S. Hrg. 111–731

THE FUTURE OF THE U.S. POSTAL SERVICE

HEARING

BEFORE THE

FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY SUBCOMMITTEE

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

OF THE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

APRIL 22, 2010

Available via http://www.gpoaccess.gov/congress/index.html

Printed for the use of the
Committee on Homeland Security and Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE

57–329 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office,
http://bookstore.gpo.gov. For more information, contact the GPO Customer Contact Center,
U.S. Government Printing Office. Phone 202–512–1800, or 866–512–1800 (toll-free). E-mail, gpo@custhelp.com.

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

JOSEPH I. LIEBERMAN, Connecticut, *Chairman*

CARL LEVIN, Michigan
DANIEL K. AKAKA, Hawaii
THOMAS R. CARPER, Delaware
MARK L. PRYOR, Arkansas
MARY L. LANDRIEU, Louisiana
CLAIRE MCCASKILL, Missouri
JON TESTER, Montana
ROLAND W. BURRIS, Illinois
PAUL G. KIRK, JR., Massachusetts

SUSAN M. COLLINS, Maine
TOM COBURN, Oklahoma
JOHN MCCAIN, Arizona
GEORGE V. VOINOVICH, Ohio
JOHN ENSIGN, Nevada
LINDSEY GRAHAM, South Carolina
ROBERT F. BENNETT, Utah

MICHAEL L. ALEXANDER, *Staff Director*
BRANDON L. MILHORN, *Minority Staff Director and Chief Counsel*
TRINA DRIESSNACK TYRER, *Chief Clerk*

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

THOMAS R. CARPER, Delaware, *Chairman*

CARL LEVIN, Michigan
DANIEL K. AKAKA, Hawaii
MARK L. PRYOR, Arkansas
CLAIRE MCCASKILL, Missouri
ROLAND W. BURRIS, Illinois

JOHN MCCAIN, Arizona
TOM COBURN, Oklahoma
GEORGE V. VOINOVICH, Ohio
JOHN ENSIGN, Nevada

JOHN KILVINGTON, *Staff Director*
BRYAN PARKER, *Staff Director and General Counsel to the Minority*
DEIRDRE G. ARMSTRONG, *Chief Clerk*

CONTENTS

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00003 Fmt 5904 Sfmt 5904 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

THE FUTURE OF THE U.S. POSTAL SERVICE

THURSDAY, APRIL 22, 2010

U.S. SENATE,
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES,
AND INTERNATIONAL SECURITY,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 3:32 p.m., in room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper, Akaka, and Coburn.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. The Subcommittee will come to order. Welcome to each of our witnesses. Welcome to the folks who have shown up and who are sitting in the audience today.

We have some good news. There are not going to be any more votes today, so we are not going to be interrupted, and we will have a chance to have a full discussion, and you will have a chance to give all of your testimonies, and we will have a chance to ask questions. That is the good news. The bad news is sometimes when we have no more votes today, some of my colleagues like to head for the airport, and they head back to their own States. So I would not look for a full house here on our side. But these are very important issues, as you know, and a couple of my compadres will come in and join in the questions.

But we are grateful that you are all here. This hearing is the latest in a series that this Subcommittee has held over the past several years as the Postal Service struggles to adapt to an evolving mailing and communications industry and more recently to a deeply troubled economy—an economy which I am pleased to report, at least from my own perception, is coming back. Go back a year ago, our economy was shedding 600,000 jobs a month, and last month I think we added about 150,000 jobs. A year ago, our GDP was down by 6 percent. The last quarter we reported on, it was up by 6 percent. And big companies especially are making money, investing in capital investments, so I think better days lie ahead. And it may not be fast, but I think better days are coming back. Even the Troubled Asset Relief Program (TARP) money, all the TARP money that we gave away to the banks and to GM and all this, is actually being repaid. And things are just actually more encouraging on a beautiful day here in April, Earth Day, so welcome to this hearing on Earth Day.

As we all know, our economic crisis that our country has faced over the past 18 months has impacted just about every family and just about every business in our country. I would argue, however, that it has damaged the Postal Service and some of its customers more, maybe far more than most.

The Postal Service releases its financial data I believe every quarter, and I have grown used to reading disappointing news in those reports, as have many of you. Not always. You can go back a couple years ago, and it was not that long ago that the Postal Service actually paid down its line of credit to the Treasury and had right-sized the organization and found a lot of ways to trim costs. But the last year and a half has been very challenging.

The latest report is for the first quarter of fiscal year 2010. The latest report is largely more of the same, at least more of the same we've seen over the last couple of years. And in a period that coincides with the holiday season, usually the Postal Service's most successful quarter, mail volume was down compared to the previous year, resulting in a loss of just under $300 million, and that is in a quarter where the Postal Service usually makes money. It is sort of like a lot of our retailers in this country make money. That is where they make their money in that quarter, as we know. And even those dismal results are unfortunately slightly better than many observers had feared.

The Postal Service tells me that while some sectors of our economy have shown signs of recovery—and I spoke to that earlier—businesses and the public at large are not yet rushing back to hard-copy mail, at least not yet. During the depths of the recession, the Postal Service hired three highly respected consultants to look at its business model and the future of the mail. Their findings make it clear, at least to me, that we should not count on growing mail volume in the coming years to fix the Postal Service's financial difficulties.

According to data released in early March by the Postal Service, even after our economy has begun to pick up steam—and it is—mail volume is expected to increase only slightly from where it is today. However, electronic diversion of the mail is expected to continue to increase over the next decade or so. By 2020, I am told that mail volume could be as low as 118 billion pieces. That is nearly 60 billion fewer pieces than the Postal Service handled in 2009 and 95 billion pieces fewer than the Postal Service saw and handled in 2006, which I believe was the busiest mailing year that you all had experienced to date. This trend, according to the Postal Service, will lead to more than $230 billion in cumulative deficits between now and 2020.

Now, I know this is just one group of consultants' estimates, I think very highly regarded consultants, but it is one group of consultants' estimate of where things are headed for the Postal Service or could be headed for the Postal Service. In many ways, it is a worst-case scenario because it assumes that the Postal Service will not be able to attract significant new revenues through innovation or new products or new services. It also assumes that Congress will not act to address certain key issues such as the Postal Service's retiree health obligations.

These dire predictions, of course, must be analyzed before we take dramatic action to fundamentally change the nature of the Postal Service. That said, we would be foolish if we were to hesitate and hope for a return to the golden years, if you will, of the 1990s and the early 2000s.

We need, I believe, to face the reality of today. As technology advances, more and more Americans will take advantage of e-mail, of electronic bill pay, and other innovations to communicate, conduct business, and even read periodicals that once arrived in their mailboxes.

In addition, we need to realize that the day of reckoning for the Postal Service may not come in 2020 or some other distant date. It could come next year. I understand that if the Postal Service does not receive some sort of assistance from the Congress in the very near future, the Postal Service could run out of cash and borrowing room at some point in 2011 as they bump against their line of credit with the Treasury. This would put the Postal Service's ability to meet payroll and deliver the mail our Nation counts on in great danger.

So I believe it is imperative that the Congress, the Administration, the Postal Service, and other stakeholders work together in the coming weeks and months to develop a package of reforms and adjustments that can get the Postal Service through its immediate crisis while setting the stage for longer-term changes. In doing this, we must set aside the old biases and parochial interests that influenced and in some cases hindered previous postal reform efforts. Instead, we must concentrate on preserving the service that postal employees provide to the American people.

Some of the changes we would make or we should make are, I think, plain common sense. For starters, we should restructure the aggressive front-loaded retiree health pre-funding schedule that was included in the 2006 postal reform bill. That payment schedule was developed when mail volume was high, and it was written into the law long before the current recession began and at a time when electronic diversion of the mail was expected to progress more slowly than appears to be occurring today.

We should also carefully examine the Postal Service Inspector General's contention that the Postal Service has significantly overpaid its obligation to the old Civil Service Retirement System. If his findings are accurate, fixing this error alone could go a long way toward addressing the Postal Service's current and future challenges.

I must point out, however, that addressing these retiree health and pension issues will not end our work. The savings that would be generated by those fixes would cover only a portion of the Postal Service's long-term deficits. It would be irresponsible for them to ignore or significantly delay the more difficult changes that will need to occur.

One of these changes could be the elimination of Saturday delivery, which the Postal Service formally proposed at the end of last month. According to the Postal Service, moving to 5-day delivery could save the Postal Service more than $3 billion a year. We need to spend some time examining the details of what the Postal Service has put forward, but I am not aware of any changes, structural or otherwise, that would save this much money and help the Postal Service preserve the quality of service it does provide throughout the rest of the week.

The other difficult change that could come in the future is the transformation of the Postal Service's network of retail facilities. The Postal Service currently maintains more than 36,000 post offices and other retail units. Postal management envisions replacing a number of these facilities with alternate retail options. This could involve increased Internet sales and the use of unmanned postal kiosks. It could also involve providing postal retail access in grocery stores or other businesses that are open longer hours and are more likely to be located in areas where postal customers and potential postal customers conduct their business and live their lives.

I think that is an interesting proposal which, if executed well, has the potential to actually expand retail access while maybe saving some money, too.

Both of these efforts—the move to 5-day delivery and the restructuring of the Postal Service's retail network—will be hampered, unfortunately, by a roadblock that the Congress places in the Postal Service's way. I have stated any number of times that Congress does not always do a good job behaving like a 535-member board of directors for the Postal Service. In the 2006 postal reform bill, we tried to give the Postal Service, if you will recall, the ability to operate more like a business, including allowing the Postal Service to adjust delivery speed and frequency over time in response to changes in the market.

We on this side of the dais need to do our oversight and be certain that the Postal Service is on the right path, or at least be as certain as we can. But it is long past time for us on our side, on the legislative side, to largely get out of the way and allow postal management to take the steps that it needs to take in order to adjust to the new realities that the Postal Service faces.

We have been joined today by a couple of my colleagues, including a fellow with whom I have discussed these issues, and from whom I have learned a lot from over the last 6 or 7 years, as we tried to figure out a path forward, and I am happy to yield to Senator Coburn and then to Senator Akaka. Welcome.

OPENING STATEMENT OF SENATOR COBURN [1]

Senator COBURN. Thank you. I would ask that my opening statement be made a part of the record.

Senator CARPER. Without objection.

Senator COBURN. I agree with a lot of what Senator Carper said, but we cannot just fix the pension and we cannot just fix the health care payments. The business model is broken. The generation below me does not want you, does not use you, does not need you. Until we figure out a way to create a revenue stream for the Postal Service, everything we are going to do is going to be futile.

So what I would propose is that we rethink things: How do you allow the Postal Service to contract with the State of Oklahoma to

[1] The prepared statement of Senator Coburn appears in the Appendix on page 42.

do driver's licenses or to do car tags or to do voter registration? In other words, give them the ability to create a revenue stream with the great employees that they have so that their skills are utilized as the volume goes down.

I think the Postal Service has done a great job on parcel. I think we have seen good change there. I think they are very competitive. But until we figure out a way to increase the revenue stream—and the others are false. I mean, they are going to come, but they are going to come out of other areas of the Federal Government. So the net savings to the Federal Government is zero, even though we transfer that back to you all. It is still a cost to the American taxpayers. And it is probably a fair cost.

The point is we have got to have some creative thinking as you downsize to meet the demands of First-Class Mail, and that means you, the workforce, us, and your customers, especially your bulk mailing customers. There has to be a business plan. I have looked at the one that has been presented. It does get you out of the hole because it does not change the revenue. I still think the projections are low. I told General Potter last year at this time that his projections were too rosy, and my projections were better than your projections on First-Class Mail. You cannot keep hoping that it is going to improve, because it is not. It is going to continue to decline because we have had a cultural shift in the usage of First-Class Mail.

I have grown daughters from 40 to 32, and none of them mail anything.

Finally, I would say to you—and, Senator Carper, help me on this—as we go into labor negotiations, the financial health of the Post Office has to be a consideration as you move forward. It cannot be ignored even though it was stripped out by the House in the conference. It is ludicrous—it is like shooting yourself in the foot by saying, well, we are not going to think about what the long-term viability of this organization is as we negotiate labor agreements.

With that, I have said enough, and I look forward to the testimony. Thank you all for being here.

Senator CARPER. Thank you very much, Senator Coburn. Now for Senator Akaka, from the Aloha State.

Senator AKAKA. Thank you, Mr. Chairman.

Senator CARPER. You are welcome. Thanks so much for being here.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Great to be here with you, and I would tell you that what your and our Ranking Member's statements have mentioned are certainly things that we need to consider. I think these are future endeavors that we need to work on.

We find ourselves today in a very different situation than we did after enactment of postal reform in 2006. What looked like a successful new era for the Postal Service has become one of deep financial uncertainty. Mail volumes have steadily declined in the wake of the worst economic crisis this country has faced since the Great Depression. Americans are not using the mail today as they did just a few years ago. The Internet has replaced the post office for many consumers' communications and business needs. The decline in demand for some postal services is permanent.

However, as traditional lines of business decline, there are real opportunities for the Postal Service to translate new ideas into revenue. I would like to work with the Postal Service and my colleagues to remove any barriers that may be discouraging profitable innovation.

Reducing expenses is equally important. Working closely with employees and unions, the Postal Service has made progress on right-sizing its workforce. However, workforce cuts can and should only go so deep. The Postal Service has requested that Congress modify the burdensome payment schedule for pre-funding retiree health benefits. Now may not be the time to aggressively pursue pre-funding benefits. I support the Postal Service's request and I supported Senator Carper's bill to adjust these payments.

Unfortunately, a provision affecting collective bargaining rights was added during the committee process which caused me to vote against the bill in committee. In the interests of moving forward with immediate payment relief, this controversial debate should take place apart from this otherwise good legislation.

The Postal Service has taken the initiative to find other cost reductions to close this budget gap. Its 10-year plan outlines many ideas, some more controversial than others. The Postal Service has since asked for action on the entire package. However, I am convinced that some of these ideas demand more analysis and debate.

Five-day delivery, of course, is one of the Postal Service's most controversial recommendations. This would especially impact postal customers in more remote areas and could bring about a substantial change in the universal service obligation. While I understand that the Postal Service believes this could save $3 billion per year, there are differing estimates. I am not convinced that enough sound analysis has been done to determine the real savings. Also, cutting one day of delivery would eliminate 17 percent of delivery service for a projected 5-percent savings. This is a heavy trade-off and one that could further reduce customer demand for postal services.

Recently, the Postal Inspector General raised concerns to the Postal Service about potentially overpaid contributions to the Civil Retirement System. How this issue is resolved could alter the Postal Service's finances substantially, and we need to see what happens in that case.

It is important that we have begun the process of openly discussing financial issues at the Postal Service. Others, including the Postal Regulatory Commission, will continue to contribute to our understanding of these proposals and their implications. I urge patience and restraint as we undertake this process, while recognizing the urgency for finding relief. It is important to gather information and identify the options that will best serve the interests of the Postal Service, its employees, its customers, and the Nation.

Thank you very much, Mr. Chairman.

Senator CARPER. Thank you, Senator Akaka. It is great to be with you again.

I am going to go ahead and introduce our witnesses, starting with Phillip Herr. We had a little poll up here to see how you really do pronounce your name, and you are the only one who has pronounced it "Her." But since that is the way you pronounce it, that is the way we will pronounce it. Mr. Herr, we are glad to see you again, Director of Infrastructure Issues at the Government Accountability Office (GAO). I understand you have been with GAO since 1989, managing reviews for a variety of domestic and international governmental programs since that time. Welcome. Nice of you to join us.

Our next witness is John Potter, the 72nd Postmaster General of the United States. And how long have you been our Postmaster General? About 6 years?

Mr. POTTER. Nine years.

Senator CARPER. Nine years. Does it seem like six? [Laughter.]

Mr. Potter began his career at the Postal Service in 1978, held a number of senior management positions there before being named Postmaster General in 2001.

Next we have David Williams, Inspector General of the U.S. Postal Service. Mr. Williams has a breadth of experience in the Federal Government serving as Inspector General for a total of five Federal agencies during his career. What other ones?

Mr. WILLIAMS. It involved the Treasury and the IRS, which is the Treasury's second IG; Social Security; the Nuclear Regulatory Commission; and while I was at one of those, I simultaneously ran the HUD IG for about 8 months.

Senator CARPER. All right. Thank you for all that.

Finally, we have Ruth Goldway, who is the Chair of the Postal Regulatory Commission. Nice to see you. Thank you for joining us. Ms. Goldway is currently serving her third term on the Commission. Before beginning her time there, she had served, among other roles, as mayor and city council member in Santa Monica, California, in the State of California's Department of Consumer Affairs. Welcome.

Ms. GOLDWAY. Thank you.

Senator CARPER. Good to see you. We would ask that you limit your comments to about 5 minutes, and after that, if we get a little too far, I will rein you in, but your entire statements will be made part of the record. Once you have completed your statements, we will start asking some questions.

Mr. Herr, welcome. Please proceed.

TESTIMONY OF PHILLIP HERR,[1] DIRECTOR PHYSICAL INFRASTRUCTURE ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. HERR. Chairman Carper and Dr. Coburn, thank you for the opportunity to participate in this hearing and discuss GAO's report that was released last week. Today I will focus my remarks on the Postal Service's financial condition and forecast and strategies and options to facilitate progress toward its financial viability.

Turning first to the Postal Service's financial condition, as mail volume declined 36 billion pieces in fiscal years 2007 through 2009, the Postal Service's financial viability has deteriorated, leading to $12 billion in losses. Current forecasts are that mail volume will

[1] The prepared statement of Mr. Herr appears in the Appendix on page 44.

decline to 167 billion pieces this fiscal year, the lowest level since 1992. The Postal Service projects a record loss of over $7 billion this fiscal year while adding $3 billion in debt. Its outstanding debt will increase to $13.2 billion, close to its $15 billion statutory limit.

The Postal Service does not expect mail volume to return to its former levels when the economy recovers. The continuing shift to electronic communications and payments has fundamentally changed how mail is used. By fiscal year 2020, the Postal Service projects further volume declines to at least 150 billion pieces, the lowest level since 1986. First-Class Mail volume is projected to decline by another 37 percent over the next decade, and less profitable standard mail, primarily advertising that is subject to economic fluctuations, is projected to remain roughly flat over the next decade.

Turning to actions needed to facilitate the Postal Service's financial viability, in July 2009, GAO added the Postal Service's financial condition to our high-risk list and reported that action is needed in multiple areas for the Postal Service to make progress toward financial viability. We identified strategies and options that fall into three major categories:

First, compensation and benefits currently represent 80 percent of Postal Service costs, presenting opportunities for cost savings. In terms of retirements, about 162,000 postal employees are eligible to retire this fiscal year and about 300,000 are expected to retire over the next decade. In terms of benefit costs, postal employees have about 80 percent of their health benefit premiums paid, 8 percent more than most Federal employees.

Second, cost savings can be achieved by consolidating processing and retail networks given volume declines. Removing excess capacity is necessary in the 600 processing facilities where First-Class Mail processing capacity exceeds needs by 50 percent. The network of 36,500 retail facilities can also be reduced. Maintenance has been underfunded for years, resulting in deteriorating facilities and a maintenance backlog. Approximately 30 percent of postal revenue currently comes from stamps purchased at non-postal locations such as grocery stores, indicating that customers have already begun shifting to alternatives.

Another opportunity is consolidating the field administrative structure by reviewing the need for 74 district offices and an additional eight area offices. And because cost cutting alone will not ensure a viable Postal Service, generating revenue through pricing and product flexibility is needed. The new Flat Rate Priority Mail boxes are an example of how the Postal Service has successfully generated new revenues.

Turning to our report, "Matters for Congressional Consideration," to facilitate progress in difficult areas such as realigning postal operations and its workforce, Congress may wish to consider an approach similar to a BRAC-like commission used by the Department of Defense. Congress has previously turned to a panel of independent experts to restructure organizations and establish consensus. We believe a commission could also help ensure that Congress and stakeholders have confidence in resulting actions.

We also suggest that Congress consider changes in two other areas. One would be to revise the statutory framework for collective bargaining to ensure that binding arbitration takes the Postal Service's financial condition into account.

Another change to consider would be modifying the Postal Service's retiree health benefit cost structure. We believe it is important that the Postal Service fund its retiree health benefit obligations to the maximum extent its finances permit. Currently, about 460,000 retirees and their survivors receive this benefit, and another 300,000 postal employees are expected to use it by 2020.

In considering revisions, it will be important to assess what the Postal Service can afford, strike a fair balance of payments between current and future ratepayers, and determine how changes would affect the Federal budget.

Mr. Chairman, in conclusion, no single change will be sufficient to address the Postal Service's pressing challenges. The longer it takes to realign the Postal Service to the changing use of the mail, the more difficult change will be.

This concludes my prepared statement, and I am pleased to answer any questions.

Senator CARPER. Mr. Herr, thanks for that testimony.

Mr. Potter, Postmaster General, please proceed.

TESTIMONY OF HON. JOHN E. POTTER,[1] POSTMASTER GENERAL AND CHIEF EXECUTIVE OFFICER, U.S. POSTAL SERVICE

Mr. POTTER. Good afternoon, Mr. Chairman and Senator Coburn. For the past 2 years, I have testified about the dire financial situation facing the U.S. Postal Service. I am pleased to report that the Postal Service has a plan of action to close the growing gap between revenue and expenses. But before discussing our plan, however, I would like to say a few words about our Inspector General's recent audit concerning $75 billion worth of Postal Service overpayments to the Civil Service Retirement System pension fund. This is a significant finding and one that could have an enormous bearing on the speed with which we need to make changes. We support the IG's conclusion and urge you to take action on his recommendation.

Refunding the $75 billion to the Postal Service, however, would not eliminate the need for us to take additional actions, but it would lessen our immediate financial crisis.

