use of telecommunications. The prospects are that written communications will likely decline or remain stable, while the costs to the Postal Service of maintaining a national service will continue to increase along with the population. OMB is currently studying the postal situation in an attempt to more specifically define the financial problems of the

Postal Service. This study will provide an identification of the key problem elements and possible short and long range solutions to these problems. It is expected that the study will identify some possible solutions for further analysis.

#### OPTIONS

At this time we see the following options for dealing with the Congress on the current postal financial problem:

- #1. Continue our current position, providing assurances of continued borrowing rights for Postal Service and acknowledgement that some portion of the accumulated debt may have to be canceled.
- #2. Same as option #1 above, but support legislation to create a postal study commission to look into the postal situation. As a part of its charter, the commission would deal with the question of the disposition of the accumulated postal debt.
- #3. Same as options #1 and #2 above, but also indicate that you would not veto a provision adding up to \$500 million in additional Federal operating subsidies for fiscal 1976, 1977, and 1978.

#### DISCUSSION OF OPTIONS

Option #1 - Under this option we would continue our current position that postal users, not the taxpayers, should bear the costs of providing postal services. We would continue to press for cooperation on the part of the Congress and the Postal Service to think through the current postal problems and look at the alternative solutions for achieving self-sufficiency. At least until such a review is made, the Federal government would not support additional subsidies or other stop-gap legislative approaches. The Postal Service is in no danger of running out of funds over a reasonable period of time, during which a study and legislative action based on the study could be undertaken.

In order to satisfy Congressional and postal management concerns during the period of a study it would be envisioned

under this option that the Service and the Congress would be provided with written assurances from the Administration of continued Federal borrowing rights, so that the Postal Service can continue to meet its obligations. It may also be necessary to acknowledge that ultimately any accumulated debt that cannot be reasonably recouped by the Service will have to be canceled by the taxpayers, one way or another.

#### PRO

- . This option would maintain our present posture of support for the underlying principle that postal costs should be borne by the mail users.
- . It would indicate to the Congress our willingness to deal realistically with the current postal financial situation, by assuring continued borrowing rights and an open mind on possible forgiveness of some of the accumulated postal debt.
- . It would keep the pressure on postal management to explore possible cost savings measures.
- . If successful, it would forestall an increase in the public service subsidy, thereby avoiding a higher floor for future subsidies and a premature change in the current public service concept.

#### CON

- . This option would leave the Congress without any action on its part. In our meetings with Congressman Derwinski and Senator McGee they advised us that members of Congress are looking for some form of a crutch, that is, a specific piece of legislation which takes some positive step and can be pointed to as dealing with the current postal problems. Assurance of continued borrowing rights would very likely not satisfy the Congress.
- . The availability of borrowing rights is not a real concern for the Postal Service. Postal Service believes that as long as it is within

its statutory borrowing limit it will be able to continue to get financing. The Postmaster General is more interested in obtaining operating funds to give postal management a cushion.

- . Even with the assurances of borrowing rights and possible cancellation of a portion of its accumulated debt, the Postal Service may respond with the announcement of major service reductions and/or another increase in postage rates within the next few months. Major service reductions or another announced rate increase would place heavy pressure on both Congress and the Administration to prevent such actions by providing additional subsidies.
- . It would indicate some commitment on our part to cover a portion of the Service's accumulated debt, which could cost \$2 billion.

Option #2 - Under this option we would continue to oppose the need for stop-gap subsidies, as in option #1, but would either propose or support legislation to establish a public postal study commission to review the financial problems of the Service over the next nine months to one year. The commission would be instructed to include in its report a recommendation for handling that portion of the Service's debt which cannot reasonably be expected to be recouped through postage revenues. This may, for example, result in a recommendation that any increase in operating debt accumulated during the period of the study would be written off (this would probably be \$500 million to \$1 billion), or that the entire accumulated operating debt (expected to be about \$2 billion) would be written off. It might be possible to write off the debt as an "off-budget" transaction, in order to avoid the impact on the budget deficit, although this would be inconsistent with current budget practices. This is discussed further in the attachment to this memorandum. A sub-option would be to agree now to legislation to cancel a portion of the operating debt, if this would be helpful in obtaining Congressional agreement.

We would continue under this option to provide the same Administration assurances, as in option #1, of continued Federally-supported borrowing rights to take the Service through the study period.

The principal purpose of this approach would be to try to obtain Congressional agreement to delay subsidy increases or other major changes during the next several months, while the study is underway.

PRO

- . This option would help to satisfy Congressional desires expressed by Senator McGee for some form of action on their part to deal with the postal problem.
- . If agreement is reached, it would avoid increased operating subsidies, at least until the Commission has completed its study.
- . It would add Congressional pressure on postal management to control costs.
- . It would provide time for a reasoned study of both the short and long term problems facing the Service before making any major changes.
- . Cancellation of a portion of the debt would be preferable to increasing operating subsidies. It would be helping the Service to recover from past problems, rather than providing a subsidy for future mailers.
- . It would avoid any specific commitment at this time to cancel any portion of the postal debt.