The Postal Service has to change in light of the recent downturn in mail volume and the forecast of additional decline due to diversion of hard-copy mail to the Internet. Our management team, with the support and approval of our Board of Governors, has developed a responsive, ambitious, and balanced plan that offers a way forward.

To help close our forecasted $238 billion gap by 2020, our action plan has identified $123 billion worth of cost savings that are within postal control. Our actions include lowering costs through continuous improvement and effective working management, adopting standardized procedures within our network, and consolidating plants and delivery routes. We are also saving costs by renegoti-

[1] The prepared statement of Mr. Potter appears in the Appendix on page 54.

ating transportation contracts and engaging in new ways to purchase supplies.

We recognize the need to grow revenue. We are embracing innovation through efforts like a product test with Hallmark for postage paid greetings, Priority Mail contract pricing, and Priority Mail cubic pricing, and our successful 2009 Summer Sale for advertising mail which we plan to offer again in 2010.

We are also pursuing growth in areas where we already have a presence, like increasing the number of post office boxes available for rent and expanding sites where we provide passport transactions. Our goal is to introduce new products consistent with our mission and to expand and modernize our retail access.

Our actions alone, though, will not close the financial gap. We do need congressional help in some key areas. Specifically, we request your assistance in restructuring the pre-funding of retiree health benefits, adjusting the frequency of mail delivery, providing the freedom to offer access to the Postal Service in places other than traditional post offices, requiring arbitrators to consider the financial condition of the Postal Service, applying the Consumer Price Index cap to all market-dominant products as opposed to on a class-by-class basis, introducing new products consistent with our mission, and, finally, helping us to acquire more streamlined oversight.

The first two proposed changes will generate the largest and most immediate financial benefits and move us toward narrowing our financial gap. If Congress is unable to act this fiscal year on broader legislation, our projections show that we will run the risk of running out of cash early in 2011. Therefore, should there be insufficient time this year to pass comprehensive legislation, the Postal Service will request a reduction in our retiree health benefit trust fund payment this year similar to 2009.

We recognize that our agenda is ambitious, and the challenge will be finding the right balance between taking actions necessary to mitigate our financial crisis while at the same time implementing a smooth transition for our customers and our employees. The GAO recognizes the challenges facing us, too. In their recently released report on the Postal Service, they do a thorough job of reviewing strategies for long-term structural and operational reform. I am pleased that many of the GAO's findings are consistent with the Postal Service's action plan. The GAO agrees with us that we need congressional action to remove some of our current legal and regulatory constraints.

One area where we take exception with the GAO report is their recommendation that additional panels of experts or commissions be established to develop legislative options. We believe that a sufficient body of evidence exists to help guide the Congress on the changes needed for the future, and the time for action is now.

Our action plan provides us a solid path to ensure that the Postal Service remains strong, healthy, and viable into the future. Our challenges are urgent, and I look forward to working with Congress, GAO, the Postal Regulatory Commission (PRC), and the entire postal community in implementing the best choices for success.

Thank you for your support, and I will be happy to answer questions at the appropriate time.

Senator CARPER. Thank you, General Potter. Mr. Williams, please proceed.

TESTIMONY OF HON. DAVID C. WILLIAMS,[1] INSPECTOR GENERAL, U.S. POSTAL SERVICE

Mr. WILLIAMS. Mr. Chairman and Senator Coburn, I appreciate the opportunity to appear today to discuss the financial situation facing the Postal Service. The fiscal condition is serious, and the Postal Service has an ongoing aggressive plan to address it.

A concern of my office is that the plan calls for huge simultaneous actions across a very broad and fast-moving front. These will produce significant project management challenges as well as unintended consequences among the initiatives that now include the Flats Sequencing System, Intelligent Mail barcode, plant network and post office optimization, 6- to 5-day mail delivery, and a major transformation of its sales and marketing effort.

A second concern is that a large portion of the Postal Service financial loss is not a result of the Postal Service business model or the Postal Accountability Enhancement Act (PAEA) of 2006. We believe that $7 billion of the expected $11 billion loss this year is a mischarge by the Federal Government against the Postal Service. In earlier years, the mischarge accounted for all of the losses and the absence of profitability anticipated in PAEA. Until the Postal Service is no longer bled white by the Federal Government before it opens its doors for business, identifying challenges and constructing solutions are highly prone to error. We may be fixing the wrong things and learning the wrong lessons. For instance, is the Postal Service facing a $4 billion or an $11 billion loss this year? Does the Postal Service have a debt to the Treasury or owe nothing? These issues are not difficult to grasp or to correct. While the solutions are being found, I do not believe that contributing to benefit funds that appear to be overfunded is prudent during a financial crisis.

This year, Congress directed the Postal Service, OPM, and OMB to develop a fiscally responsible legislative proposal for Postal Service benefit payments. My office has identified three areas for resolution:

An exaggerated 7-percent health care inflation forecast instead of the 5-percent industry standard, resulting in an overpayment of $13.2 billion by 2016.

An excessive 100-percent pension benefit plan pre-funding requirement compared to OPM's own pre-funding level of 41 percent and the S&P 500's 80-percent rate. Even using the higher 80-percent funding goal would result in a $52 billion surplus.

Last, the Postal Service pension fund was overcharged $75 billion so that employees could retire at promised levels. When the Post Office Department became the Postal Service, employees that belonged to the Federal pension fund now contributed to the Postal Service. Retirement costs were divided according to the number of years employees have belonged to each fund. However, the Federal pension fund paid retirements based on 1971 salaries, not final sal-

[1] The prepared statement of Mr. Williams appears in the Appendix on page 65.

aries. The Federal pension fund collected full contributions, but paid only partial benefits.

OPM has explained that these mischarges were in response to what they believed to be the will of Congress expressed in 1974 legislation. However, the 1974 language was repealed by Congress in 2003 when large overpayments were discovered. At the time, OPM inexplicably had not detected a 41-percent overfunding error in this $190 billion pension fund. Congress directed OPM to use its authority to oversee the reforms using accepted dynamic assumptions that include pay increases and inflation. OPM switched to dynamic funding for the Postal Service portion, but did not for their share. The Postal Service was forced to pay the $75 billion difference.

Resolving these issues would provide an accurate map of financial challenges that require resolution. The resolution would also allow the Postal Service to execute its plan at a safer velocity less prone to error and at a pace where unintended consequences can be identified and resolved.

My office does believe that long-term solutions are needed to effectively address a few critical areas. These include the optimization of the network of plants and post offices and changing its rigid work rules to match the ebb and flow of customers and mail. In addition, simplified pricing is needed to replace the over 10,000 prices contained in the 1,700-page customer manual to encourage new customers and improve revenue accountability. This will allow Postal Service operations to closely fit business opportunities.

A significant success factor for leadership through the journey to 2020 will be fairness and transparency and a single focus on reform. Postal stakeholders have demonstrated they are responsible and dedicated, but they deserve assurance that everyone is lifting and sharing responsibilities for needed action. It is important to understand that the accommodations made outside the interests of the Nation can easily become the pebbles that cause a crippling avalanche, halting actions that the Postal Service must take.

Thank you.

Senator CARPER. Thank you, sir. And for our final witness, Ms. Goldway, please proceed.

TESTIMONY OF HON. RUTH Y. GOLDWAY,[1] COMMISSIONER, POSTAL REGULATORY COMMISSION

Ms. GOLDWAY. Thank you, Chairman Carper and Senator Coburn. Thank you for the opportunity to testify on the future of the U.S. Postal Service.

I am pleased to share with you today the Commission's work in matters that are before the Congress as you deliberate on solutions for the Postal Service's future.

On March 30, we initiated a docket to review the Postal Service's proposal to eliminate Saturday mail service. I want to personally assure this Subcommittee that I and each of my colleagues have an open mind on this proposal. There is some confusion among the press and the public. No decision has yet been made. We look forward to hearing both the evidence offered by the Postal Service and any views presented by interested members of the public. The

[1] The prepared statement of Ms. Goldway appears in the Appendix on page 76.

Commission will hold public hearings so that the Postal Service, mailers, stakeholders, and the public offer their perspectives and insights. Nearly 2,000 public comments have been received thus far. We are also scheduling seven field hearings to engage citizens across the country.

On March 29, the Commission released its Annual Compliance Determination (ACD) which carefully reviewed the Postal Service's financial problems. I have printed copies with me here today. You received e-mail copies earlier.

As detailed in the ACD, on September 30, 2010, the Postal Service must make a $5.5 billion payment to fund future health benefits, then make payments for worker's compensation obligations and meet payroll. It could run out of cash.

Two major unresolved issues impact the Postal Service's finances and affect the 5-day delivery issue. The first is whether the Postal Service has overfunded its employee pensions by $75 billion, as the Postal Service's Inspector General says. The Postal Service has appealed its current CSRS liability to our Commission, a process established by the PAEA. The Commission will retain an independent actuary to review the pension calculations performed by the OPM, by the Postal Service's OIG, and by any alternative industry best practices. The review will also examine the relevant underlying laws. We hope to report to Congress, OPM, and the Postal Service in early July.

The second issue involves the calculation and financing of future postal retiree health benefits funds. A recent Commission study found that a recalculation could lower the Postal Service's total liability by $35 billion and reduce payments by more than $2 billion yearly, while meeting the original funding goals of the PAEA.

The Postal Service's Office of Inspector General suggests that even greater reductions are possible. My colleagues and I support readjusting the payments to an affordable level, perhaps over a longer period of time, and/or tied to the Postal Service's ability to pay. We see this as an essential part of any plan to help the Postal Service in the coming decades.

The Postal Service's 10-year plan contemplates substantial financial losses. But in response to these potential losses, the Postal Service proposes to reduce service to cut costs. Its plan promises fewer employees to serve the public, fewer processing plants and postal-operated retail facilities, reduced mail collections, fewer collection boxes, as well as eliminating Saturday mail delivery service. Those who rely most on the mail—the elderly, the poor, rural America, and those who cannot or will not connect to the Internet—will suffer. I do not believe that this vision is the inevitable future of the Postal Service. Even in the Internet age, mail has a unique power to touch readers and deliver results for senders. It can drive sales, touch emotions, deliver votes, and shape important personal decisions that affect life and country.

Despite economic volatility, terrorism, and digital diversion, mail has been remarkably resilient. Between 2000 and 2008, First-Class Mail declined about 1.2 percent a year, while standard mail actually increased by 1.6 percent. This gradual shift toward a lower-margin mail mix was addressed to some extent in the PAEA which allows the Postal Service to compete and earn higher incomes in its shifting services. The recession has cut into the success of these ventures.

On a somewhat positive note, it appears likely that the Postal Service will far exceed its own forecast this year. The latest financial report received by the Commission reveals that through the end of February, it is nearly $1.2 billion ahead of forecast. The turnaround in the economy may finally be impacting the mailing industry.

The Postal Service's sustained efforts to increase productivity, improve processes, and lower its costs are commendable and should continue unabated. However, focusing on cost cutting to solve deficits is simply not enough. The PAEA requires the Postal Service to continue to provide universal service at fair and efficient rates and requires the Commission to carefully monitor both the rates the Postal Service charges its customers and the quality of the service provided. Reductions in service that affect the value of the service to customers and rate increases are really in reality two sides of the same coin. It would be helpful if the discussions on postal issues also focus on a positive and constructive approach to the future.

In other words, what does the American public need for its constitutionally mandated communications system? How can we make the Postal Service more valuable to the American people? What new products does the public need that the Postal Service is uniquely positioned to provide?

The Postal Service is capable of new ideas. I commend the Postal Service's efforts to build upon its Website, expand customer access via the Internet, and increase sales of stamps at supermarkets. The Service has expanded its competitive Flat Rate Priority Mail program, has begun offering Hallmark cards, and has launched volume-incentivizing sales and advertising initiatives. The Commission approved the Postal Service's only experimental product filed under the PAEA. More innovation should be developed by the Postal Service as soon as possible and, where appropriate, submitted to the Commission for review.

In my written statement, I have outlined a number of ideas that emphasize value to the customer and revenues rather than volume losses, and that I believe could be transformative, positioning the Postal Service to survive and thrive in the coming decades.

Thank you. That concludes my testimony.

Senator CARPER. Thank you very much for that testimony.

Senator Coburn has to be out the door around 4:30, and I am just going to yield to him for however long he would like to question the panel.

Senator COBURN. Thank you. I will try not to abuse that privilege.

Senator CARPER. Go ahead. Abuse all you want until 4:30 p.m.

Senator COBURN. I have to comment on Senator Akaka's remarks. Eighty percent of the cost in the post office is labor. You cannot fix this problem without looking at all the costs. To say that we should not consider in terms of the labor input in solving this problem means we will never solve it. So I want to move that off the table right away. I say this with no disrespect to our postal employees. But to say that the post office, as an independent service, does not have the right to not pay if it is supposed to pay based on what it can afford to pay. It is either a private company or it is not. We need to figure out which way we are going to go.

Postmaster Potter, what is the status of the Flats Sequencing system (FSS) system and the Intelligent Mail barcode (IMb) system? Because, really, a good question has been raised here. If you cannot implement those two systems, how can you implement all the other things you want to do to reform the post office?

Mr. POTTER. The Intelligent Mail barcode system is being—it has been deployed. The number of mailers that are using it is growing by leaps and bounds every day. We have had billions of pieces of mail deposited using the full Intelligent Mail barcode. So that is well on the track to achieving what we expected.

When it comes to the Flats Sequencing System, we have had some issues regarding the quality of the equipment. They have not passed muster. We are working with the vendor. We believe that within a couple of months we will be back on schedule. But we are not going to pay for a piece of equipment that is not performing. Where we do have the equipment running, we are capturing the savings that we expected to get out of that machine.

Senator COBURN. OK. In GAO's report in April and in their testimony today, they make several recommendations regarding actions that Congress and the Postal Service must take to ensure the long-term viability of the Postal Service. Do you agree with their recommendations?

Mr. POTTER. I agree with all of them but one, and the one I have a concern about is that if we continue to study, we are just going to dig a deeper hole. I am of the opinion that we need to take action and do it as quickly as possible.

Senator COBURN. Part of those recommendations is that any binding arbitration include the financial health of the Postal Service as a determining factor in the outcomes of labor contracts. Do you agree with that?

Mr. POTTER. I fully support that. It is built into my testimony, both oral and written.

Senator COBURN. Mr. Williams.

Mr. WILLIAMS. I do, sir.

Senator COBURN. Ms. Goldway.

Ms. GOLDWAY. I do not think I can speak for the Commission on this.

Senator COBURN. Well, then, speak for you, if you would.

Ms. GOLDWAY. What I believe is that there certainly should be more flexibility built into union work rules in the future.

Senator COBURN. No, that is a different question. Should the financial health of the postal system be part of the consideration as we set the labor contracts for the Postal Service?

Ms. GOLDWAY. I do not think that I really know enough about that to answer that question.

Senator COBURN. OK. Eighty percent of the costs of the post office are labor or associated with labor costs. And the fact that it is running a deficit, a projected deficit, even in spite of the recommendations we have from the IG here, it is still going to have a deficit. How do you run an organization if you are going to ignore the financial consequences of what is getting ready to happen to the organization?

Ms. GOLDWAY. I am not sure that it is the financial arbiter's role to make that decision. I would like to see the Postal Service and its employees really focus on creating a flexible workforce that I believe will save the Postal Service a great deal of money in its future labor costs.

Senator COBURN. Well, that is one of the considerations, is their financial condition is one of the reasons that they want to have a flexible workforce. They become more efficient.

Ms. GOLDWAY. I think they should have a flexible workforce in addition to provide better service to the American public. I think that is part of it as well.

Senator COBURN. Ms. Goldway, you say it is unfair for somebody not to get mail on Saturday?

Ms. GOLDWAY. No, I do not think that is what I said.

Senator COBURN. But you said there will be harm generated by somebody not getting mail on Saturday. Please explain to me why somebody is going to get harmed by not getting their mail on Saturday.

Ms. GOLDWAY. Well, we have had testimony from small newspapers in rural parts of the country that deliver mail on Saturday. Their major strategic advantage in having a newspaper and a business in the community when they report on the Friday evening football scores of all the high schools, and if they cannot get that newspaper to their subscribers on Saturday, they are either going to fold their newspapers or they are going to go to their Walkman, and the money will be lost——

Senator COBURN. The same thing is happening to the newspapers that is happening to the Postal Department.

Ms. GOLDWAY. In some cases, yes, it is true. But interestingly, in the rural areas——

Senator COBURN. And we also have this Marconi device called the radio where you can get the scores, which was invented some time after the Guttenberg press. So the fact is there is absolutely no net long-term damage for us delivering something on Saturday that we, first of all, cannot afford to do. I guess the other way to ask the question, I would argue, is: What is the net benefit economically to the country and economically to the post office of delivering Saturday mail? When you look at that, I think you are going to get a different picture. The economic benefit is most of the businesses are not operating on Saturday. If you look at activity other than retail activity, everything else drops down in this country except retail activity. I just think when you are looking at the kind of losses the Postal Service is facing, I think there is a legitimate question to ask, why, when you reduce the service by 17 percent, you only get 5 percent savings. That is a much more important question for us to be asking, and I think that is one you ought to have to answer.

Ms. GOLDWAY. Let me assure you that the Commission's process will be to ask all of the questions that you point out. We will look at the harm that is caused to some people and the great benefit that may be provided in other areas. And it is exactly the cost/benefit analysis that we will try to provide to get all the information and all the costs and make it——

Senator COBURN. Well, I would love for you to send me how you calculate those football scores into that cost/benefit analysis.

Let me ask one other question of General Potter. In your 10-year plan, you describe numerous actions that are needed to address the financial problems that you see facing the business and an estimated cost savings associated with them. One of those actions includes a more flexible workforce. But you do not associate any savings from that in your plan. Why not?

Mr. POTTER. Because what we build into the plan is reduced work hours, and those reduced work hours are a result of maximizing the flexible workforce that we anticipate.

Senator COBURN. How many work hours are you paying for now that you are not getting benefit from?

Mr. POTTER. We have, we will call it, standby folks, folks who are not productive. We are down to about 1,000 people who are in that status. We identify people because of the fact that we do not want them to just kind of gravitate into the woodwork and find things to do. We have reduced that number from 16,000 down to 1,000 in the last 6 months. And so it is a matter of, again, identifying people and then using our contracts to move them to productive work. But we do have 1,000 folks who are not gainfully employed right now.

Senator COBURN. OK. What about some of Senator Carper's recommendations about the flexibility of more areas, greater penetration in nontraditional postal reception and service?

Mr. POTTER. We have asked for that freedom as part of our plan. What we have not done, though, is we have not identified any specific area where we would make an investment. We worked with Accenture, and we looked at activities that are being done by posts around the world, for example, banking, selling cell phones, a number of other businesses, logistics that other posts have gotten into. And Accenture's response to us was, yes, there is a potential profit, but it requires risk because not every post that makes investments has a return, and we do not have the capital right now to make those investments.

And so their suggestion to us was that we should pursue the freedoms, at some point in the future pursue those.

Senator COBURN. So if you could contract with the State of Oklahoma where the Postal Service, would manage all the tags, would you support that?

Mr. POTTER. We would embrace that. We think that any identity card in America, whether it is a license or a passport or anything that has to do with identification—there is even discussion of future cards for health benefits. We believe that as the Federal Government, with our footprint, that we would be an ideal agency to provide that resource to the Federal Government.

Senator COBURN. You could contract voter registration, for example.

Mr. POTTER. Exactly.

Senator COBURN. All these things that are being done, you could contract with States on a per State basis to do those facilities.

Mr. POTTER. Yes.

Senator COBURN. Can you do it cheaper than they are doing it now?

Mr. POTTER. That is a good question, and it is one that with our current labor rates might be challenging.

Senator COBURN. Yes, OK. The other question goes back to Senator Akaka's statement. Why isn't there more than 5-percent savings with a 17-percent reduction in service?

Mr. POTTER. That is a good question. I will explain it on a very high level. First of all, we do not deliver to every address on Saturday that we do the rest of the week. So businesses that are closed Saturday, we do not deliver to those addresses. Our routes reflect that. We have stations in New York City, for example, that are literally closed on Saturday because there is no delivery.

Second, one of the big differences is that we use non-career employees on rural routes on Saturdays, and so there are no savings associated with that.

Senator COBURN. Why are there no savings with a non-career employee who is not going to deliver on Saturday?

Mr. POTTER. There are savings, but they are about half of what they would be during the rest of the week because they do not get benefits.

Senator COBURN. All right. They are contracted employees?

Mr. POTTER. Well, they are part of our workforce. They are called non-career, but they are represented by the union. So when you look at those, there is an explanation for why you do not get the full savings out of them.

Senator COBURN. We would be very interested in seeing your analysis to explain why you have a 17-percent reduction in service but yet only a 5-percent savings. You have given several excellent reasons.

Mr. POTTER. The third thing that is major is that we are assuming that there will be some reduction in revenue, and we do offset the savings with a reduction of revenue. So the savings are actually higher than that, and we dropped them down as a result of the revenue.

Senator COBURN. I live on a rural route or almost a rural route, and the mail I would have mailed on Saturday, am I not going to mail it on Monday?

Mr. POTTER. You are going to mail it on Monday.

Senator COBURN. So why is there a reduction in the revenue?

Mr. POTTER. Because of examples of folks like Ms. Goldway just described, newspapers that mail on Friday for Saturday delivery will not mail that Saturday paper for Monday delivery. And there are advertisers who target mail for Saturday delivery have told us that they would draw down.

Senator COBURN. So is there a better day?

Mr. POTTER. No, there is not because we have analyzed that. That is our lightest-volume day of the week, and it is much easier to explain to the American public that we are not delivering on Saturday. We have businesses that are closed so it makes the most sense. If we pick a Wednesday, then we would not be delivering to businesses, and 90 percent of our revenues come from commercial entities. We want to continue to deliver to those businesses.

Senator COBURN. Ms. Goldway, in your most recent release, Postal Regulatory Commission's Annual Compliance Determination Report, you note that 14 postal market-dominant products do not cover their attributable costs to the tune of an annual cost of $1.7 billion. Does the PRC have the authority to raise these rates to cover these costs? And if yes, why wouldn't you raise those rates?

Ms. GOLDWAY. That is a very important question. It is $1.7 billion when you include the market-dominant rates and the contributions from periodicals, etc. They are all included in that.

The difficulty is there is a real contradiction in the PAEA. On the one hand, it says that all rates must cover its costs, and the Postal Regulatory Commission should assure that the Postal Service does that. On the other hand, it says that all rates cannot go up more than the rate of inflation, the CPI, and especially in the last 2 years, the Consumer Price Index (CPI) has, in fact, been a deflation. So if you direct the Postal Service to do one thing, you are violating the law in the other relationship.

What we have been trying to do over the years is to direct the Postal Service to improve that ratio so that the costs and the actual rates are closer together than they have been. Unfortunately, in some areas, like periodicals, that gap has gotten bigger, and what we have directed the Postal Service to do is to provide us a specific plan no later than next year—and hopefully in the context of any rate case they might file—to address that problem and to see how we can improve that and reduce that gap.

Senator COBURN. There is no allowance for your Commission to—if they have not had a rate increase for a period of time, even though there was inflation, you do not get an opportunity to look at what the price was the last time they raised it and the cumulative inflation rate over that period of time?

Ms. GOLDWAY. There is an opportunity for the Postal Service to use its unused Consumer Price Index cap if it has not used it all and allocate it to a next year to raise rates more than the CPI. But since we are in a period of deflation, that is not possible.

Senator COBURN. So even though we had 3, 4, and 5 percent inflation 3 years ago, they cannot utilize that if they did not?

Ms. GOLDWAY. They used almost all of the Consumer Price inflation rate increase that they were allowed to in their last rate——

Senator COBURN. Let me ask the question another way, and I would love to hear Senator Carper's take on this. So, by law, we have said you cannot raise rates. Your volume is going down, and, by law, we do not allow the financial health of the Postal Department to be determined in any labor contracts. Maybe we ought to allow them to raise rates to meet the needs of their revenue stream. Why would we not change—and I will yield back, and thank you for allowing me to go first.

Senator CARPER. No. I am glad you are here. I appreciate very much all of your questions.

Let me just follow up on that, General Potter, in terms of your ability under the 2006 legislation to raise rates above the rate of inflation. Do you want to just take a minute and tell us what your flexibility is under the law?

Mr. POTTER. Under the law we have a provision that allows the Postal Service to ask for an exigent rate case, and we are looking at that, and that would enable us to raise rates above the rate of inflation.

In addressing some of the concerns that Senator Coburn just raised, one of the issues that we do have is that we can only raise rates up to the rate of inflation by class of mail. And so with as many classes as we have, there is an imbalance over time, so that constraints us.

Senator COBURN. But my point is that is what we need to change for you.

Mr. POTTER. Exactly.

Senator COBURN. You need the flexibility to make the revenues that you can get.

Mr. POTTER. And that is what we are requesting, Senator.

Senator CARPER. OK. I want to go back to the testimony of Mr. Williams. I am going to read a paragraph out of his testimony, and then, General Potter, I am going to ask you a question or two on it, if I could. It says, "Last, in January 2010, my office"—this is the IG—"released a report that illustrates how the current method of determining the Postal Service's CSRS pension responsibility is inequitable and violates accepted accounting practices. These accepted accounting practices require that pension funding calculations include inflationary adjustments. As a result, the Postal Service has been overcharged $75 billion."

Since what year would that be? Since 1970——

Mr. WILLIAMS. Well, it would begin in 1974. And 2003 was——

Senator CARPER. Overcharged $75 billion since roughly 1974. "Also, the 100-percent pension pre-funding target being excessive when compared to the Standard & Poor's 500 and the OPM's achieved funding levels."

Let us assume, General Potter, that the IG is correct in saying that the Postal Service has been overcharged by $75 billion in the way that you have been funding the CSRS pension responsibility. Let us say that is correct. Let us say that the second point here is correct also with respect to the 100-percent pension pre-funding target is excessive when compared to the S&P 500 and OPM's achieved funding levels. Let us say they are both correct.

If both of those assertions are correct, how does that change what you need to do at the Postal Service and what we need to do?

Mr. POTTER. Well, we are talking about $120 billion being given to the Postal Service.

Senator CARPER. Those are some big if's.

Mr. POTTER. Yes, well, you are talking about $120 billion that, let us say in theory, was given to the Postal Service. What would we do with that money? Well, first, I think we would pay down our debt. We would make sure that Civil Service——

Senator CARPER. Debt to the Treasury?

Mr. POTTER. Debt to the Treasury, which is now at $10 billion. We would fund our retiree health benefit system up to the required level, the trust fund, which would probably be about——

Senator CARPER. Under the 2006 law?

Mr. POTTER. Under the 2006 law. We would fund that. We would have plenty of money to fully fund that. And I think we would be in a very solid financial position for at least 5 to 7 years.

Senator CARPER. OK. Thank you.

I want to ask a couple more questions, if I could, of you, General Potter. My recollection is this is not the first time that a Postmaster General has raised the possibility of shifting to 5-day delivery, and I am not sure—who was your predecessor?

Mr. POTTER. Bill Henderson.

Senator CARPER. OK. One of your predecessors, I think back in 1980, was a fellow by the name of William Bolger. Did you know him?

Mr. POTTER. I was in the Service when he was the Postmaster General, but I cannot say I knew him.

Senator CARPER. All right.

Mr. POTTER. I was a clerk at the time.

Senator CARPER. Fair enough. From a clerk to a king. [Laughter.] To the General. But, anyway, I understand that he first formally suggested 5-day delivery to the predecessor committee for this Committee. It used to be the Governmental Affairs Committee, and now it is the Homeland Security and Governmental Affairs Committee. But I am told that in 1980 he raised the possibility, maybe even suggested that the Postal Service consider going from 6- to 5-day service. At the time he said other ways to save this money are not readily apparent, and 30 years later we are hearing pretty much—well, it is not exactly the same argument, but we are hearing a similar kind of argument.

I do not know if he is still alive, but we have gone 30 years and the Postal Service is alive, kicking a little bit, but we have heard this idea before, and there turned out to be other things we could do to keep the Postal Service alive than going from 6- to 5-day service. So how is this different—I think I know what you are going to say, but how is this different from 1980?

Mr. POTTER. Well, if you look back at 1980, it was pre-automation, and so the Postal Service has increased efficiency significantly by automating mail, having machines that can read barcode and sort mail. In addition to that, we have seen significant growth in our advertising product, another hard-copy product. We went from a very small volume of mail in 1980—I think it was actually in the 1970s when he was talking about it—to today where it actually peaked at over 100 billion pieces of mail, and it is 50 percent of the mail. So there was an opportunity to grow revenue.

What we have facing us right now, Senator, is the fact that hard copy is being substituted with electronic communication, and so the opportunities to pursue products in the hard-copy arena just are not there given the fact that society is moving to do as much as it can electronically. And so therein lies the big difference.

I think that there is some misnomer about, what we could do if we kept our retail operations open. At the end of the day, delivery still has to be paid for by the mail that we are delivering, and the sobering thing for me when I looked at this was that in the year 2000 we were delivering five pieces of mail per delivery per day. Today we are down to four pieces per delivery per day, and our anticipation is that we are on our way to three in the year 2020. And the mix has changed from First-Class Mail, and there is going to be more advertising. In 2000, we were delivering on average in 2009 dollars, we were delivering $1.80 to every door every day. Today that number is down to $1.40, and in 2020 it is going to be down to $1. And while we can have other sources of revenue generated, the fact of the matter is delivery is not going to pay for itself going forward. And that is why the Postal Service Board of Governors proposed going from 6- to 5-day delivery, because we believe that delivery has to be able to pay for the amount—the frequency that we provide.

Senator CARPER. All right. Thank you.

Again, a follow-up question, if I could, for you, General. Part of your plan for the coming year that has received the most attention is, as you know, the idea of maybe going from 6- to 5-day-a-week delivery. While polling consistently shows that the public at large would be supportive of such a move, at least when given a choice between it and other maybe less popular cost-cutting efforts, the proposal continues to meet some resistance.

Would you take a minute or so to talk about how the proposal you made to the Postal Regulatory Commission on Saturday delivery addresses some of those concerns that have been raised by groups like credit card companies, like pharmaceutical companies, like post office box owners, and others who have expressed concerns to date?

Mr. POTTER. Senator, in the last 6 months, we spent a lot of time talking to as many stakeholders as we possibly could. When we originally drafted our plan for 6- to 5-day delivery, our savings was actually above $3.5 billion. But as we heard from constituencies and heard their concerns, what we have done is we have made adjustments to that plan, including keeping our network facilities open around the clock throughout the country, enabling folks who receive payments through the mail to continue to receive those payments on weekends and 24 hours a day, because as mail is processed, we make it available to them.

When it comes to people who have post office boxes, many of whom are remittance type mailers, people who receive monies, we have decided that we are going to keep post offices open on Saturday. We are going to continue to sort mail to those post office boxes. And so folks who want to receive their mail on Saturday can open a post office box, and those folks who currently receive checks at those post office boxes will get their mail on Saturday.

And so, again, wherever we could, we made accommodations to assure that people had access, where necessary, to the mail.

Senator CARPER. OK. Thanks. I would just say as an aside my next question is going to be for Ms. Goldway, but a couple of weeks ago, I led a congressional delegation to Afghanistan and to Pakistan, and we spent a fair amount of time with our troops up and down the country in Afghanistan. I compare their ability to communicate with their families and others back in the United States with what we faced in Southeast Asia. I remember during the Vietnam War how much we looked forward to receiving mail from our families, from home, and from friends. I lived in California at the time, and we deployed to Southeast Asia, but every week I would get the Sunday San Francisco Chronicle in the mail. It would come maybe 3, 4, or 5 days late, but I would get it. I would get the *Time* or *Newsweek* magazines. I would get bills. I received letters from family and friends. And when I was over in Afghanistan and I talked with a lot of our troops—and I just want to say how proud

I am of them, there's high morale, people are working hard to do a good job, not just for the folks in Afghanistan but for all of us.

But it is interesting. They still get some mail, but for the most part, they had cell phone service. We could not communicate by phone during the period of time when I was deployed overseas. They can communicate with their BlackBerrys or by e-mail. Some of them have Webcams so they can actually do video back home to their families. It is just a remarkable change in people's abilities to communicate. They can get their newspaper subscriptions, their magazine subscriptions, do it all electronically. Just a different world in a lot of respects.

Mr. POTTER. They cannot get those home-baked cookies other than through the mail. [Laughter.]

Senator CARPER. And they still look forward to those.

Ms. Goldway, I think you have made a number of statements recently, including, I think, at a House hearing last week, that appear to me and maybe some other observers to take a position in opposition to the Postal Service's plans to eliminate Saturday delivery and close some post offices. This is a concern to me because we expect you as chair of the Postal Regulatory Commission to be objective as you consider these issues.

Could you just give our Subcommittee your commitment that you will be approaching the hearings that your Commission will be holding on Saturday delivery and any future proceedings on post office closings and other issues with an open mind?

Ms. GOLDWAY. Absolutely. I believe entirely in the Commission's role to be the objective arbiter on this issue and to provide the Postal Service and the Congress with a fair and balanced report, to get as much information as we possibly can.

If I have erred, I think it is because I really did feel that the public was concerned that this decision had already been made, that the pronouncements made it seem as though it was a fait accompli, and I really wanted to make sure that the arguments, both pro and con, were surfaced and discussed before a decision was made.

Senator CARPER. OK. Thanks very much.

Let me just follow up with another question, if I could. I think you stated in your testimony that the Commission plans to take maybe up to 9 months to study the Postal Service's proposal related to Saturday delivery. It took a similar amount of time, I am told, for the Commission to render an opinion on a recent Postal Service proposal related to the closure of several dozen post offices. I will be real honest with you. That seems to me to be an awful lot of time either to consider the closure of a couple dozen post offices or a long period of time, frankly, for the Commission to complete its work, especially when you consider the fact that the 9/11 Commission came out with its report just 7 months after President Bush signed the bill that created it into law, and they had a whole lot more to say grace over than the Commission does in either of these instances.

So considering the fact that the Postal Service could literally run out of money during that 9-month period of time, and given the liklihood that it could run out of borrowing room some time in 2011, it is important that postal management and Congress really hear from the Commission on the advisability of finding savings by going from 6- to 5-day-a-week service. Why do you think it would take 9 months to consider the Postal Service's proposal? And can you present for the record—you do not have to do it today, but just present for the record, if you would, a detailed timeline of the Commission's plan for examining this important issue?

Ms. GOLDWAY. I really share your concerns about how long these processes take. Unfortunately, the due process requirements under this provision which require us to hold public hearings and take formal testimony make it difficult to reduce the timeline very much.

Next week, we will hold what we call a pre-hearing conference where we will hear from the participants and get a better sense of how many participants there are, how much information they are going to request. We have 11 witnesses with significant testimony that the Postal Service has presented to us, people who want to cross-examine those witnesses, take testimony of their own that they want to submit, and then there is time that the public needs to review all of those documents that are submitted to us. And when we add up the calendar, it seems to add up to a long period of time.

We did the Station and Branch Advisory Opinion in 8 months. In part, that took time because there was additional information we needed to get from the Postal Service. But in all fairness, the original proposal was to close 4,000 post offices. By the end of the process, given the public exposure that process had, the Postal Service's recommendation went down to 137. But it was a process that I think could not be shortened given the due process requirements of the law.

We will try our best, and we certainly will report to you after next week when we have developed the full schedule for the review, and we will do our best to make it as speedy and as efficient as possible given the constraints we have.

Senator CARPER. All right. Thank you. Again, I might be wrong in this, but I think the 9/11 Commission came out with its report about 7 months after former President Bush, had signed the bill that created it into law. This was a bipartisan Commission—I want to say about 10 people—chaired by Tom Kean, former governor of New Jersey, and the vice chair was Lee Hamilton. I think they came up with 70 recommendations to the Congress and to the President that they developed in that period of time. I think they did it unanimously, and we ended up adopting 45 or 50 of them. So if they can do that much and do it in that short a period of time on an issue that difficult, my guess is you all can beat that 9-month goal, and I would sure encourage you to.

Ms. GOLDWAY. We will try.

Senator CARPER. Thank you. And I look forward to your timeline.

I am going to have a couple questions for everybody, but before I do that, I want to go back to General Potter, if I can. You mentioned a couple of revenue-generating measures that you have already undertaken, and we applaud those. I think you said that there are no big revenue-generating initiatives that can help the Postal Service make progress in closing its projected budget gap, underlining the word "big." You also note in your testimony that other lines of business pursued by foreign posts, such as banking and selling cell phones and actually providing Internet service, will not help very much. In fact, I do not think we allow you to provide those kinds of services. Those are not generally allowed because they are deemed to be competitive with products and service offered by the private sector here in this country.

But let me just ask, how did you come to those conclusions, the idea that there are no big revenue-generating ideas that are out there?

Mr. POTTER. Well, we came to the conclusion, as I said earlier, with the help of the three consultants that we had: McKinsey, the Boston Consulting Group, and Accenture. And what we asked them to do was explore the marketplace and look at opportunities to grow the business. There were over 70 different ideas that were looked at, and, again, their conclusion was that in the short run they are not going to help us significantly close the gap, that in the long run we needed the flexibility. But, for example, identification cards and other things, there is a whole infrastructure that has to be put into place with a huge investment so it would take time, significant time, to build up that business. We talk internally a lot about how does growth help the business and what could we do, looking at new products.

So I think if you think about products in the private sector or anywhere in the first year if you could generate $200 million in revenue from a product, it would be significant. I mean, we are talking major products. Profit might be in the neighborhood of $100 million. So for us to close the gap, we need 70 of those. And they just do not happen. As the IG earlier testified, at some point in time these things become as much of a distraction as anything, and they do tend to divert your attention from what needs to be done. So that is why we decided, after hearing from the consultants, we were going to concentrate on the mail because both from a revenue standpoint that was our biggest opportunity to generate growth in packages and advertising mail, and from a cost standpoint that is where we have the biggest opportunity to help our financial situation by lowering our costs.

And so it was not hard to conclude that concentrating on our core business was the most important thing that we could do as a management team in the short run.

Senator CARPER. All right. What percentage of your employees are likely to be within retirement age within, say, the next 5 years or maybe within the next 10 years?

Mr. POTTER. Well, as was mentioned earlier, about half of our employees are eligible to retire.

Senator CARPER. Right now?

Mr. POTTER. Within the next 10 years some 300,000 employees will be eligible to retire. We have 600,000, slightly less, about 593,000 career employees today. We have over 100,000 people who are currently eligible, we have another 100,000 who could be optionally eligible, and another 100,000 who will become eligible over the next 10 years.

Senator CARPER. So you have roughly 600,000 employees today.

Mr. POTTER. Right.

Senator CARPER. And if you go back 10 years, 8 to 10 years ago, how many full-time employees did you have?

Mr. POTTER. We had over 800,000. About 803,000.

Senator CARPER. All right. So the workforce is down by about a quarter.

Mr. POTTER. About a quarter, yes, sir.

Senator CARPER. OK, good. Let us talk about vehicles that you use. You have, I am sure, tens of thousands of vehicles, maybe more.

Mr. POTTER. Over 200,000.

Senator CARPER. Over 200,000. Some of those are maybe new, but most of them are not.

Mr. POTTER. Most of them are old. Most of them are in the 17- to 22-year-old vehicles.

Senator CARPER. And I presume that some of the older vehicles are not especially energy efficient. Maybe they are diesel powered or gasoline powered?

Mr. POTTER. They are gas-powered vehicles that you see on the street delivering mail. The bulk of our fleet—about 140,000, 150,000—of those vehicles are gas powered.

Senator CARPER. I think you or someone mentioned earlier the percentage of your costs at the post office that are attributable to labor costs, personnel costs. Was it 80 percent?

Mr. POTTER. Eighty percent, yes.

Senator CARPER. Eighty percent. Any idea what percent of your total costs could be attributable to the cost of vehicles, purchasing, maintaining, and fueling? Any idea what that would be?

Mr. POTTER. Transportation in general is $6 billion.

Senator CARPER. And what percentage is that, about 8 or 9 percent?

Mr. POTTER. Yes, it is up there, right. Out of $70 billion, so it is in that neighborhood.

Senator CARPER. I know you all are looking at some different options with respect to vehicles in the future, and I would just be interested to hear what you are considering there, what are some of the opportunities, maybe some of the opportunities that might be out there.

Mr. POTTER. Well, the first opportunity is we have 44,000 alternate-fuel vehicles, and we are working with a couple of the big car manufacturers. We found out that they have mapped where those alternate fuels are available, and we are repositioning our vehicles to take advantage of that today.

In addition to that, we have a number of tests of electric vehicles we just put out for contract with five different manufacturers to help us design an electric vehicle that would serve the Postal Service. We have a number of tests that are being done by our engineering division on hydrogen vehicles, electric vehicles, hybrid vehicles. Basically, we are looking at them all.

Right now there is no one technology that appears to be stepping out of the pack, so to speak. We are very much engaged, though, in looking at what we use our vehicles for and what might be appropriate. So certain routes we have determined an electric vehicle would be fine, where we would come in and recharge it overnight. In other cases, depending on the distance that needs to be traveled, we might need a hybrid vehicle to satisfy our needs.

One of the things that we have concluded, though, given our history—because we have bought electric vehicles and other types of, I will call it, experimental vehicles over time. One of the things that we are very cautious about is to make sure that when we do make an investment in replacing the current fleet, we buy a commercially available vehicle because by definition a commercially available vehicle has 10 years' worth of parts and support. And we have had a number of situations where literally the manufacturer has called us up and said, "Here is your money back. We are out of business." And so we have to be very careful that when you make an investment, in 140,000 vehicles, a multi-billion-dollar investment, that it is one that will be supported over a significant period of time.

The last time we made investment in vehicles, we have the aluminum vehicles that folks see around the country. We call them our "long-life vehicle." They truly are long life. The bodies on those vehicles are still holding up. We are replacing drive trains, chassis, and the vehicles are fantastic. Actually, it was Grumman at the time who built them, and they are well designed. We want to make sure that when we do make the investment, we make as good an investment as was made 20 years ago.

Senator CARPER. OK. I want to stay on this for just a moment. You mentioned what sounded like a smart idea, and that is, moving some of your alternative-fuel vehicles to be located at places around the country where they can actually get the alternative fuels that power them.

I think we have talked about this before, but have you given any thought in your discussions with the auto companies that, given the fact that the Postal Service is everywhere, in every community across the country, and we are trying to figure out how to do a hydrogen infrastructure for fuel cell-powered vehicles, that there might be some way, some intersection there between your presence, the Postal Service's presence everywhere, and the potential need to be able to built a hydrogen infrastructure? Has there been any discussion of that?

Mr. POTTER. There have been discussions, but the major car companies I have spoken to think that the hydrogen vehicle technology is years away, and it appears to me that the technology in the short run that will be more promising is electric as battery technology improves.

Senator CARPER. Is there a potential for——

Mr. POTTER. And so there has been discussion with some electric utility companies around the country.

Senator CARPER. Talk about that for us, about the idea of vehicle to grid and just maybe give us a primer on that and how it might pertain to the Postal Service.

Mr. POTTER. Well, we do have a large fleet, and once—I really believe, after having discussed this—this is my personal opinion at some point some technology is going to win. And right now part of the challenge for someone who is a buyer of the technology is the fact that you are not sure which is going to come out. But at some point in time, every commercial van in America is going to use whatever it is, electric or whatnot. And at that point in time, then I think the market will have hydrogen fueling stations. Some of the discussions with the power companies were along the lines of when would you charge that vehicle. Could we set it up and time it such that they do not ratchet down their generation overnight, that we would be able to use it overnight?