CON

- . Establishing a public study commission with a charter to deal with the postal financial problem in general and postal debt in particular, could result in unacceptable recommendations by the Commission for increased taxpayer support of postal operations.
- . Congress may not be willing to settle for just a study commission without some additional direct funds for the Postal Service. Without strong assurances from the Hill, we could end up with a study commission as well as additional subsidies. Congressman Derwinski has indicated

his desire to work out some arrangement to delay or prevent a confrontation on this issue, and Senator McGee expressed an interest but was basically noncommittal. It is not clear that the Senator would accept this approach.

- . It is anticipated that most members of Congress would expect the Postal Service to not take any actions until the commission made its report, but there is no assurance that this approach would forestall major service reductions or a rate increase by the Postal Service while the commission was carrying out its study.

Option #3 - This option is essentially the same as option #2, but would also include a tacit indication to the Congress that you would not veto a provision in the legislation establishing the public study commission that would provide the Postal Service with an additional interim operating subsidy of up to \$500 million a year over the next three years.

#### PRO

- . This approach would improve chances of getting Congressional agreement. It would provide the Congress a more clearly delineated action dealing with the postal problem, thus satisfying Congressional concerns and avoiding the major increases in public service subsidies now being proposed.
- . It would contribute significantly to reducing the Postal Service's estimated operating deficit. It would improve Congressional chances of extracting from the Postal Service a delay in the need for major service reductions or another increase in rates.

#### CON

- . Such action would run contrary to our established position. It would provide taxpayer assistance to the Postal Service to subsidize service costs which should ultimately be borne by the mail users.

- . It would establish a higher level of subsidy, which after three years, would make it virtually impossible to return to existing subsidy levels; that would require either a sudden large increase in rates or major cost reductions. It would be appropriate to assume, therefore, that the higher level of subsidy would become the base.
- . It would establish a precedent for future requests from postal management for further increases in subsidies to bail it out of financial problems.
- . It would reduce pressures on the Postal Service to control or reduce costs, at least for the next three years. It would establish the practice of covering Postal Service deficits with appropriations, which could reduce or remove any incentives on postal management to develop a more efficient operation.

#### RECOMMENDATION

I recommend that we pursue option #2, but I would like to discuss this issue with you before you make a decision.

#### DECISION

Option #1. Continue our current position, providing assurances of continued borrowing rights for Postal Service and acknowledgement that some portion of the accumulated debt may have to be canceled.

RR7

Option #2. Same as option #1 above, but support legislation to create a postal study commission to look into the postal situation. As a part of its charter, the commission would deal with the question of the disposition of the accumulated postal debt.

Option #3. Same as options #1 and #2 above, but also indicate you would not veto a provision adding about \$500 million in additional Federal operating subsidies for fiscal 1976, 1977, and 1978.

Attachment

## Options for Dealing with Postal Service Debt

There are basically two approaches to dealing with the Postal Service's accumulated debt. The first would involve a regular appropriation "on-budget" to the Postal Service for purposes of retiring the debt now held by the Federal Financing Bank (FFB). The full appropriation would count as a budget outlay. The second approach would involve an appropriation to the Postal Service or the Federal Financing Bank "off-budget" accounts which would not be counted as a budget outlay.

The "on-budget" approach would be the normal way to account for such a Federal transaction under the unified budget concepts. As a general rule the Federal budget is expected to be a comprehensive document encompassing the complete range of Federal activities for full public and Congressional scrutiny. The major problem that would accompany any full counting of the debt write off "on-budget" is the impact it would have on the budget totals, adding up to \$2 billion in Federal outlays. This could make a significant increase in the budget deficit in any one year.

Currently the general operations of the Postal Service and the credit operation of the Federal Financing Bank are not counted as part of the Federal budget totals, but are carried as annexed or "off-budget" operations. The governmental activities which are shown "off-budget" are limited and for the most part have been removed from the Federal budget totals by statute. The Postal Service was placed "off-budget" to reflect its conversion to independent status consistent with the 1970 Reorganization Act and its self-financing nature. It is therefore technically possible to make a case for appropriating funds to the Service or the FFB to deal with an "off-budget" problem. The off-budget approach has the advantage of avoiding any sizable increase in Federal budget deficit. This is however, the only advantage. Despite the "off-budget" treatment of the Postal Service's general operations, the Federal payments and subsidies provided to the Service since reorganization have always been counted in the budget totals. To write off the debt through an "off-budget" transaction would be inconsistent with our treatment to date. It would violate the concepts of the unified budget, and would also set a "government-wide" precedent for similar financing of other governmental activities. It would therefore make it difficult for the Administration to resist Congressional efforts to pursue similar type off budget financing arrangements in other areas. Lastly, there are no persuasive arguments that could be made publically for supporting this type of a budget approach.