We have even gone so far as to have discussions with people about using the batteries in our vehicles to store wind power, wind-generated electricity, and it would be able to not only take energy from the grid but also return it.

Senator CARPER. Sure. Provide the storage.

Mr. POTTER. Right, and so——

Senator CARPER. The wind does not always blow. We are looking off the shore of Delaware to deploy a windmill farm in about 2 years, and hopefully when we gather here maybe 4, 5, 6 years from now, we will have windmill farms from North Carolina up to Maine. The wind will not always blow every place up along the coast, but the idea is to link them all together. And when the wind is blowing we need the ability to store the electricity when we have more than we can use. So there might be some economic opportunity there.

Mr. POTTER. I am really excited about what I am hearing. It is a very dynamic time, and I believe that we are going to make a tremendous amount of progress in the next couple of years. I wish it were a little further along so we can make some decisions, but I think right now the best tack is to be patient and to just stay abreast of everything that is going on.

Senator CARPER. Well, I am glad to hear you are doing sort of like the five project deals. That is good.

Let me ask a question of Mr. Herr and Mr. Williams, if I can. We have let you off pretty easy here, so I will not let you slip out the door without asking you a couple questions.

The Postal Service is depending on, as we know, some very dire volume and revenue projections to aid in its planning over the coming years. I understand that these numbers came out of the work of a group of consultants, whom we have talked about already, that the Postal Service hired in the last year.

In your view, are the projections—and, that is, the loss of about 65 billion additional pieces of mail and a cumulative deficit of more than $230 billion, is that valid? And is further study needed, in your view, before we begin to act on them? Do you want to go first, Mr. Herr?

Mr. HERR. Yes, in doing the work, for our report that was released last week, we met with those consultants. We also did our own outreach with folks from the private sector, very broad outreach in terms of leading mailers and groups of that nature. And what we heard from the Boston Consulting Group in terms of their analysis was consistent with what we had heard from what other people are projecting.

One thing I would note is that their worst-case scenario is about 118 billion pieces of mail, and their most optimistic scenario is about 150 billion. So there is a range, and the lower number would reflect a more aggressive adoption of broadband technology and the Internet.

Senator CARPER. OK. Mr. Williams.

Mr. WILLIAMS. We looked at the Boston Consulting Group. They have a great reputation, and the report was impressive to us, but it was a forecast. There is tremendous background noise going on, too, because of the economic downturn and then the sort of surprising recovery. So that is tough work trying to peer into the future through that.

Senator CARPER. What did Yogi Berra say? "Never make forecasts, especially about the future." [Laughter.]

Mr. POTTER. I think he might have been right about that. But electronic diversion is real. A number of our great partners are also being devastated by the digital age that normally provide mail to us. Books and music are being downloaded and many other examples. We feel good about the accuracy of that projection. Having said that, we tried it ourselves in the context of some other work. We thought it would be about 159 and ranging on either side of that. So they tended in our minds to prop up against one another, and we think, unfortunately, that is good.

With regard to the projected losses, over $230 billion, I guess my thought there is that was an attempt to identify the universe or the boundaries of the space in which the action has to occur in order to prevent that from happening. And I think it is everyone's hope that we prevent all the losses from occurring. But if there is success, it will be inside the space of that $230 billion.

Senator CARPER. OK. One more quick question for General Potter, and then I would like to come back to you, Ms. Goldway.

We were talking with—I do not know if it was folks from the Letter Carriers—maybe it was—about continuing Saturday service, and to continue it with folks who would be working maybe as something other than full-time employees, maybe as part-time employees, maybe people who just work on Saturdays, maybe even retirees, different approaches to bring down the cost to the Postal Service of offering service on a Saturday. My recollection is somewhere we may have had a conversation where you all actually looked at that several years ago, that option. Is that a live option? Is there anything to it? Yes or no, what do you think?

Mr. POTTER. It is an option that was looked at several years ago in negotiations, and it did provide savings to the Postal Service.

Senator CARPER. I presume it would not be close to $3 billion, but would it be $1 or $2 billion? Any idea?

Mr. POTTER. It would be less than $1 billion a year, so in terms of contributions it could make, it would not close the gap as significantly as eliminating Saturday. Now, that in concert with some of the suggestions that have been made by Dave Williams and his Inspector General group that would make a contribution to help close the gap, but it is not as significant as elimination of Saturday delivery.

Senator CARPER. OK. Fair enough. Thank you.

Ms. Goldway, I think you clearly stated in your testimony, your view that the Postal Service should not base its efforts in the coming years solely on the forecasts that its consultants have provided. You also point to other studies that have shown a continued demand for hard-copy mail, which would be encouraging.

Tell us, if you will, for the record—or just tell us now, if you can, what are these studies that you cited? Can you give us a little more details on how the authors of those studies arrived at their findings?

Ms. GOLDWAY. Well, I am not sure my testimony pointed to any other studies about the continuing demand for hard-copy mail. In fact, Boston Consulting and McKinsey indicate that there is a continuing demand for hard-copy mail—not at the same levels that there is now, but they certainly do that. I have certainly spoken to American Greeting Cards and other greeting card manufacturers whose volumes declined only about 2 percent in the last couple of years, and they certainly think in their category of mail that there is ongoing strong demand for mail.

My point was that while demand for mail may be diminishing, there is still a very strong need to have a communications network that provides mail delivery, and that in order to support that delivery network, the kind of mail that is in the system has to be mail that pays its own way or, in fact, pays a great deal more, that the focus is too much on volume and not enough on value, and that we could probably talk about fewer pieces of mail as long as that mail contributed more to the system. So packages contribute more to the system, and perhaps there is more opportunity to raise prices on mail that includes the IMb and additional track-and-trace capabilities. And then there are other revenues that could support the post offices or the transportation network separate from the volume of mail itself.

I think what I really wanted to point out was that I felt that the worst-case scenario presentation that the Postal Service is basing its argument on provides a kind of negative tone, and that if we were to focus more on some of the positive things that the Postal Service can do—and they are doing many—to create a network for the 21st Century, we would be better off. And those customers who want to stay in the mail or who use the mail would think better of it than simply focusing on the doom and gloom that has gotten so much attention in the last month.

Senator CARPER. Well, we all know that the media loves to report good news. [Laughter.]

Actually, there are some good-news stories in what the Postal Service has been doing. I think managing through this diversion to electronic media, managing through the economic recession, the biggest recession since the Great Depression, and doing it in a way that they did not give anybody a pink slip, basically just did it, managed it through attrition, and flat-rate boxes and your partnerships with FedEx and UPS, those are good stories. They do not always get the attention that they deserve.

I have maybe one more for Ms. Goldway, and then maybe one or two for the entire panel, then we will break for dinner. [Laughter.]

Ms. Goldway, you said at one point, I think, in your testimony that, "We believe that the cost-cutting efforts outlined in the Postal Service's plans would result in a decrease in mail volume." Could you just go ahead and elaborate? You have spoken a little bit about this already, but just elaborate a little, if you could, your concerns in this regard.

Ms. GOLDWAY. Well, if you try to mail a package and you go to the Postal Service on a Saturday and the post office is only open from 10:00 to 12 Noon and you want to do it at 2 p.m., what are you going to do? You are going to go to FedEx, or you are going to figure out some other way to mail your package. You may not wait until Monday to do it. And the Postal Service has been reducing hours at some post offices. If you cut mail delivery, as they are proposing, 17 percent, there is bound to be some decrease in volume.

I think the biggest picture is to think of it this way: A decrease in volume for a customer—a decrease in service is kind of the equivalent of raising the price. You get less for the money. So what are you going to do? Are you going to make a decision to go ahead and use that service, or are you going to find an alternative?

So I think there is a general assumption that there is some decrease in volume and usage when you decrease delivery or decrease access. The question is the balance, and that is one of the things that the Commission does all the time when it looks at rate increases. We say, Well, there is going to be a rate increase, how is that going to affect volume? Some amount of volume is going to go out of the system when you raise the prices.

So we do that sort of evaluation now, and the point is that we have to because the Postal Service is looking at service cuts, begin to look at that evaluation with regard to service as opposed to volume in terms of these issues. Does that make sense?

Senator CARPER. Yes, I think so.

Mr. POTTER. If I could just respond to that.

Senator CARPER. Please.

Mr. POTTER. I think one of the things that is misunderstood is this whole notion of access and the fact that we are talking about increased access in our plan. People choose to focus on one aspect of access. It is when a post office is open. Well, when you look going forward at the projections for mail volume, what we are projecting is that mail volume—and, by the way, we use the best-case scenario of $150 billion in our plan, not the worst case. We are projecting that First-Class Mail volume will drop by 30 billion pieces over the next decade. The bulk of that mail is single-piece mail, so it is people who buy stamps and pay bills. We believe that much of that is going to move online. And when you think about a post office, 50 percent of what they sell today is stamps. If those stamp sales are going away, how do we maintain access to the American public and balance the cost problem that we have of keeping those places open? Well, the way to do it is sell postage and sell packages and other services in other locations that are open, sometimes 24 hours a day.

Senator CARPER. Like my supermarket?

Mr. POTTER. Like your supermarket. You know, is it 14 hours a day, 7 days a week? Provide that access in other locations, because we believe that is the way of saving revenue. Short of that, Dr. Coburn earlier talked about alternate sources of revenue, and we would like to embrace that so we could keep post offices open.

But if those avenues do not work out and if we are not allowed to pursue them legally because of competition, potentially unfair competition, with the private sector, then we have to look at ways to provide access to the American public. And we are doing that with a robust effort online—we are improving our Website—kiosks, as well as alternate locations that sell—contract postal units that sell everything that we do in the lobby with the exception of registered mail.

That is the kind of thing that we are talking about. We are talking about expanding access to grow revenue. That is part of our plan.

Senator CARPER. OK.

Mr. POTTER. Now, the 6- to 5-day delivery, obviously, people will perceive that as perhaps less service. But when 70 percent of the American public consistently in surveys that are done by *USA Today,* by the *Washington Post,* by *Rasmussen*—when they all say that that makes sense as a way to go to change a service to keep rates affordable and to keep the service going, I think we have to listen to the American public.

Ms. GOLDWAY. If I could just add that the public polls also show that even in larger numbers people support wanting to maintain their post offices. So it may well be that we need to shift a lot of access and expand access in different kinds of services in supermarkets and through the Web. But the American public has a longstanding attachment to its post offices, and I think it would be a mistake to ignore the value and the potential they have for maintaining and building a system.

Mr. POTTER. If I could just add one last thing.

Senator CARPER. Please.

Mr. POTTER. Of the 36,000 post offices we have today, 5,000 are contract postal units. The people who use those units have no idea that they are not in a post office, but they have access, greater access than they do at the current post office. And that is the concept we are looking to pursue.

So I think as the American public learns more about what the plan is, I do not think they are wedded to the building; they are wedded to be able to go to a location, pick up their mail, visit their post office boxes, pay for postage. We just have to change that concept in recognition of the cost factor in terms of our retail costs. When you put our presence in other locations, you now have people who can share duties. They can do postal work sometimes, and at other times of the day they can do other work, whatever that retail outlet is, where today in a post office by law we can do one thing: We can sell stamps, sell postage.

So, when you look at retail in general, when I walk into my grocery store, I see a bank, I see a Starbucks, I see the fact that there is traffic there and other folks are taking advantage of that traffic. Today only 600 people walk into the average post office in America, 600 people over the course of a week. That is 100 a day. When you start to think about the low end of that average, we have a lot of time where we have folks that are not that gainfully employed.

Senator CARPER. OK. Thank you. A couple more questions, and these will be for, I think, the entire panel, so Mr. Herr and Mr. Williams, put on your seat belts, here we go.

Perhaps the biggest issue on the table now, as we consider how to address the Postal Service's financial difficulties, is the Postal Service's retiree health and pension obligations. We talked a little bit about this, but I want to come back before we close and return to it.

I think Mr. Williams makes a good case in his testimony that Congress and OPM have done the Postal Service and its customers a disservice over the years in miscalculating what the Postal Service owes the Federal Government to care for postal retirees. I do not know that the Congress actually has done that. I do not think we actually calculated or miscalculated what the Postal Service owes, but somebody has, and maybe it is OPM. But it is clear that on the retiree health side I think we are way too aggressive in asking the Postal Service to pre-fund its retiree health obligations. It's maybe the most conservative approach I have ever seen, pre-funding the health obligations of an employer in this country, private sector or public sector.

I will start with you, General Potter, but let me just ask each of you if you agree that further changes, even some painful ones, will still be necessary even if we are able to address retiree health and pension issues?

Mr. POTTER. Senator, as I said earlier, depending on what the changes are, I believe that ultimately what we have put together in our package makes sense for America. If changes are made, significant changes, along the lines of what our OIG has proposed—and I have to tell you, I do not always agree with the IG, but in this case, I am 100 percent behind him.

Senator CARPER. I am not surprised. [Laughter.]

Mr. POTTER. But we could delay some of the changes, frequency of delivery and, again, depending on the magnitude of the change that is made with CSRS and retiree health benefits. But when you look out long term, the type of changes that we have been described in our plan will need to be made by the U.S. Postal Service in order to continue to be financially stable going forward.

Senator CARPER. OK. Thank you. Mr. Williams.

Mr. WILLIAMS. I think even going into the storm, for a number of reasons, some of them were just the fact that the world was moving faster and we were becoming more agile—we were way too large, even before we entered this economic downturn and the rest of the storm.

Senator CARPER. You think we were way too large, "we" being?

Mr. WILLIAMS. The Postal Service. My office is just about right, by the way. [Laughter.]

Mr. POTTER. That is an example, Senator, of where we disagree. [Laughter.]

Senator CARPER. We live in a country where about a third of us are overweight or obese. Is that where you are going with that?

Mr. WILLIAMS. I do think we owe it to our customers to have an organization that is the proper size, not larger than demand requires, and we certainly owe it to the employees to try to be as faithful to them as they have been to us. And I think that if we have time to right-size—we definitely have to right-size. And if we have time to, we certainly want to make sure that we can rely on attrition and shrinkage of things such as overtime to ride out that right-sizing exercise, which I am sure is essential.

We want to be agile. We want to be able to take on the future. For every reason in the world, we want to right-size, and we want our work rules to look forward into the future.

Senator CARPER. OK. Mr. Herr.

Mr. HERR. To me the basic premise has been that the Postal Service is supposed to be self-financing. And so if you think about the decrease in revenues, you have to realign how much Postal Service there is going to be with the revenues that are coming in.

Reflecting for a minute on your comment on retiree health care, I think Congress made that decision in 2006 which, when we look back, was the peak of mail volume. It may be the all-time peak, when there was a lot of mail, there were a lot of solicitations. I think most of us got multiple credit card solicitations on a daily basis.

Senator CARPER. From Delaware.

Mr. HERR. Well, from many places. I am not sure.

Senator CARPER. Some from South Dakota.

Mr. HERR. I cannot say I recall reading all the return addresses. But I think the point was, it was a good idea to pre-fund. It is important. As I mentioned earlier, there are close to 500,000 people getting those benefits. So pre-funding made sense, but I think it was aggressive. But it was also a time when people thought there was some surplus funding available to do that. So we believe it is important now to look at what that is, make it more affordable, but to continue, as the Postal Service can, to make those payments so that those individuals and their families and their survivors will have that benefit.

Senator CARPER. Good. Thank you. Ms. Goldway, I am going to ask you to briefly respond, if you will, and then I have at least one more question.

Ms. GOLDWAY. I think we all agree, the whole mailing community is unanimous in that the burden of the health care retiree benefit funding is overly ambitious and should be adjusted. And I think what my testimony last week and this week is trying to present is that the situation requires—for major changes, requires more time and thought than the immediate concerns of this immediate financial issue, and that in order to make the changes that the Nation wants and will accept and that really are suitable for the 21st Century, we need more time.

You mentioned that the PAEA limited the amount of opportunity the Postal Service had to provide non-postal services because there had been a record that they really had not done it very well. The introduction of new services had not gone very well in the previous 10 years. So if they are going to introduce new services, I think they need to be carefully reviewed. To the extent they need to be reviewed by the Commission, they should be. If they are going to reduce service, we have to balance what those impacts are.

I think all of us want to see a vital Postal Service, recognizing that there is lower volume, but given the ability we have to adjust the health care retiree benefit fund, I think there is a little more time. The economy should be going up, at least for the next 2 years. Even the Postal Service sees an uptick in volume, and we should take that time to make the right decisions.

Senator CARPER. I have a few more questions to ask. I am not going to ask them today, but I am going to submit them in writing and just ask you to respond to them, if you will.

You have been very good with your time today, and we thank you for sharing this much of it with us.

I want to say again to the folks who work at the Postal Service and the folks that you lead, General Potter, our appreciation to all of you for serving us, and our appreciation to all of you for serving us through difficult and trying times.

We appreciate, Mr. Williams, the work that your folks are doing and maybe pointing to an area where there may be a way to enable us to better manage right-sizing this operation and meeting financial challenges, the economic challenges that lie ahead. I hope that is true, and we will find out in the weeks ahead as we drill down on what you have proposed.

As always, to the folks at GAO, we appreciate your helping us in a whole lot of ways, including this way, providing advice and counsel to us.

And, Ms. Goldway, it is always good to be with you and to hear from you. We appreciate your commitment to service and your willingness to chair the entity that you lead.

I would just close by asking you to please do your dead level best, you and those you lead, to beat that 9-month target by a whole lot, and we would appreciate it if you could very much.

Ms. GOLDWAY. As my son says, "Got it."

Senator CARPER. All right, everybody. That is it for Earth Day 2010, and hopefully our Good Earth will be around 10 years from now and so will the Postal Service and we will all be in better shape.

Thank you very much. This hearing is concluded.

[Whereupon, at 5:26 p.m., the Subcommittee was adjourned.]

APPENDIX

FOR IMMEDIATE RELEASE

TOM CARPER

UNITED STATES SENATOR · DELAWARE

FOR RELEASE: Apr. 22, 2010
CONTACT: Emily Spain (202) 224-2441

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

HEARING: "The Future of the United States Postal Service"

Opening Statement of Senator Thomas R. Carper, Chairman

"My thanks to our witnesses and guests for joining us today. This hearing is the latest in a series that this subcommittee has held over the past several years on the Postal Service's struggles to adapt to an evolving mailing and communications industry and – more recently – to a deeply-troubled economy.

"As we all know, the economic crisis that our country has faced and, by some indications, is beginning to recover from, has impacted just about every family and business in our nation. I would argue, however, that it has damaged the Postal Service and some of its biggest customers far more than most.

"The Postal Service releases financial data every quarter. I've grown used to reading some pretty bad news in those reports. The latest report for the first quarter of fiscal year 2010 is largely, more of the same. In a period that coincides with the holiday season and is usually the Postal Service's most successful, mail volume was down compared to the previous year, resulting in a loss of just under $300 million. And even these dismal results are, unfortunately, slightly better than many observers feared. The Postal Service tells me that while some sectors of our economy have shown signs of recovery, businesses and the public at-large are not rushing back to hard-copy mail – at least not yet.

"During the depths of the recession, the Postal Service hired some very well-respected consultants to look at its business model and the future of the mail. Their findings make it clear – at least to me – that we should not count on growing mail volume in the coming years to fix the Postal Service's financial difficulties.

"According to data released in early March by the Postal Service, even when the economy picks up steam, mail volume is expected to increase only slightly from where it is now. However, electronic diversion of the mail is expected to continually increase over the next decade or so. By 2020, I'm told that mail volume could be as low as 118 billion pieces. That is nearly 60 billion fewer pieces than the Postal Service handled in 2009 and 95 billion pieces fewer than we saw in 2006 – the busiest mailing year we've seen to date. This trend,

ph44585 on D330-44585-7600 with DISTILLER
VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00041 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
57329.001

according to the Postal Service, will lead to more than $230 billion in cumulative deficits between now and 2020.

"I know that this is just one group of consultants' estimate of where things are headed for the Postal Service. And in many ways, it's a worst-case scenario because it assumes that the Postal Service won't be able to attract significant new revenue through innovation and new products and services. It also assumes that Congress will not act to address certain key issues, such as the Postal Service's retiree health obligations.

"These dire predictions, of course, must be analyzed before we take dramatic actions to fundamentally change the nature of the Postal Service. That said, we would be foolish if we were to hesitate and hope for a return to the golden years of the 1990s and early 2000s.

"We need to face the reality of today. As technology advances, more and more Americans will take advantage of e-mail, electronic bill pay and other innovations to communicate, conduct business and even read periodicals that once arrived in their mail box.

"In addition, we need to realize that the day of reckoning for the Postal Service may not come in 2020 or some other distant date. It could come next year. I understand that if the Postal Service does not receive some sort of assistance from Congress in the very near future, it could run out of cash and borrowing room at some point in 2011. This would put the Postal Service's ability to meet payroll and deliver the mail our nation counts on in great danger.

"So it is imperative that Congress, the administration, the Postal Service and other stakeholders work together in the coming weeks and months to develop a package of reforms and adjustments that can get the Postal Service through this immediate crisis while setting the stage for longer-term changes. In doing this, we must set aside the old biases and parochial interests that influenced and, in some cases, hindered previous postal reform efforts. Instead, we must concentrate on preserving the service that postal employees provide to the American people.

"Some of the changes we should make are plain common sense. For starters, we should restructure the aggressive, front-loaded retiree health pre-funding schedule that was included in the 2006 postal reform bill. That payment schedule was developed when mail volume was high and was written into law long before the current recession began at a time when electronic diversion of the mail was expected to progress more slowly than it appears to be occurring today.

"We should also carefully examine the Postal Service Inspector General's contention that the Postal Service has significantly overpaid its obligations to the old Civil Service Retirement System. If his findings are accurate, fixing this error could go a long way towards addressing the Postal Service current and future challenges.

"I must point out, however, that addressing these retiree health and pension issues won't end our work. The savings that would be generated by those fixes would cover only a portion of

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00042 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.002

the Postal Service's long-term deficits. It would be irresponsible, then, to ignore or significantly delay the more difficult changes that will need to occur.

"One of these changes could be the elimination of Saturday delivery, which the Postal Service formally proposed doing at the end of last month. According to the Postal Service, moving to five-day delivery could save the Postal Service more than $3 billion a year. We need to spend some time examining the details of what the Postal Service has put forward but I'm not aware of any changes, structural or otherwise, that would save this much money and help the Postal Service preserve the quality of service it provides throughout the week.

"The other difficult change that could come in the future is the transformation of the Postal Service's network of retail facilities. The Postal Service currently maintains more than 36,000 post offices and other retail units. Postal management envisions replacing a good number of these facilities with alternate retail options. This could involve increased Internet sales and the use of unmanned postal kiosks. It could also involve providing postal retail access in grocery stores or other businesses that are open longer hours and are more likely to be located in areas where postal customers -- and potential postal customers – conduct their business and live their lives.

"I think this is a very interesting proposal that, if executed well, has the potential to actually expand retail access while saving money too.

"Both of these efforts – the move to five-day delivery and the restructuring of the Postal Service's retail network – will be hampered, unfortunately, by roadblocks that Congress places in the Postal Service's way. I've stated many times that Congress doesn't do a good job behaving like a 535-member board of directors for the Postal Service. In the 2006 postal reform bill, we tried to give the Postal Service the ability to operate more like a business – including allowing them to adjust delivery speed and frequency over time in response to changes in the market.

"We need to do our oversight and be certain that the Postal Service is on the right path. But it is long past time for us to get out of the way and allow postal management to take the steps that need to be taken to adjust to the new reality that the Postal Service faces."

###

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00043 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.003

STATEMENT OF SENATOR JOHN MCCAIN, ACTING RANKING MEMBER

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

"The Future of the U.S. Postal Service"

April 22, 2010

Senator Carper, thank you for holding this hearing today on the future of the U.S. Postal Service. Let me also thank our witnesses for being here today to help identify a comprehensive solution to the Postal Service's continuing fiscal crisis.

The Postal Service is experiencing déjà vu, once again facing an estimated $7 billion loss at the end of this fiscal year amid a continuing, steep decline in mail volume. It will draw down another $3 billion from its line of credit with the U.S. Treasury, yet still be so strapped for cash that it will not be able to both make retiree health benefit trust fund payments <u>and</u> meet October's payroll. It also continues to face huge obstacles in reducing excess capacity and labor costs, which account for an astronomical 80% of overall expenses.

There is no doubt the Postal Service's current business model is unsustainable. The evolution of electronic communications and the effects of an economic recession has left it financially crippled. If the Postal Service, its employees, and Congress do not make tough choices, taxpayers will end up picking up the tab. In these times of runaway government spending and soaring federal deficits, another taxpayer bailout is simply not an option.

The Government Accountability Office recently issued a comprehensive report on options for Postal Service reform. Strategies include reducing compensation and benefits costs; reducing other operations and network costs

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00044 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

pt44585 on D330-44585-7600 with DISTILLER

57329.004

while improving efficiency; and generating revenues through product and pricing flexibility. Aggressive implementation of these strategies and options will allow the Postal Service to make considerable strides toward financial viability. Unfortunately statutory, regulatory, and collective bargaining barriers prevent it from moving full speed ahead.

Currently, the Postal Service is statutorily required to pay wages and benefits comparable to the private sector, yet it does not have the workforce flexibility of the private sector. It cannot layoff employees during business downturns. It is restricted in its outsourcing capabilities. It cannot assign idle employees to perform tasks outside their designated craft. And, the Postal Service must pay for health and life insurance benefits greater than those offered by other federal agencies.

Moreover, in attempting to reduce operating and network costs by closing unneeded facilities and adjusting delivery standards, the Postal Service has hit major roadblocks. Since 1983, Congress has mandated that mail be delivered six days a week regardless of mail volume. Additionally, Congress has prevented the closing of certain postal facilities for no other reason than to maintain jobs in certain Members' districts.

The Postal Service is at a critical crossroads. Projections indicate an accumulated deficit of $238 billion over the next 10 years if the Postal Service continues down its current path. Congress cannot simply grant another waiver for the required payment into the retiree health benefit trust fund and defer the issue until next year.

I call on the Postal Service take more aggressive action to reduce costs and increase revenue. I call on the employee unions to be flexible in collective bargaining negotiations. And I urge my colleagues to lift legislative restrictions that prevent the Postal Service from reaching maximum operating efficiency.

Thank you again, Mr. Chairman.

Opening Statement Of Senator Tom Coburn
FFM Postal Hearing
April 22, 2010

Good afternoon. Thank you to Senator Carper for holding this hearing, and thank you to our witnesses for joining us.

Today we are here to examine the financial future of the Postal Service. It is my opinion, that the financial future of the Postal Service is bleak if Congress, the Postal Service, Postal unions, and the mailing industry do not make tough choices and take fast action to ensure the long-term viability of the Postal Service.

At the heart of the problem is a business model that is broken. The primary source of revenue for the Postal Service, first class mail, continues to fall at alarming rates and shows no signs of ever recovering.

Many have tried to blame this on the bad economy, but while this has played a part in mail volume decline, the fact is, the younger generations no longer use the Postal Service to pay bills or even communicate through letters or cards.

In fiscal year 2009, total mail volume declined by 26 billion pieces, while revenue dropped nearly $7 billion. From fiscal years 2007 to 2009 the Postal Service incurred close to $12 billion in losses. According to the Postal Service, over the next 10 years they will face a staggering $238 billion shortfall. By 2020, they are projected to lose 33 billion annually.

Mail volume is projected to fall from 177 billion in 2009 to 150 billion in 2020. That represents a 37 percent decline in First-Class Mail alone. In my opinion, the numbers for mail volume decline and revenue losses are optimistic under the current business model.

On March 2, 2010, Postmaster General Potter released a 10-year plan titled: "Ensuring a Viable Postal Service for America." The plan is meant to address the declining mail volume and revenues, as well as be a tipping point to drive discussion within the Postal Community, which includes a $900 million industry and employs close to nine million people, and Congress on how to "fix" the Postal Service. While I don't believe it is the ticket out of this financial mess, I think it is a good starting point but much more needs to be done.

The Postal Service must be given the necessary authority and flexibilities to address its exorbitant labors cost. This is one area that the postal reform bill did not address adequately. That being said, the Postal Service shares in the blame for their high labor costs. The current strategy of cost reduction through workforce attrition and early retirement will not be enough. Congress and the Postal Service must use every tool at our disposal, including reducing benefits and to bring these costs down to a more manageable level.

In addition, the Postal Service must be given greater flexibilities in introducing new forms of revenue to allow it to better respond to the ever changing world and compete more effectively in the marketplace.

We in Congress and the Postal Service can no longer choose to support temporary fixes to sustain the Postal Service for short periods of time. If we continue to act in this irresponsible way, the American taxpayer will be the one that ultimately suffers. We must make hard choices now so future generations of Americans will have a viable Postal Service.

I would again like to thank the witnesses for being here and look forward to their testimony.

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

For Release on Delivery
Expected at 2:30 p.m. EDT
Thursday, April 22, 2010

U.S. POSTAL SERVICE

Action Needed to Facilitate Financial Viability

Statement of Phillip Herr, Director
Physical Infrastructure Issues

GAO
Accountability * Integrity * Reliability

GAO-10-601T

April 22, 2010

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-10-601T, a testimony to the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated significantly during fiscal years 2007 through 2009. USPS was not able to cut costs fast enough to offset declines in mail volumes and revenues resulting from the economic recession and changes in the use of mail, such as electronic bill payment. In July 2009, GAO added USPS's financial condition to its high-risk list and reported that USPS urgently needed to restructure to improve its financial viability.

The Postal Accountability and Enhancement Act (PAEA) of 2006 required GAO to evaluate strategies and options for USPS's long-term structural and operational reform and report by December 2011. Because of USPS's financial crisis and the need for urgent action, GAO accelerated its work and issued a report (GAO-10-455) on April 12, 2010.

This testimony provides
(1) information on USPS's financial condition and outlook and
(2) GAO's perspective on the actions that are needed to facilitate progress toward USPS's financial viability. This testimony is based on GAO's recently issued report and recent testimonies on USPS's financial condition and outlook.

View GAO-10-601T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

U.S. POSTAL SERVICE

Action Needed to Facilitate Financial Viability

What GAO Found

USPS is facing a major financial crisis. Mail volumes, the primary source of USPS revenues, declined by 36 billion pieces (about 17 percent) over the last three fiscal years (2007 through 2009). Mail volume declines were largely due to the economic downturn and changing use of the mail linked to the continuing shift to electronic communications and payments. USPS's financial outlook is poor as it projects future declines in mail volumes, stagnating revenues, large financial losses, increasing debt, and significant financial obligations, including for retiree health benefits. USPS projects a record loss of over $7 billion in fiscal year 2010. Furthermore, USPS expects to borrow $3 billion, bringing its total outstanding debt to $13.2 billion, close to its $15 billion statutory borrowing limit with the U.S. Treasury. Looking forward, USPS projects that by fiscal year 2020, total mail volume will further decline by 15 percent, to the lowest level since 1986. Absent additional actions to cut costs and increase revenues, USPS expects financial losses will escalate over the next decade.

GAO recently reported that making progress toward USPS's financial viability would primarily involve taking action to rightsize operations, cut costs, and increase revenues. Making the necessary progress would require USPS and Congress to pursue strategies and options that would

- reduce compensation, benefits, and other operations and network costs using the collective bargaining process to address wages, benefits, and workforce flexibility, as well as generating revenues through pricing and product flexibility; and
- address legal restrictions and resistance to realigning USPS operations, networks, and workforce.

USPS included many of these strategies and options in the action plan it issued in March 2010, but these planned actions under its existing authority will not be enough to make it financially viable. Therefore, action by Congress and USPS is urgently needed to

- reach agreement on actions to achieve USPS's financial viability;
- provide financial relief through deferral of costs by revising USPS retiree health benefit funding while continuing to fund these benefits over time to the extent that USPS's finances permit; and
- require that any binding arbitration resulting from collective bargaining would take USPS's financial condition into account.

To facilitate reaching agreement about the difficult constraints and legal restrictions that hamper progress, Congress could consider establishing a panel of independent experts, similar to the approach used by the Department of Defense's Base Realignment and Closure (BRAC) Commission, to coordinate with USPS and stakeholders to recommend a package of proposed legislative and operational changes needed to reduce costs and address challenges to USPS's business model.

United States Government Accountability Office

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00049 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.009

Mr. Chairman and Members of the Subcommittee:

I am pleased to participate in this hearing on the U.S. Postal Service's (USPS) financial condition, a topic we have addressed in recent reports and testimonies. My statement will provide (1) information on USPS's financial condition and outlook and (2) our perspective on the actions that are needed to facilitate progress toward its financial viability.

My statement is primarily based upon our report released last week on USPS's business model.[1] The report responded to a provision in the Postal Accountability and Enhancement Act of 2006 (PAEA) that required GAO to evaluate strategies and options for the long-term structural and operational reform of USPS.[2] We also drew on our recent testimonies on USPS's financial condition and outlook and our July 2009 report in which we added USPS's financial condition to our high-risk list.[3] For our recent report, we primarily drew on this past work; other studies; USPS data; interviews with USPS, unions, management associations, Postal Regulatory Commission (PRC), and mailing industry officials; and stakeholder input. We conducted our work in accordance with generally accepted government auditing standards. Additional information on scope and methodology is available in each full product. Related GAO reports and testimonies are listed in the attachment to this statement.

USPS's Financial Condition Has Deteriorated and Its Financial Outlook Is Poor

USPS is facing a major financial crisis. Mail volumes, the primary source of USPS revenues, declined by 36 billion pieces (about 17 percent) over the last 3 fiscal years (2007 through 2009). In particular, First-Class Mail and Standard Mail—which together accounted for 94 percent of volume and about 78 percent of revenue in fiscal year 2009—experienced major declines. These declines were largely due to the economic downturn and the continuing shift to electronic communications and payments.

Both USPS and Congress took actions in fiscal years 2007 through 2009 to help offset these declines by reducing billions in USPS costs. For example,

[1]GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

[2]Pub. L. No. 109-435, §710, 120 Stat. 3198 (Dec. 20, 2006).

[3]GAO, *High-Risk Series: Restructuring the U.S. Postal Service to Achieve Sustainable Financial Viability*, GAO-09-937SP (Washington, D.C.: July 28, 2009). USPS's transformation efforts and long-term outlook were on our high-risk list from 2001 to 2007.

- USPS achieved nearly $10 billion in cost savings during this time, primarily by cutting nearly 201 million work hours. Work-hour savings were achieved by workforce reductions of over 84,000 full- and part-time employees, primarily through retirements; reduced overtime; and changes to postal operations.

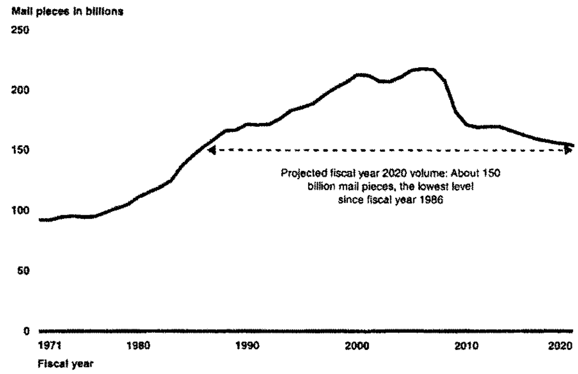
- Congressional action late in fiscal year 2009 deferred $4 billion in payments USPS was mandated to make to prefund postal retiree health benefits.[4]

These actions, along with others to generate additional revenues, however, were insufficient to fully offset the impact of mail volume declines and rising personnel-related costs. As a result, over this 3-year period, USPS borrowed the maximum $3 billion each year from the U.S. Treasury and still incurred record net losses, cumulatively losing nearly $12 billion.

USPS's financial problems are likely to continue unless fundamental changes are made to address challenges in its current business model by better aligning costs with revenues. USPS projects future declines in mail volumes, stagnating revenues, large financial losses, increasing debt, and significant financial obligations. For example, total mail volume for the first quarter of fiscal year 2010 was down almost 4.4 billion pieces, a decrease of almost 9 percent over last year. For fiscal years 2010 and 2011, USPS is already projecting annual deficits exceeding $7 billion, creating additional pressures to generate sufficient cash to meet its obligations. USPS expects to borrow $3 billion in fiscal year 2010, which would bring its total outstanding debt to $13.2 billion, close to its $15 billion statutory limit, which it could reach as early as fiscal year 2011. Moreover, USPS projections through fiscal year 2020 indicate that total mail volume is not expected to return to its former levels (see fig. 1).

[4] Pub. L. No. 111-68, §164, 123 Stat. 2023 (Oct. 1, 2009).

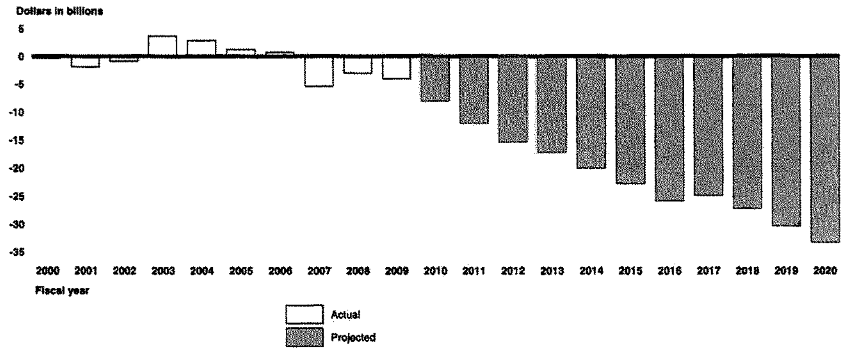
Figure 1: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020



Source: USPS.

USPS projects that financial losses will escalate over the next decade, with cumulative losses of over $238 billion by fiscal year 2020 if its planned cost reduction and revenue generation initiatives are not implemented (see fig. 2).

Figure 2: USPS Actual and Projected Net Income (Loss), Fiscal Years 2000 through 2020



Source: USPS.

Note: The projection for fiscal year 2010 is from USPS's Fiscal Year 2010 Integrated Financial Plan. USPS projections for fiscal years 2011 through 2020 are from its *Action Plan* and assume that (1) USPS takes no management actions beyond those in its fiscal year 2009 budget and (2) USPS's total statutory borrowing limit of $15 billion would be increased to accommodate these losses. USPS's $8.4 billion in cumulative net income for fiscal years 2003 through 2005 largely resulted from a 2003 law (Pub. L. No. 108-18) that reduced USPS pension benefit payments by about $9 billion over this period.

These financial challenges highlight deficiencies in USPS's business model, which is predicated on fulfilling its mission through self-supporting, businesslike operations. The financial and operational challenges facing USPS have been exacerbated by the recent economic downturn. Because of these challenges, in July 2009, we placed USPS's financial condition on our high-risk list and testified that restructuring is needed to enhance USPS's current and long-term financial viability.[6] We concluded in our most recent report that its business model is not viable because it is unable to reduce costs sufficiently in response to continuing mail volume and revenue declines. We continue to believe that major restructuring is necessary and not doing so will increase the risk that taxpayers and the U.S. Treasury will have to provide financial relief.

[6]GAO-09-937SP and GAO, *U.S. Postal Service: Broad Restructuring Needed to Address Deteriorating Finances*, GAO-09-790T (Washington, D.C.: July 30, 2009).

Actions Congress and USPS Can Take to Facilitate Progress toward Financial Viability

Action by Congress and USPS is urgently needed in a variety of areas to facilitate progress toward USPS's financial viability. We have identified a variety of strategies and options that can be taken to address these challenges. Some of these strategies can be completed within USPS's current authority, while others would need congressional involvement or require collaboration with unions through collective bargaining. The strategies fall into three major categories:

- reducing compensation and benefits costs,
- reducing other operations and network costs and improving efficiency, and
- generating revenues through product and pricing flexibility.

Other options that Congress may want to consider would more comprehensively restructure USPS's statutory and regulatory framework to reflect business and consumers' changing use of the mail. Although our report did not focus on whether USPS's ownership structure should be changed, we identified the following questions that could be helpful when considering this framework:

- *Mission:* What universal postal service, including mail delivery and postal retail service, is appropriate in light of fundamental changes in the use of mail?
- *Role:* Should USPS be solely responsible for providing universal delivery and postal retail service, or should that responsibility be shared with the private sector?
- *Monopoly:* Does USPS need a monopoly over delivery of certain types of letter mail and access to mail boxes to finance—in part or wholly—universal postal service?
- *Governance and regulation:* What is an appropriate balance between USPS's managerial flexibility and the oversight and accountability provided by the current governance and regulatory structure?

To facilitate progress going forward, it will be critical for USPS and Congress to reach agreement with other stakeholders on major issues that impede USPS's ability to implement actions to reduce financial losses, such as the following:

- *Funding postal retiree health benefits:* USPS has said that it cannot afford its required prefunding payments, and several proposals have been made to defer costs by revising the statutory requirements. It is important that USPS fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. In revising the requirements, it will be important to consider what is affordable to USPS; what is a fair balance of payments between current and future ratepayers; and what impact such changes could have on the federal budget.[6]

- *Binding arbitration:* One of the most difficult challenges is making changes to USPS's compensation systems, which will be critical to its financial condition since wages and benefits represent 80 percent of its costs. USPS and its employee unions will begin negotiations for new agreements in 2010 and 2011. In this regard, the time has come to reexamine the structure for collective bargaining that was developed 40 years ago. Since that time, USPS's competitive environment has changed dramatically, and rising personnel costs are contributing to escalating financial losses. Thus, Congress should consider modifying the collective bargaining process to ensure that any binding arbitration takes USPS's financial condition into account.

- *Realigning postal services with changing use of the mail:* As mail use by businesses and consumers continues to change, USPS has stated that it cannot afford to provide the same level of services. For example, it has estimated that costs could be reduced by about $3 billion annually if delivery frequency is reduced from 6 days to 5 days per week, but congressional action would be needed to remove statutory requirements for 6-day mail delivery. USPS filed its proposal to eliminate Saturday delivery with the PRC on March 30, 2010. This action will allow public input on this issue and lead to a PRC advisory opinion.

- *Generating revenue through new or enhanced products and services:* A key issue is whether USPS can make sufficient progress using the pricing and product flexibility provided in PAEA or if changes are needed. In 2009, USPS asked Congress to change the law so that it could diversify into nonpostal areas to find new opportunities for revenue growth. USPS and stakeholders we collected information from offered many options for diversification into nonpostal areas, including banking, financial, insurance, and government services, either on its own or in partnership

[6]See GAO-10-455 for a discussion of different approaches for funding USPS's retiree health benefit obligations.

with other private firms or government agencies. USPS also asked for additional pricing flexibility in a recently issued *Action Plan*.[7] However, it is unclear what the potential impacts of such changes would be and what statutory or regulatory changes would be needed.

- *Realigning operations, networks, and workforce:* Once Congress and USPS have determined what, if any, changes should be made in the products and services that it provides, postal operations, networks, and workforce would need to be realigned. Decisions in this area will involve difficult tradeoffs related to reducing USPS's size so as to remain self-financing and keep prices affordable, versus concerns about how such realignments would affect its workforce, the value of USPS's brand, and its network of physical assets.

When we placed USPS on our high-risk list, we suggested that USPS develop and implement a broad restructuring plan that would identify specific actions planned, key issues to address, and steps Congress and other stakeholders needed to take. On March 2, 2010, USPS issued an *Action Plan* that identified seven key areas in which it would need legislative changes or congressional support. Many of the options discussed are similar to those we have analyzed and included in our recent report. USPS's plan indicates that actions within its control can close $123 billion of this financial gap, but that actions outside its existing authority—including some involving statutory changes—will be needed to eliminate the remaining financial gap. Progress on these issues will likely take several years to fully implement once a decision is made on the scope of needed changes.

Congress, USPS, and other stakeholders need to reach agreement on the actions that should be taken, the desired operational and financial results, and the time frames for implementation. Key questions that need to be addressed include the following:

- *Universal service:* What, if any, changes are needed—that is, should delivery services be changed (e.g., frequency or standards), and should retail services be moved out of post offices to alternative locations?

[7] United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C.: March 2010). USPS's plan and related material are available at the following Web address: http://www.usps.com/strategicplanning/futurepostalservice.htm (accessed on Apr. 9, 2010).

- *Realigning operations, networks, and workforce:* How should USPS optimize its operations, networks, and workforce to support changes in services? How quickly can this happen? How can USPS best work with its employees and customers to minimize potential disruption?

- *New products and services:* What opportunities are there to introduce profitable new postal products and enhancements to existing ones? Should USPS engage in nonpostal areas where there are private-sector providers? If so, under what terms?

In our recent report, we stated that to facilitate progress in difficult areas, such as realigning operations, networks, and workforce, Congress may want to consider an approach similar to that used by the Department of Defense's Base Realignment and Closure (BRAC) Commission. USPS agreed with the report's key findings but raised concerns about using a BRAC-type panel and its timing. Congress has previously turned to panels of independent experts to assist in restructuring organizations that are facing key financial challenges. These panels have helped establish consensus and developed proposed legislative or other changes to address difficult public policy issues. Establishing a similar commission or control board of independent experts could provide a mechanism to assist Congress in making timely decisions and comprehensive changes to USPS's business model and operations.

In addition to establishing a panel, our report included two other matters for Congress to consider to address USPS's financial viability in the short term:

- Modify USPS's retiree health benefit cost structure in a fiscally responsible manner.

- Revise the statutory framework for collective bargaining to ensure that binding arbitration takes USPS's financial condition into account.

The current crisis presents an opportunity to act and position this important American institution for the future. The longer it takes for USPS and Congress to address USPS's challenges, the more difficult they will be to overcome.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Committee may have.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00057 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.017

UNITED STATES POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL/CEO JOHN E. POTTER
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES,
AND INTERNATIONAL SECURITY
UNITED STATES SENATE

APRIL 22, 2010

Good afternoon, Mr. Chairman and members of the subcommittee. For the past two years, I have testified about the dire financial circumstances facing the United States Postal Service. Once again, I am here to report that our financial situation is precarious, mail volumes continue to decline, and the cost of delivering mail to each address continues to increase. While all postal stakeholders are aware of these circumstances, I am concerned that there is insufficient appreciation for the long-term financial peril that the Postal Service faces. Expert, independent analysis clearly shows an open-ended decline in mail volume and the revenues associated with it. The foundation of our self-sufficient business model has been swept aside by a digital communications revolution and a severe economic crisis. While our Nation will continue to rely on a dedicated delivery network offering universal service, it cannot be supported now and in the future by a business model based on increasing volumes and revenue. Today, the Postal Service stands on the brink of financial insolvency. Without significant and immediate changes, this pattern of constant financial distress will continue unabated for years to come.

Over the past several months, I have had many discussions with members of Congress, Administration officials, business mailers, chief executive officers, and consumers about our financial plight and the action needed to address it. Too much attention has been focused on short-term financial fixes, such as an adjustment to our retiree health benefits fund, or a single, significant service change, such as five-day delivery. Too little attention has been paid to the need for other, significant, across-the-board changes to our regulatory and legal framework. An independent examination of the postal marketplace projects an annual Postal Service loss of $33 billion in 2020 and cumulative losses of $238 billion over the next ten years, if we make little or no changes. A piecemeal approach with short-term financial relief only delays the inevitable, and impedes our ability to maintain productive and efficient operations. Without bold, decisive, and comprehensive action by this Committee and Congress, the Postal Service will face continual financial peril.

Before I discuss the Postal Service's action plan for the future, I would like to call your attention to a study conducted by our Office of Inspector General (OIG) regarding overpayments by the Postal Service to the Civil Service Retirement System (CSRS) pension fund. Given the significance of the OIG's findings, it is imperative that this matter be given prompt consideration by Congress and the Administration. Failure to resolve this matter quickly will have an adverse effect on Congress' ability to consider other legislative proposals beneficial to the Postal Service. It should also be noted that any financial adjustment to the Postal Service's CSRS fund would not eliminate the need for the changes proposed in our action plan, but it could influence the timing of their implementation.

The OIG looked at employees who worked for both the pre-1971 Post Office Department and the U.S. Postal Service. The report reviewed how the retirement obligation for those employees was divided. The CSRS provides annuities based on the employees' highest three-year average base wage and an increasing percentage credit for years of service. When calculating the Postal Service's portion of the obligation, the Office of Personnel Management (OPM) apportioned the obligation based only on the service and base salaries at the time of postal reorganization in 1971. OPM determined that the effects of future salary increases on the amount of the total pension obligation were not the responsibility of the federal government. The OIG maintains that the responsibility for pre- and post-1971 pension costs should be divided between the federal government and the Postal Service in a more reasonable manner. Such a calculation would recognize the future earning potential of postal employees at the time of the 1971 reorganization. The OIG study concluded that the Postal Service was overcharged $75 billion. We have asked the Postal Regulatory Commission (PRC) to retain an actuary in reviewing this matter, and to submit their findings to Congress.

The Postal Service supports the OIG recommendation that the Postal Service and the federal government split the total pension obligation for an employee's civilian service based on years of employment completed pre- and post-1971. This "years of service" method would divide pension liabilities in a far more equitable manner than the current system. OPM currently uses the "years of service" method in allocating health care premiums for retirees. Moreover, the CSRS overpayment could be transferred to finance the Postal Service's Retiree Health Benefits Trust Fund. We are asking Congress to amend the *Postal Act of 2006* to do the following:

- Require OPM to use of the methodology recommended by the OIG;
- Allow the transfer of the funds from the CSRS Trust Fund to the Retiree Health Benefits Trust Fund;
- Eliminate the annual average retiree health benefits pre-payment of $5.5 billion;
- Allow the annual premiums for existing retirees to be paid from the Retiree Health Benefits Trust Fund before 2017; and
- Allow the Postal Service to begin to pay the "normal" cost for its current employees.

This would mean that the Postal Service would be fully funded for both its retirement systems, as well as its health benefit obligation. And, since the Postal Service would be paying the normal cost for current employees, the Postal Service would continue to be fully funded for its retiree health benefits obligation. This change would save the Postal Service roughly $4.6 billion annually.

The OIG report states that "freeing the Postal Service from unjustified legacy costs is critical if the Postal Service is to have the agility it needs to face an uncertain future." It is the right thing to do, and I urge you to take a close look at this critical issue. To be clear, I believe the changes proposed in our plan are inevitable. Adoption of the OIG's recommendation would, however, affect the timing of when these options would need to be implemented.

In regard to our action plan for the future, the Postal Service Board of Governors and postal management have acted vigorously in responding to the ongoing nationwide economic crisis and electronic diversion that has so dramatically eroded mail volume in recent years.

We have done so by embracing innovation. Last week, for example, we announced a new product test—Postage Paid Greetings—with our partner, Hallmark. This product, which is made possible by our Intelligent Mail barcode (IMb), allows customers to purchase a greeting card with postage included in the price. The unique IMb on each card allows Hallmark to pay the postage expense when the card is mailed. Postage Paid Greetings provides convenience to the customer, while it enhances cash flow for Hallmark and the Postal Service.

We have offered innovative pricing incentives. Consider Priority Mail. We now have the ability to offer contract pricing to commercial customers. With contract pricing we can compete more effectively with private carriers on price. This has allowed us to grow our shipping and mailing business during a challenging economic time. Still another service innovation is the adoption of cubic pricing—which gives our commercial mailing customers even more choice. Cubic pricing is the commercial version of the Flat Rate box.

The successful Summer Sale of 2009, which provided mailers a pricing discount on incremental advertising mail volume, generated nearly 1 billion additional pieces of mail. With that kind of success, we are moving forward in launching the Summer Sale of 2010 and have adopted other sales innovations for our commercial mailers interested in high density mailings.

Embracing innovation also extends to other aspects of our business such as sustainability. This summer we will be testing five different electric vehicles as part of our research and development in seeking electric conversion solutions for the future. These tests will provide valuable information on what concepts might work to best transition our aging Long Life Vehicle fleet.

We are not standing still. We have devoted this same effort in crafting a way forward in light of these circumstances. We used all the resources at our disposal to study current and future economic trends. We asked for an independent examination of the postal marketplace, projections for the future, and recommendations to address the financial and service problems we face. We sought the advice and counsel of the entire postal community in designing a path for the future that preserves affordable, universal mail service.

The results are both encouraging and sobering. While mail volume will continue to drop and postal revenues will remain stagnant over the next ten years, we can still maintain a viable and healthy Postal Service. With increased operational flexibility and reasonable adjustments to our legal and regulatory framework, the Postal Service can continue to provide quality mail services for years to come. On the other hand, this comprehensive analysis revealed that "doing nothing" or "doing little" are not options. Failure to act will only worsen our financial crisis. Applying short-term fixes will intensify the budgetary difficulties the Postal Service will face in succeeding years. Our proposals for changes must be considered in their entirety, as it will take many years for us to reap the cost reduction and revenue generation benefits of these actions.

The Action Plan that we have constructed takes into account the fact that American commerce is rapidly evolving in ways that will change our product and customer mix. While we are committed to a smooth transition for customers who have expressed their intent to leave the postal system, we must focus our energy toward customers who will continue to use the postal system well into the future. To do this, hard decisions must be made now to right-size a postal service that will meet the obligation for universal service while serving the mailing community of the future.

I am confident that the Congress, the PRC, the Government Accountability Office (GAO), the mailing community, and consumers are committed to the long-term sustainability of the Postal Service. Together, we can make the difficult, yet necessary, decisions to maintain an effective, universal mail network.

Mr. Chairman, we have compiled the results of these studies and our recommendations for change in a document entitled "*Ensuring a Viable Postal Service for America: An Action Plan for the Future.*" I ask that our action plan be included in the hearing record.

To help develop this plan we engaged three of the world's most experienced and respected management consulting firms: McKinsey & Company, The Boston Consulting Group, and Accenture, LLC. We asked each of these firms to act independently and to conduct studies and have conversations with postal customers, mailers, labor associations, regulators, and mailing industry stakeholders. We wanted them to gather information to help us determine the likely state of the mailing industry and the Postal Service over the next decade. Our expectation was for the consultants to produce ideas that would allow the Postal Service to close the growing gap between revenues and expenses without undue impact on stakeholders.

The consultant's key findings included:

- Without fundamental changes, the Postal Service's losses will continue. By 2020, cumulative losses could exceed $238 billion.
- Mail volume will decline by roughly 15 percent to about 150 billion pieces in 2020, from 177 billion pieces in FY 2009.
- The mix of mail will change; First-Class Mail will fall sharply and Standard Mail will stay fairly flat. First-Class Mail contributes more toward covering institutional costs, which support retail, processing, and delivery networks.
- The Postal Service could close the gap by as much as $123 billion, without statutory or regulatory changes, by taking product and service actions, continuing to improve processes and productivity, adopting workforce flexibility improvements, and pursuing purchasing savings. Achieving this will be extremely challenging.
- There are no multi-billion dollar, revenue initiatives that the Postal Service could pursue, inside or outside of our core competencies. Nor do the business models of foreign posts offer any short-term, practical applications for generating revenue here in the U.S.
- Key areas within our core functions have been identified and options provided to close the remaining $115 billion gap. However, legislative and regulatory changes are needed to achieve them.
- The best way to address the financial challenges and preserve the strength of the Postal Service and the entire mailing industry is through a comprehensive approach that balances the needs of all key stakeholders.

The Postal Service created its action plan based on a thorough review and consideration of the consultants' recommendations. Management and the Board of Governors can take actions that will close $123 billion of the $238 billion projected gap.

And, we are taking action to implement our plan. Through March of this year, we have reduced approximately 50 million workhours, the equivalent of 28,000 full-time employees. Last year, through our Area Mail Processing consolidations we were able to achieve $28 million in cost savings. This year we are reviewing consolidations at approximately 33 facilities, which could lead to further cost savings. We're studying real estate holdings and assets to determine which facilities it makes sense for us to sell or where we should terminate our leases. Year to date, we have reviewed 950 buildings and, so far, we have realized $9.8 million in savings from terminating or disposing of 44 facilities, as well as revenue of $29.4 million from selling real estate holdings. Our historic route reduction agreement with the National Association of Letter Carriers lead to the evaluation of more than 151,000 of routes in 2008 and 2009, and the elimination of 9,692 routes. This gave us the ability to react swiftly to the unprecedented drop in mail volume. In addition, through a combination of vehicle reassignments, lease terminations or vehicle sales, we have reduced some 10,000 vehicles from our fleet with an estimated annual cost savings of more than $17 million.

Our operations management team has been tasked with making the necessary changes to accommodate market changes and volume fluctuations. And they have done so through effective overtime controls, complement management and continued consolidation efforts.

Let me go into greater detail on the $18 billion actions within our control to lower costs and drive revenue, which cumulatively brings us to the $123 billion revenue gap identified in the plan. This $123 billion is extremely challenging and will require us to move forward without delay. The first area that we concentrated on was growing mailing and shipping services, which we think we can grow some $2 billion annually by being extremely aggressive and focused in our actions. Our research indicates that in mailing services, we have additional opportunities to grow direct or Standard Mail for small businesses. We also learned through our prior campaigns that mailers respond to First-Class Mail and Standard Mail promotions, so we intend to continue these. In Package Services, our plan is to continue the successful Priority Mail Flat Rate box campaign, to expand the number of commercial contracts, to bring back product samples in the mail and to grow the Parcel Select business. Our partnerships with FedEx, UPS and other carriers have been extremely beneficial as we are able to provide last mile delivery for customers at a price that works for our business partners and the American consumer. We also realized that there were opportunities to further grow the business in areas where we already have a presence. For example, in a number of Post Offices, we can increase the number of Post Office boxes available to rent, and we have the processes and procedures identified to manage passport transactions and can easily expand the number of locations where we can provide this and other government services.

Regarding productivity improvements, we calculate that our focus on continuous improvement and adopting standardized procedures throughout our networks will yield approximately $10 billion annually. We will manage this by continuing to consolidate plants and delivery routes. Even though we already process 91 percent of the mail through automation, we can capture additional savings through the expansion of our Flat Sequence Sorting system, which is yet another example of automation helping us become even more efficient. For many years now, we have been working with our mailing industry partners on improving address quality, and the IMb with its powerful data capability will help us improve address quality even more. In addition, IMb offers new services to customers along with transparency.

Obviously, a large part of our savings in productivity comes from workforce management, and we plan on continuing our effective use of attrition to manage workforce complement. We also think that we will benefit from the advancement of technology in that more and more Americans will chose alternative access points for securing postal services, which means that we will need fewer employees to handle customer service transactions.

Finally, another $500 million in cost saving opportunities exist in purchasing through competitive sourcing, rigorous negotiation and supply market analysis. Our supply management team is already capturing savings by renegotiating transportation contracts, and approaching purchasing supplies and mail equipment in new ways.

We intend to do everything in our authority to achieve those savings, but they are not without risk. Our plan also provides proposals to address the remaining $115 billion gap and is a balanced and reasonable approach to creating a financially sound future. To implement the plan, a number of fundamental changes are necessary, some of which would require legislative changes. The necessary solutions are:

- Restructure the Prefunding of Retiree Health Benefits – If no adjustments are made to the CSRS fund, we request that Congress permit these payments to be deferred and shifted to a "pay-as-you-go" system comparable to what is used by the rest of the federal government and the private sector. This would provide the Postal Service with an average of $5.6 billion in cash flow per year through 2016. As noted previously, correcting the Postal Service's overpayment to the CSRS pension fund and transferring that amount to the Retiree Health Benefits Fund would eliminate any need for these payments.
- Delivery Frequency – We request the ability to adjust permanently the number of mail delivery days to better reflect current mail volumes and match customer usage.
- Expand Access – We will continue to modernize our channels for alternate access by providing services where our customers are already transacting business. We also will continue to increase and enhance customer access through private sector retail partnerships, kiosks, and improved online offerings. However, the Postal Service needs to

be relieved of the statutory prohibition against closing a Post Office for solely economic reasons.

- Workforce – We will work during our upcoming collective bargaining negotiations to establish a more flexible workforce that is better positioned to respond to the changing needs of customers and take advantage of the over 300,000 voluntary separations projected to occur over the next decade, as employees become eligible to retire. We would also ask that Congress pass legislation that requires an arbitrator to take the financial health of the Postal Service into consideration.
- Pricing – We request that Congress apply the Consumer Price Index price cap to the entire basket of Market Dominant products, rather than the current restriction which caps prices for every class at the rate of inflation. This will allow pricing to respond to the demand for each individual product and its costs. In addition, we will use existing flexibility to pursue an exigent price increase. Assuming other parts of our plan can be implemented, the exigent price increase will be moderate and not occur before 2011.
- Expand Products and Services – We ask that Congress permit us to evaluate and introduce more new products and services consistent with our mission. This will allow us to better respond to changing customer needs.
- Oversight – We ask that Congress provide a more streamlined and efficient process that provides appropriate oversight while promoting effective business practices. This will help to achieve the solutions in our action plan.

Some of these solutions could be implemented relatively quickly, while others would require much more time to achieve. Adjusting retiree health benefit payments and implementing five-day delivery will generate the largest and most immediate financial benefits for the Postal Service. Nonetheless, each part of the plan is critical to restoring the Postal Service's financial health. No one solution is the answer to reversing our financial condition. We believe a balanced approach that provides the Postal Service with the flexibility to respond to market dynamics and the speed to bring products to the market quickly, and that incorporates initiatives focused on cost, service, price, new products, and changes in the law would be the best approach. It is also the one that is most likely to perpetuate a financially sound Postal Service, able to meet the needs of the American people. We are ready to proceed with the plan. But we need Congress to provide the legislative reform necessary to move forward.

I would like to provide greater detail regarding our legislative proposals. The *Postal Act of 2006* included ambitious requirements for the Postal Service to prefund its legacy costs. While this appeared to be good public policy at the time, these measures did not anticipate, and were inconsistent with, the economic realities the country would soon face. I refer specifically to the provision that requires the Postal Service to prefund 73 percent of all future retiree health benefits—a 75-year liability—in just a ten-year period ending in 2016. This prefunding mandate is not shared by other federal agencies or private sector companies. The aggressive schedule, a product of budget scoring rules, requires annual prefunding payments averaging $5.6 billion. Moreover, the Postal Service's prefunding account had a balance of more than $35 billion at the end of FY 2009.

Between 2006 and 2009, mail volume fell by 17 percent and revenue fell by 6 percent. Consequently, we do not have the ability to meet this unique statutory requirement to prefund retiree health benefits at the accelerated pace. This enormous obligation costs Postal Service customers—not taxpayers—approximately $50 billion in prefunding over the ten-year period. Eliminating this requirement is one of the major components of our action plan.

The Postal Service greatly appreciates the action taken by Congress last year to enact legislation that restructured the payment for 2009. However, for 2010 and beyond, there is no assurance that similar adjustments will be granted. A restructuring of the payment obligation is urgently needed to allow the Postal Service to continue to fulfill its mission now and in the future. Legislative change would also reduce the need for the Postal Service to borrow funds from the U.S. Treasury for the sole purpose of depositing the money back into a fund at the U.S. Treasury. The Postal Service needs a quick decision by Congress on how this issue will be addressed to provide clarity regarding the amount and timing of other actions that are necessary to close the gap. Our preference is a comprehensive solution, but we need similar relief this year to ensure liquidity in Fiscal Year 2011.

Regarding our request to change the frequency of the number of mail delivery days each week, the statutory requirement for six-day mail delivery has been in existence since 1983. It imposes a very large financial burden, and is inconsistent with the overall mandate of the law requiring the Postal Service to operate like a business. Due to the unprecedented decline in mail volume, there no longer is sufficient volume to sustain the cost of the current six-day delivery network. The number of pieces of mail per delivery has declined from an average of five pieces in 2000 to four pieces in 2009, a 20 percent reduction. Without any changes in the business model, we can expect an average of three pieces per delivery by 2020. However, assuming a scenario of five-day delivery and FY 2009 mail volume, the amount of mail per delivery would increase to more than five pieces. Revenue per delivery point dropped by more than 20 percent between 2000 and 2009, because our largest volume declines occurred in profitable First-Class Mail.

Moving to five-day delivery is necessary to ensure financial viability, both now and into the future. Reducing the frequency of delivery is the single most effective way for the Postal Service to substantially reduce operational costs—allowing us to reduce annual net costs by more than $3 billion. It would greatly assist us with regaining a portion of our financial footing and help to ensure that affordable universal service is maintained nationwide. It is a prudent step a business would take given the financial projections for the future. I would note that both Canada and Australia have five day delivery and their Posts remain strong and useful to their citizens. In Germany, which has maintained six-day delivery, the price for their equivalent to a First-Class stamp is 80 cents.

Market surveys conducted independently and on behalf of the Postal Service show that customers want to see the Postal Service survive and flourish. Most are willing to accept the elimination of Saturday delivery to reduce the Postal Service's losses. And, most would rather have Saturday delivery eliminated than have stamp prices increased significantly, as would be needed to ensure the Postal Service's financial stability. I would also like to cite the results of a Gallup survey conducted in March 2010. The survey showed that 68 percent of those polled favored a change to five-day delivery "as a way to help the Postal Service solve its financial problems" over other alternatives such as increasing postage prices or closing local Post Offices. This result was echoed by recent *USA Today* and *Washington Post* polls reporting that the majority of those surveyed support five-day delivery as a means of addressing our financial problems. In the *USA Today* survey, 87 percent of Americans rated the Postal Service's performance as "excellent" or "good."

In anticipation of a possible change, we have conducted extensive stakeholder outreach through dozens of meetings with customers. We identified mailer issues and ensured their consideration in developing the proposed five-day plan. These exchanges helped us to understand and address the needs of the mailing industry and the public concerning a potential change in the frequency of mail delivery. The Postal Service has developed a comprehensive operations plan for five-day delivery that addresses most, if not all, possible impacts from required software programming modifications to workforce adjustments. Two major assumptions guided the development of the concept: existing service standards would be maintained and any changes would comply with existing collective bargaining agreements.

Our plan for five-day delivery, which was filed with the PRC last month, includes:

- Residential and business delivery and collections would be discontinued on Saturday.
- Post Offices will be open on Saturdays.
- Post Office Boxes would receive mail delivery on Saturday.

- Express Mail would continue to be delivered seven days a week, including Saturday and Sunday.
- Remittance mail (bill payments) addressed to Post Office Box and Caller Service customers would still be made available to recipients seven days per week.
- Firm hold outs (mail that a business picks up at the Post Office) would continue to be available for Post Office Box addressed mail Monday through Saturday, nationwide.
- No mail pick-up from collection boxes on Saturdays except for dedicated Express Mail collection boxes.
- Acceptance and drop-shipping of destinating bulk mail would continue on Saturday and Sunday.
- Alternate contract locations would remain open on their normal schedules.
- Access to online services via *usps.com* would continue to be available 24/7.

Any change in the number of delivery days will require Congress to eliminate the appropriations language that mandates six-day-a-week delivery. Should Congress approve such a change, we are committed to implementing an in-depth communications plan for our customers and employees to make the transition as smooth as possible. In fact, we have established a dedicated website that describes in detail our plan for implementation. Upon approval, we intend to provide customers with six months notice prior to implementing a change which we estimate would be no earlier than mid-2011.

If five-day delivery is enacted, we expect to handle adjustments to our career workforce through attrition, not layoffs, consistent with existing collective bargaining agreements. However, five-day delivery will substantially reduce the need for part-time, noncareer employees, most of whom work one day per week for the Postal Service. I would like to elaborate on why this is the best time to move forward on implementing five-day delivery. Due to the number of retirement eligible employees we have in our system, and due to the fact that we have structured a number of positions as temporary positions, we would be able to enact this change without having to layoff any career employees. Approximately, 25,000 full-time employee assignments would be reduced. This could be accomplished by eliminating full-time carrier technician and relief carrier assignments, reducing part-time flexible and transitional employee work hours and reducing overtime. In accordance with our collective bargaining agreements, some delivery positions would be reassigned. Our window of opportunity is now and I encourage Congress to consider the impact of their decision upon our workforce.

Legislative action is also needed to provide the flexibility to realign our retail network in order to improve service while lowering costs. The Postal Service's primary goal in adjusting its retail network is to find the right balance between cost, efficiency, and providing universal service. In order to do this, we need the flexibility to close Post Offices. This will require the elimination of the statutory prohibition against closing Post Offices solely for economic reasons. The law concerning how we manage Post Offices needs to be modernized to allow our customers to be served where they shop. With more options for consumers, including *www.usps.com*, self-service kiosks, big-box outlets, banks, and the ability to buy stamps in grocery stores and at ATM machines, any law governing Postal Service business practices needs to reflect what consumers want—convenient access to services. Expanding access is part of the action plan and we already have results to share. Today, in more than 300 Office Depot locations, you can now also purchase postal services. We're now working with Pitney Bowes on testing self-service mailing and shipping kiosks in about a dozen Target stores nationwide and have discussions underway with other major retailers on ways that we can partner together.

Saving costs on "brick and mortar" expenses will help us remain viable. Continuing to partner with the private-sector to expand nationwide access will help in meeting customer demand for increased access and greater convenience.

Customer research indicates that the American public is not concerned about Post Offices closing if postal services were moved to other retail locations. Many actually preferred to have postal services provided in nearby retail locations. In considering whether to consolidate or close a Post Office, the Postal Service operations plan would take into account convenient alternative places where customers can access postal services. As this realignment takes place, it would be a long-term process of adjusting the number of brick-and-mortar Post Offices while expanding access points for postal services.

The Postal Service must become a leaner organization. The large number of expected employee retirements creates an important opportunity to achieve this through what can be an orderly process of attrition, and by establishing more flexible work rules through the collective bargaining process. Through 2020, approximately 300,000 current employees will be eligible to retire. It would not make sense to replace them with full-time employees if demand is moving in a direction better suited to a part-time workforce.

The Postal Service is fully committed to negotiating collective bargaining agreements that are fair to our employees and our customers. National economic conditions, the current and future viability of the Postal Service, and the need to bargain in good faith for wages and benefits must all be a part of contract negotiations. Under existing law, arbitration is always a possibility. The financial health of the Postal Service and the affordability of postal products should be key considerations in any arbitration ruling. While some arbitrators have considered the fiscal health of the Postal Service, they are not required to take it into account. Our legislative proposal calls for a change to our collective bargaining process that was initially proposed in legislation introduced in the Senate last year. We ask that legislation be adopted to require arbitrators to take into account the Postal Service's financial condition before making any decision.

In order to react to market forces and offset potential declines in revenue and volume, we are also seeking legislative adjustments to the pricing mechanism found in the *Postal Act of 2006*. That law divided postal products into two broad categories: Market Dominant and Competitive, with different rules for each. Market Dominant, or mailing services, refers primarily to First-Class Mail, Periodicals, and Standard Mail. Rate increases for mailing services products are tied to a price cap applied to each mail class based on the Consumer Price Index -- All Urban Consumers.

Competitive, or shipping services, refers to products such as Priority Mail and Express Mail that compete with private carriers. Shipping services products do not have a price cap, but have a price floor. Market Dominant products account for about 90 percent of revenue. The Postal Service wants to ensure that prices of Market Dominant products can be based on the demand for each individual product and its costs, rather than capping prices for each class at the rate of inflation. We ask that the inflation price cap be applied to Market Dominant products as a whole, rather than to each class of mail under this category. In asking that the price cap be applied by category, rather than individual products, the Postal Service is seeking the flexibility to price according to market conditions and to maximize revenue. This action would help us ensure that products cover their costs.

As technology and customer needs change, so will the definition of mail. The Postal Service seeks additional flexibility to innovate its products and better meet changing customer demands, while tapping into new sources of revenue. Currently, every potential new product, including individual customer contracts, requires before-the-fact review by both the Postal Service Governors and the PRC. This can delay the implementation of customer contracts, leading to mailer frustration and providing an advantage for competitors. In some other instances, such as the addition, deletion, or transfer of a product from the market dominant to the competitive product lists, there are no time limits on the review. The current regulatory framework should be changed to broaden the definition of postal products, enable streamlined, after-the-fact product and pricing reviews, and place time limits on all areas of review.

We are also seeking adjustments in the oversight of the Postal Service. Our current oversight model includes Presidentially-appointed Governors (USPS) and Commissioners (PRC), Congress, portions of the Executive Branch, GAO, the Postal Service Inspector General, and other federal agencies. In many situations, roles and responsibilities overlap and are not sufficiently clear. Changes in law are necessary to make oversight processes more responsive to market needs. They should include looking at issues such as time limits on reviews, and moving from before-the-fact to after-the-fact reviews. Collectively, these changes would ensure continued protection of customer interests while providing flexibility to manage in the changing postal environment.

I would like to comment on the recently released report by the GAO regarding the Postal Service business model. I appreciate all their efforts and contributions to this critical issue. Their report was mandated by the *Postal Act of 2006* for completion in 2011. However, GAO was asked by this Committee to accelerate its completion given the national, economic conditions of the past two years and our tenuous financial circumstances. For these same reasons, GAO added the Postal Service to the High Risk list in 2009.

Many of GAO's findings are consistent with the analysis and action plan we have submitted for your consideration. GAO's findings include:

- The Postal Service's financial condition is dire, and its outlook is poor. Immediate Congressional action is needed for the Postal Service to attain financial viability. If no action is taken, risks of larger Postal Service losses, rate increases, and taxpayer subsidies will increase.
- The Postal Service must apply the management flexibility called for in the *Postal Act of 2006*, by continuing to restructure its operations, networks, and workforce.
- Congress should consider revising Postal Service retiree health benefits funding and requiring any binding arbitration to take the Postal Service's financial condition into account.
- The Postal Service should pursue the development of new enhanced products to increase revenue.

The GAO report describes a number of strategies and options available to Congress and the Postal Service for long-term structural and operational reform. The Postal Service can improve its financial viability by working with Congress and taking aggressive actions to reduce costs. However, as GAO notes, the Postal Service is unlikely to succeed without Congressional action to remove the legal and regulatory constraints that impede our ability to increase revenue and decrease costs. I look forward to working with Congress, the GAO, PRC, and the entire postal community in implementing the best choices for our continued success.

We do have a concern about one of the options listed in the GAO report. They note that Congress may want to establish a commission of independent experts to assist in making changes to the Postal Service's network, business model, and operations. We believe that such a commission would only add a layer of bureaucracy and delay to problems that require immediate attention. Our challenges are urgent and well documented. Congress should be seeking the most expeditious and effective resolutions to the Postal Service's financial difficulties. Commissions and additional studies will not contribute to that process.

GAO also suggests that the Postal Service be required to provide Congress with regular reports to ensure that our financial condition is improving. We agree, and plan to ensure transparency and accountability through a number of regular reports we currently are required to file. One of the central components of the *Postal Act of 2006* was to provide greater transparency in Postal Service operations. That objective has been met, and existing procedures for documenting our financial and operational condition are sufficient.

Our findings, recommendations, and legislative proposal come as no surprise to postal stakeholders. In our effort to develop a long-term action plan for success, we have made a concerted effort to consider proposals and feedback offered by the entire postal community. Our plan of action has been shared with Congress, the PRC, GAO, mailers, employee groups, and consumers. While no one is to blame for our current financial condition, we must all work together to overcome it. Efforts to fine tune this organization can only occur in a transparent environment with full participation by all stakeholders. We are committed to continuing this process of an open dialogue to ensure the future success of the Postal Service.

Mr. Chairman, our founding fathers recognized the need for a basic and fundamental service to "bind our Nation together." For over 230 years, the Post Office has served that indispensible purpose helping our country grow and prosper. In 1970, Congress passed legislation creating an independent establishment to be operated in a business-like manner. This hallmark legislation was based on the necessity that a national, government–sponsored, postal network required sound business practices and the freedom from political manipulation. Given the communications and technological advancements between 1970 and 2006, it is not surprising that further changes to our legislative mandate were needed to keep up with the times. More fine-tuning is needed to preserve self-sustaining, universal mail services for all Americans.

The Postal Service must be leaner and have the ability to quickly respond to customer needs. Our action plan is a path to a future in which the Postal Service will remain a vital driver of the American economy and an integral part of every American community. We will continue to deliver the greatest value of any comparable post in the world. If given the flexibility to respond to an evolving marketplace, the Postal Service will be an integral part of the fabric of American life for a long time to come.

Thank you for your support of our ongoing efforts to ensure a sound Postal Service. I look forward to working with you and other members of Congress to achieve the passage of legislation that will address our near-term and future challenges. I will be happy to answer any questions that you may have.

###

Hearing before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security Committee on Homeland Security and Governmental Affairs United States Senate

Written Statement
On
"The Future of the U.S. Postal Service"

April 22, 2010

David C. Williams
Inspector General
United States Postal Service

Mr. Chairman and members of the Committee, I appreciate the opportunity to submit my written testimony concerning the overcharge of the United States Postal Service (Postal Service) for its Civil Service Retirement System (CSRS) obligations. This issue has a significant impact on the Postal Service's financial viability, its compliance with the Postal Accountability and Enhancement Act (PAEA), and thus its ability to provide world-class universal service to the nation.

On July 1, 1971 the United States Post Office Department (POD), then an agency of the federal government, became the Postal Service, a new self-financing independent government entity. Although the Postal Service is self-financing, it is subject to the Office of Personnel Management (OPM) for health care and pension obligations. The administration of these programs resulted in the Postal Service being overcharged four separate times.

Congress has continually untangled and corrected funding problems:

- In 2002, it was discovered that the Postal Service's pension fund would be overfunded by $78 billion. Congress corrected this in 2003.
- In 2003, the Postal Service was made responsible for $27 billion in military service pension obligations for Postal Service employees. Congress corrected this in 2006.
- In 2009, we found that the OPM used an exaggerated 7 percent health care inflation forecast instead of the 5 percent industry standard, resulting in an overpayment of $13.2 billion by 2016. In response Congress urged the Postal

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00070 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.030

Service to coordinate with the OPM and the Office of Management and Budget to develop "a fiscally responsible legislative proposal."

Lastly, the Postal Service pension fund was overcharged $75 billion, so that employees could retire at promised levels. When the POD became the Postal Service, employees that belonged to the federal pension fund now contributed to the Postal Service. Retirement costs were divided according to the number of years employees had belonged to each fund. However, the federal pension fund paid for retirements based on 1971 salaries, not final salaries. The federal pension fund collected full contributions, but paid only partial benefits.

The OPM has explained that these mischarges were in response to what they believed to be the will of Congress expressed in 1974 legislation. However, the 1974 language was repealed by Congress in 2003, when large overpayments were discovered. At that time the OPM inexplicably had not detected a 41 percent overfunding error in this $190 billion pension fund. Congress directed the OPM to use its authority to oversee the reforms using accepted "dynamic assumptions" that include pay increases and inflation. The OPM switched to dynamic funding for the Postal Service portion, but did not for their share. The Postal Service was forced to pay the $75 billion difference.

In 2009 my office began working with the Hay Group, an actuarial firm, to review the OPM's CSRS methodology and found that it unfairly burdens the Postal Service:

- In calculating the federal government's share, the OPM methodology assumes that all salary inflation after 1971 should be paid by the Postal Service instead of being divided with the federal pension fund and associated with the respective years of service. This has caused the Postal Service to be overcharged $75 billion for its share of the CSRS pension payments. In essence, for almost 40 years the Postal Service paid all of its and all of the federal government's share of inflationary costs.

- It is instructive that the OPM in this case ignores its own formula which includes final salary and inflationary adjustments for federal and military funds to determine Postal Service pension benefits.
- The OPM methodology of calculating the federal fund's share was constructed using a "freeze frame"[1] approach which allows the federal government to escape the effect of salary increases mostly due to inflation and the growth of the economy on pension costs in violation of accepted accounting practices. It is completely unrealistic to assume employees would receive no pay adjustments for almost a 40-year period, yet the OPM uses just such a methodology in paying its share for former POD employees. This does not comply with the use of dynamic assumptions that the OPM was directed to use in 2003.
- Using the OPM methodology, an employee who worked 15 years for the POD and 15 years for the Postal Service causes the Postal Service to be responsible for 70 percent of the pension obligation, while the federal funds share would be 30 percent, instead of an even division.

[1] To assume former Post Office Department employees retired in 1971 and received no inflationary salary adjustments or the use of a final salary.

- In 2004 the Postal Service appealed the OPM's methodology and it was denied by OPM. Their denial relied on repealed 1974 legislation that made the Postal Service responsible for the pension costs of salary increases. The new legislation in 2003 directed the OPM to abandon the 1974 legislation and use "dynamic assumptions" that include inflation and pay increases. This is the same methodology the OPM uses with its other funds including the cost of retiree health care premiums for the Postal Service.
- A methodology based on dynamic assumptions — the same methodology the OPM uses to split the cost of retiree health care premiums between the Postal Service and the federal government — would comply with accepted accounting standards. That proposal would finally align the pension and health care methodologies for the OPM.
- Using dynamic assumptions, the federal government and the Postal Service would each be responsible for 50 percent of the pension obligations for an employee who worked half their career for the federal government and half for the Postal Service. The current methodology relies on the Postal Service to pay all of its pension obligations and much of the federal government's share.

Lastly the Postal Service was given a funding target of 100 percent for both pension and health care pre-funding. In contrast the OPM has pension funding premium levels of 41 percent for federal employees and 24 percent for the military. The OPM's own health care prefunding for federal employees is 0 percent. The Standard & Poor's 500 companies' (S&P 500) pension funding is 80 percent.

Correcting <u>either</u> the overcharge <u>or</u> the target pre-funding level would result in the ability to pay off the Treasury debt associated with meeting the overcharges. Annual costs and premiums could be financed out of the interest earnings and surplus. PAEA has a provision to monitor fund levels annually to determine if contributions are adequate to meet target levels.

The vision of the Postal Service in the PAEA was to create a more corporate entity subject to efficient market forces. That cannot be done if the Postal Service continues to be subjected to annual payments of more than $7 billion a year before it enters the market place. Mr. Chairman, I would be hard pressed to name a corporation that could do well in the market place if $7 billion a year were taken from it before it could open its doors for business. The current overcharges of $75 billion have been seen by many in the mailing industry as an unauthorized tax on Americans. Ironically the postal trade press has termed this the "stamp tax."

The mischarges should be backed out and fund balances reset to proper levels to achieve the retirement reforms Congress enacted in 2003. In addition, another option for the Postal Service could be to use the $75 billion to pledge to the retiree <u>health</u> fund instead of making payments. The details concerning the 3 possible solutions can be found in the appendix.

Timely action by Congress and the OPM will provide the Postal Service immediate relief from this financial burden, but it will not wholly close the financial gap. Almost $4 billion

ph44585 on D330-44585-7600 with DISTILLER
VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00074 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
57329.034

will remain to be dealt with by the Postal Service through the reduction of 93 million workhours in FY 2010. Based on the latest projections, the Postal Service is on pace to cut the necessary workhours as they try to meet the loss.

APPENDIX:
My office would like to elaborate on three alternative solutions to correct the excessive pre-funding levels. Our first solution is designed to correct the OPM's current CSRS pension funding methodology that has overcharged the Postal Service $75 billion from 1972 to 2009. This can be simply fixed by taking the following steps:

- First, the Postal Service's CSRS pension obligations should be calculated using a years-of-service methodology to allow for the return of the $75 billion the Postal Service has already overpaid and going forward.
- Second, $10 billion of the $75 billion CSRS surplus should be used to pay off the Postal Service's Treasury debt, since this debt was incurred making payments to pre-fund retiree health care. This would save the Postal Service over $150 million a year in debt service.
- Third, another $10 billion of the CSRS surplus should be used to pay the total outstanding CSRS pension liabilities, which have increased over its life.
- Fourth, transfer the remaining $55 billion of the CSRS surplus to the retiree health care fund. The $55 billion combined with the already set aside $35 billion will provide a retiree health care fund of $90 billion. The OPM has determined that $87 billion is needed to fully fund the Postal Service's retiree health care liability as of 2009. In addition, under the PAEA any CSRS pension surplus is already scheduled to be transferred to the retiree health care fund at the end of 2015. We propose that the schedule be accelerated so that the transfer occurs immediately.

ph44585 on D330-44585-7600 with DISTILLER
VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00076 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
57329.036

- Fifth, stop the required payments of more than $5 billion under the PAEA because the account would be funded. This would allow the Postal Service to use the fund for its intended purpose to pay this year's $2 billion retiree premium.
- Most of these simple changes only advance the timing of provisions already in existing law and do not fundamentally alter the funding structure established by the PAEA. The Postal Service's pension and retiree health care obligations would be determined with the same methodology. The Postal Service's pension and retiree health care obligations would be fully funded; unlike the federal government that relies on federal pension funding of 41 percent, military pension funding of 24 percent, federal retiree health benefits at 0 percent and military retiree health benefits at 29 percent.

As I said before, there is no established funding goal. An established goal by Congress of around 80 percent as suggested by the S&P 500 and my office would allow for a second solution to the $75 billion overcharge to the Postal Service for its share of the CSRS pension payments from 1972 to 2009. This solution would be optimal if the $75 billion could not be repaid to the Postal Service. This solution would consist of four parts:

- First, the Postal Service's pension fund obligation would be reduced from 100 percent to about 80 percent. This would make about $52 billion available to the Postal Service.
- Second, $10 billion of the $52 billion should be used to pay off the Postal Service's Treasury debt, since this debt was incurred making payments to

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00077 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.037

prefund retiree health care. This would save the Postal Service over $150 million a year in debt service.

- Third, transfer the remaining $42 billion to the retiree health care fund to achieve more than an 80 percent funding level.
- Fourth, stop the required payments of more than $5 billion under the PAEA because retiree health care would be funded. This would allow the Postal Service to finally use the funds and its interest income for its intended purpose — paying for retiree health care.

The third solution could be used once the OPM acknowledges the Postal Service's $75 billion overpayment to the CSRS pension fund. This overpayment should not be incorrectly categorized as a "surplus," as the Postal Service is *immediately* entitled to this overpayment. The surplus CSRS funds, on the other hand, are due to the Postal Service on September 30, 2015, and will be comprised of any excess funds that exist once the CSRS pension is fully funded.

An OPM acknowledged $75 billion overpayment becomes an asset of the Postal Service which allows the Postal Service to pledge the excess retiree pension funding to the retiree health fund instead of making payments. The Postal Service can acquire this asset to pledge through the Treasury's issuance of a bond on behalf of the OPM that is payable to the Postal Service. A special Treasury bond, without market value, issued to the Postal Service would allow the Postal Service to pledge this bond (asset), pursuant to 39 C.F.R. § 2005(b) (1) to satisfy its retiree health fund obligations.[2] Under 39 USC 2005(b),

> *"The Postal Service may pledge the assets of the Postal Service and pledge or use its revenues and receipts for the payment of the principal of or interest on obligations issued by the Postal Service under this section, for the purchase or redemption thereof, and for other purposes incidental thereto, including creation of reserve, sinking and other funds which may be similarly pledged and used, to such extent and in such manner as it deems necessary or desirable…."*

The $75 billion Treasury bond, at some undetermined time in the future, would result in a transfer of actual funds to the retiree health fund obligations. This transfer could be coordinated with the PAEA mandated 2015 transfer of funds between the retiree pension fund and the retiree health fund.

[2] The issuance of an interagency debt instrument is exemplified by the arrangement between the Social Security Administration (SSA) and the Treasury.

- The surplus SSA tax revenues are maintained in a SSA Trust Fund which, like the Postal Service Fund, is an off-budget fund.
- Because the Treasury had spent SSA's tax-generated revenues, it has since provided SSA with $2.5 trillion in special-issue Treasury bonds that SSA may redeem, as necessary, when its annual tax revenues no longer cover its disbursements.
- This fiscal year, SSA will begin redeeming some of its Treasury bonds.

Testimony of Chairman Ruth Y. Goldway,
Postal Regulatory Commission
Before the
U.S. Senate Homeland Security and Governmental Affairs Committee's
Subcommittee on Federal Financial Management, Government Information,
Federal Services, and International Security
April 22, 2010

Chairman Carper, Ranking Member McCain, Members of the Subcommittee, thank you for the opportunity to testify on the Future of the United States Postal Service.

The Commission is engaged on several fronts to address the vulnerability of the Postal Service and fulfill our legislative mandate for a modern and transparent system for regulating rates and assuring high quality service performance. Our previously issued report on the Postal Service's Retiree Health Benefits Fund (RHBF) liability and our recent Annual Compliance Determination (ACD) as well as action on the cases before us may clarify major issues now before the Congress. We are pleased to share this work with you as you deliberate on solutions for the Postal Service that will best serve the long-term interest of the Nation.

Five-Day Delivery

On March 30, 2010, we initiated Docket N2010-1 to conduct a thorough public review of a Postal Service proposal to eliminate Saturday mail service nationwide. Based on press reports and comments we have received, it appears that there is confusion about the process. I must reiterate to the public that no decision has yet been made to reduce service to five days. This important matter requires the consideration of both the Commission and the Congress.

The Commission's Docket provides for public, on-the-record hearings to analyze the Postal Service's proposal and supporting evidence, as well as related alternatives that may be raised by participants. The Commission's process allows mailers, stakeholders and members of the public to offer their perspective and insights. The Commission has received nearly 2000 public comments thus far by letter, email and fax. We are also scheduling seven field hearings to ensure that the views of local communities are well represented in the public record.

Our process will ask the following questions, among others: How much will the Postal Service really save? Will mail volumes decline more or less than the Postal Service anticipates? To what extent will adverse impacts on citizens, businesses or public institutions be ameliorated by Postal Service operational adjustments? What will be the economic impact on communities, mailers and the Nation?

The Postal Accountability and Enhancement Act (PAEA) requires the Commission to monitor service levels to prevent deterioration in service and assure that the Postal Service meets its Universal Service Obligation (USO). Five-day service may meet the USO. It does so in other nations. However, it could well be that six-day service remains a strategic marketing advantage for the Postal Service even if it is not part of the USO. Perhaps a pilot project in a limited geographic area or for one month of the year would be instructive. The implications of reducing service are unknown and must be carefully considered.

We expect to resolve these and many more questions posed by participants and present our Advisory Opinion to the Postal Service within six to nine months. The Commission will, of course, make the proceedings readily available and present our Opinion to Congress.

The Postal Service may prefer an abbreviated review and immediate action by Congress to approve their plan. However, considering the requirement of the law to hold hearings, the complex matters involved, and based on prior experience – such as our Advisory Opinions on Postal Service plans to close retail facilities nationwide and to reconfigure its mail processing network – it is not practical or desirable for the Commission to act more quickly. Due diligence should not be sacrificed nor American citizens and stakeholders denied their opportunity to participate. It is a government monopoly providing a vital service and we believe the Congress should have the full benefit of the regulatory agency's oversight function as Congress makes its decision.

PENSION LIABILITY

The Commission released its Annual Compliance Determination on March 29th. The report's substance may have been overshadowed by the Postal Service's release of its five-day delivery on March 30th. The Commission gave careful consideration to the Postal Service's overall financial problems. The potential near-term savings in cutting delivery days has significantly less impact than addressing issues of retiree liabilities. And could add to the rate of mail decline at a time when mailers and the economy are just beginning to recover from a severe recession.

The Postal Service fiscal year ends in just five months on September 30th. At that time, the Postal Service must make a $5.5 billion payment to the Treasury to fund future health benefits. Shortly thereafter, it will need to make sizeable payments for workers compensation obligations and to meet payroll. These large debts, falling so close together, could cause the Postal Service to run out of cash. This is similar to the situation it faced last year when Congress provided $4 billion in relief.

There are two unresolved issues that could have major immediate impact on the Postal Service's financial crisis, as well as a material effect on the five-day delivery issue.

First is the question of whether the Postal Service has overfunded its employee pensions by $75 billion as contended by the Postal Service Office of Inspector General (OIG). If this finding is accurate and the funds were used to address other postal liabilities, Postmaster

General Potter has said that the five-day proposal would not be needed, at least not for five years.

The Postal Service has appealed the Office of Personnel Management's (OPM) treatment to the Commission, in a process established by the PAEA. The Commission will retain an actuary to review OPM's calculation of the Postal Service's pension liability in light of the OIG's findings.

We have issued a solicitation for competitive bids and made a tentative selection of an actuary. At present, we are in the process of finalizing the contract. Under the scope of work, the actuary will review the pension calculations performed by OPM, by the Postal Service's OIG, and as by any alternative methods that represent industry best practices. The review will also examine the relevant laws underlying the issue. We hope to have the actuary's report by July 1st and will report its expert findings to Congress, OPM and the Postal Service with our comments shortly thereafter.

RETIREE HEALTH BENEFIT FUNDING

The second issue involves the calculation and financing of the future costs for postal retiree health benefits. Last May, Members of the House Oversight Committee asked the Commission to look at OPM's computation of Postal Service liability for future retiree health benefits and the annual payments that result to fund the Retiree Health Benefits Fund (RHBF) created by PAEA. Based on a dynamic calculation of long-term medical inflation rates and the declining postal workforce, we found that a recalculation could lower the Postal Service's total liability by nearly $35 billion and reduce the required annual payments by more than $2 billion while meeting the original funding goals of the PAEA. An OIG report suggested that even greater reductions were possible.

It must be noted that in any case the payment schedule has proven too ambitious for the Postal Service to meet, given the devastating effects of the recession on mail volume and revenue. My colleagues and I support readjusting the payments to an affordable level, perhaps over a longer period of time and/or tied to the Postal Service's ability to pay. We see this as an essential part of any plan to help the Postal Service survive and prosper in the coming decades.

POSTAL SERVICE PLAN FOR THE FUTURE

On March 2 of this year, the Postal Service issued a report entitled "Envisioning America's Future Postal Service." In a litany of problems and worst case scenarios, the Postal Service estimates that there will be cumulative financial losses of $238 billion by the year 2020 if no changes are made, including no adjustments to pension or RHBF payments and no other cost savings or improvements in productivity.

The Postal Service's response to these potential losses is to cut costs and reduce service. Its plan promises fewer employees to serve the public, fewer processing plants and postal operated retail facilities, and reduced mail collections and fewer collection boxes – more than 24 thousand collection boxes were removed from American neighborhoods just in the past year

– as well as eliminating Saturday mail delivery service, which heretofore has been considered a competitive advantage for the Postal Service.

The basic outcome of all these ideas is that there may well be less mail and less Postal Service and that those who rely exclusively on the mail, the elderly, the poor, rural America and those who cannot or will not connect to the internet may suffer the most.

Even more troubling, its plan stops at the year 2020. There is nothing in the plan to indicate how forecasted mail declines will be arrested in the following decade. On the contrary, the plan's proposals seem likely to spur further declines, a downward trajectory that suggests further shrinkage of the system, with mail and this fundamental communication infrastructure disappearing in tandem.

POWER OF THE MAIL

I do not believe that this vision is the inevitable future of the Postal Service. I believe in the Constitution of the United States and Title 39's mandate to provide a postal system that binds the Nation together. Even in the Internet Age, mail has a unique power to touch readers and deliver results for senders. It can drive sales, touch emotions, deliver votes, and shape important personal decisions that affect life and country.

The Postal Service plan, regrettably offers only dire forecasts regarding volume decline and growing debt, projections that have been questioned by both the Commission's expert staff and the Congressional Research Service.

Until recently, despite economic volatility, terrorism and digital diversion, mail has been relatively resilient. Between 2000 and 2008, First-Class Mail declined an average of 1.2 percent a year, while Standard Mail increased by an average of 1.6 percent. This gradual shift toward a lower-margin mail mix was addressed in the PAEA, by the creation of a new competitive business model so the Postal Service could earn offsetting revenue and income in its shipping services. This model appears to have ameliorated the problem for which it was designed. As discussed in the ACD, competitive products contributed more than 5.5 percent to institutional costs and generated $37 million in profits. But the swamping effects of the recession make it difficult to assess its long-term potential.

It also is difficult to know, if or by how much the recession may have accelerated the existing trend of electronic diversion, since all mail segments declined significantly. The Postal Service's consultants' research indicates that increased diversion is likely. Nevertheless, long-term forecasts of mail declines based on theoretical diversion are problematic. Other studies point to the persisting inelasticity of demand for many mail products. In other words, some products are pretty stable and may even accommodate rate increases.

If the last few years have taught us anything, they have shown how unpredictable the future can be. In my 12 years on the Commission, I can recall times when the Postal Service predicted billion dollar losses and ended the year with billion dollar gains.

Even in this difficult year, it appears likely the Postal Service will far exceed its own expectations. The latest financial report received by the Commission reveals that through the end of February it is nearly $1.2 billion dollars ahead of its forecast. Although mail volume is down by 8 percent, Standard Mail volume grew slightly for the month and Shipping Services are up 1.3 percent for the year. Both of these products are sensitive to changes in economic conditions. It may be that the economy is starting to have a positive effect on the mail.

Seeing this kind of variability in only six months, it may be prudent to view projections that lie six years or more down the road with some caution.

A BETTER APPROACH TO THE FUTURE

The Commission commends the Postal Service for its sustained effort over many years to increase productivity, improve processes and lower its costs. We appreciate that this effort must continue and evolve for the future. Today's discussions, however, must not simply focus on costs and deficits. The Postal Service should reposition its goals to meet the needs of an evolving society.

These are questions that the Postal Accountability and Enhancement Act requires the Commission to ask. What does the Constitution and the law require? What is best for the Nation? How can the Postal Service maintain and improve its universal service to citizens and the business community who rely on the mail? The PAEA requires the Postal Service to continue to provide universal service at fair and efficient rates. The PAEA requires the Commission to carefully monitor both the rates the Postal Service charges its customers and the quality of service provided. Under a rate cap regime such as that imposed by the law, any reduction in service that affects the value of the service to the customer could be considered the equivalent of a rate hike.

The PAEA directed the Postal Service and the Commission to establish modern service standards to "preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining." This suggests that social concerns must be balanced against economic concerns when changes are proposed.

Congress also clearly intended that the Commission have a role in both considering and improving visibility into customer satisfaction, as evidenced by the inclusion of the statutory provisions concerning customer satisfaction in the PAEA.

It would have been helpful if the consultants hired by the Postal Service had been tasked to look at what it will take to keep open as many post offices, and station and branches as possible; what new products the public needs that the Postal Service is uniquely positioned to provide; how to keep delivery at 6 days, the level required by Congress; and then how to determine the service levels that are the most advantageous to its future success.

It also would have been informative if the consultants and analysts reviewed the Postal Service's recent attempts at innovation. In this decade, the Postal Service embarked on two projects that it described as transformative: the Intelligent Mail Barcode (IMb) and the Flat Sequencing System (FSS).

The Postal Service promised that the IMb would revolutionize the transparency and efficiency of letter mail for the Postal Service and its customers, creating new value in the mail and opportunities for growth. The Commission believed the Postal Service and agreed to use the IMb as the basis for a measurement system to track service quality. Yet, we and the mailing community continue to wait for that promise to be realized.

Similarly, FSS promised to transform the processing of flats and catalogs so that they could be sorted automatically into walk sequence, at lower cost and with higher quality. Both the IMb and the FSS are behind schedule in their implementation. It would be helpful at this juncture to know if the Postal Service thinks these projects are not as promising as originally envisioned. What can be done to speed up their introduction and acceptance system-wide? Perhaps the Commission should be doing more with regard to measuring service and insisting on reducing the cost of flats handling. An objective analysis of these questions would better inform future plans.

As a former Mayor and an advocate for community based economic development, I would have hoped a detailed, innovative new retail strategy had been explored that would, at a minimum, improve the revenues of post offices to the point that their continuance is economically as well as socially justified. I commend Postal Service efforts to build its website and expand customer access through internet use, and increase sales of stamps at supermarkets. But ask the small towns of America if they think government business should be conducted in Walmarts. The functions of a Post Office cannot be easily transferred to Walmart as the Postal Service proposes. Envisioning the future calls for a transformative process, not a capitulation to big box retailing.

Ideas for Positive Change

The Postal Service is capable of new ideas. It expanded its competitive flat-rate Priority Mail program, began an innovative partnership to sell Hallmark cards in its retail stores, and launched volume incentivizing sales and advertising initiatives. The Commission has also approved the Postal Service's first experimental product under the PAEA. More ideas for expanding in these areas or other innovations should be developed by the Postal Service as soon as possible and, where appropriate, submitted to the Commission for review. The Commission's record of positive approval Postal Service innovations speaks for itself.

The work of the Commission exposes my colleagues and me to ideas from mailers, stakeholders, the Postal Service and the public. Here are some of the more transformative ideas proposed for inclusion in the Postal Service's target plans for 2020:

1. Develop mail products based on value to the customer not necessarily on volume. This is the fundamental tenet needed to fix the Postal Service's broken business model. Our Annual Compliance Determination pointed to 14 market dominant products that failed to cover attributable costs amounting to $1.7 billion. Thirty workshare discounts exceed avoided costs. The underlying idea is this: for years the Postal Service has been relying on volume and it can no longer do that. Instead of

continuing to focus on pushing as much volume as possible through its channels, the Postal Service needs to instead come up with new, higher-value products that people are demanding.

2. Convert the bulk of its vehicle fleet to run on electricity reducing annual fuel and maintenance expenses by more than $400 million per year and increasing America's independence from foreign oil.

3. Have a range of products that are fully trackable and traceable and comparable with those of private package companies.

4. Provide a one-stop shop for government services. Not just passports but national park passes, regional EZ passes, identity cards, and credentialing, etc.

5. Plan to participate as a full partner in the nation's 2020 census, thereby saving the country hundreds of millions of dollars.

6. Building on the money order services now offered, introduce and implement a system to provide assistance to the unbanked, replacing many usurious "pay day" operations with reliable fair service.

7. Commit to having a network of post offices in key locations that are open more hours than in 2010 and even on Sundays, and maintain at least one 24/7 post office in every big city.

8. Implement a comprehensive Vote-by-Mail system that suits the needs of all the states in the union for federal, state and local elections held at any and all times of the year.

9. Reinvent the letter carrier and tap the value of the relationship between the carrier and the customer: empower him/her to measure real-time service; to be accessible to the community by email; to be the eyes and ears of the community; and to be the sales and service point for small businesses.

10. Reorganize the workforce - not to make them part time employees - but to enhance their skills thereby adding flexibility in the processing centers and motivated outgoing sales people at retail counters.

11. Commit to having ten other ideas in place and operating within the decade.

There is no dearth of ideas for modernizing the Postal Service. Members of our own Commission staff are independently exploring ideas such as auctioning potential discounts for postage rates to get a real measure of market demand; adjusting pricing in First-Class and Standard Mail to improve Postal Service margins and encourage mailer efficiencies; and offering postal vehicles as platforms for sensors that generate revenue from other government agencies to automatically measure pollution, collect weather data, identify chemical spills, identify cell phone/wireless dead spots, spot natural gas leaks and map potholes.

Ideas like these will preserve the importance of the Postal Service to the Nation, even though they may not be sufficient to completely offset long-term societal shifts in communications.

Just as limiting access and declines in service create a self-fulfilling prophecy, improvements which may seem small can create an incremental reinvigoration that begets real growth.

Timing Changes

The Commission appreciates the pressures that the Postal Service is under and the hard work and dedication both management and employees have shown in making changes that reduce costs without too much sacrifice in service. They should and are continuing to do so. However, an axiom in the business community is that a company cannot cut its way to success. It has to have a real plan. The consensus among the mailers I have spoken with is that there is very little that is new in these Postal service reports.

The ten-year plan and the newly issued GAO report are not effective plans for the future. Rather, by concentrating on cuts at the expense of service and innovation, the Postal Service offers the path to obsolescence.

2010 is not the time to implement wholesale cuts to the Postal Service. Before the Congress decides on the Postal Service's request to cut days of delivery and resulting service levels we hope it will address the pension and retiree health benefit issues and develop manageable payment schedules for the Postal Service. The Commission is collecting evidence to provide a complete analysis of the five-day delivery proposal and our findings should provide Congress and the Postal Service valuable information on the costs and benefits involved.

Time will also provide breathing room for hard-pressed Postal customers and the economy. If history is a guide, as the economy rises it will carry the mail with it. I believe that with a positive approach it is possible to create a realistic plan that envisions the future, a future with a vibrant communications network providing universal service and meeting changing citizen and customer needs and demands.

Thank you, that concludes my testimony.

# # # #

STATEMENT OF

VINCENT GIULIANO

ON BEHALF OF POSTCOM

BEFORE THE

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

ON

THE FUTURE OF THE U.S. POSTAL SERVICE

May 5, 2010

I am Vincent Giuliano, and I am submitting this statement on behalf of the Association for Postal Commerce (PostCom), a national and international trade association that represents the interests of those who use or support the use of mail for business communication and commerce. PostCom's members are users of all classes of mail. I serve as Chairman of PostCom's Postal Policy Committee, and also as Senior Vice President of Government Relations for Valassis Direct Mail, Inc., a company that currently mails more than 3.5 billion pieces of advertising mail annually. I have been actively involved in postal affairs for over thirty years both on behalf of my company and through various industry trade associations.

I applaud the Subcommittee for creating a dialog on this most important topic. The purpose of my statement is to present a view of the current Postal Service crisis from the perspective of the mailing community, specifically postage rate payers, focusing on the enormous financial burden imposed on the Postal Service for funding of retiree health benefits. I also underscore the necessity to acknowledge and appropriately reconcile the $75 billion USPS overfunding of its Civil Service Retirement System (CSRS) pension obligation, as identified by the Postal Service's Office of Inspector General (OIG).

I have been following the Postal Service's CSRS pension issue for nearly a decade, and am familiar with the OIG's January 2010 report on the CSRS overfunding as well as related Office of Personnel Management (OPM) materials. Attached to my statement is a more-detailed analysis of the historical background of this issue, including the original funding problems with the CSRS pension system and the 1974 law that has led to the overfunding identified by the OIG.

I. <u>THE MASSIVE AND EXCESSIVE FEDERAL OBLIGATIONS ARE CREATING A CRISIS OF CONFIDENCE</u>.

Mailers provide the sole source for the revenue that's needed to pay these obligations. The danger for America's postal system is that, in the face of rising postal rates, mailers will decide that the cost of using mail for communication and commerce is no longer justifiable from a business perspective. The expectation that businesses will continue to provide the revenue needed to keep our nation's postal system fiscally solvent will not be realized. Businesses will reduce their use of mail or will switch to other communication alternatives or, in some instances, simply go out of business. If that happens, these obligations will become "unfunded" by mailers, and the burden will fall on taxpayers.

You have already heard from the Postal Service and others about its financial crisis. Its distress is due to several factors, including a decline in mail volume. That, however, is not the most urgent problem. With the exception of the recession-induced decline last year, mailer volumes and postage over the last several years have been covering *current* postal costs. The Postal Service's financial hemorrhaging has instead been caused by the mammoth obligations imposed on it by the Postal Accountability and Enhancement Act (PAEA) for the funding of retiree benefits – a staggering $7 billion annually. These, in turn, are the result of legacy costs inequitably imposed on the Postal Service and its mailers. For the users of the postal system, the resulting huge overfunding of retiree obligations is an unjustifiable tax that has undermined mail as a communications medium and brought the U.S. Postal Service to the brink of insolvency.

From the standpoint of the mailing community, the impact of these excessive payments reaches even deeper. The resulting "below the line" net financial losses, widely reported in the press, have led to an impression that the Postal Service is "going down the drain." This has created a lack of mailer confidence that it will be able to survive as an affordable and integral part of our nation's economic infrastructure. In particular, the specter of large rate increases needed to cover legislatively-mandated obligations is causing mailers nationwide to reassess their business models and seek out other communication and distribution channels, thus increasing the risk of a vicious downward spiral.

This "crisis of confidence" in the future viability of the postal system must be reversed if it is to remain a vital part of our nation's infrastructure. Congress's first order of business must be to "stop the bleeding" and place the Postal Service on a sound financial footing, starting with correction of the $75 billion pension overpayment identified by the OIG. Merely rescheduling the PAEA-mandated retiree health payments by pushing them into future years is not a real solution, as it would only postpone the day of reckoning – at which time it might be too late to resuscitate the postal system.

Correction of these pension overpayments by proper estimation of the obligations and crediting to the Postal Service would result in full funding of both the pension and retiree health benefit obligations, eliminating the need for the burdensome PAEA payments. That, in turn, would enable the Postal Service to stabilize its finances and reassure mailers of its continued viability as an affordable medium. Indeed, full credit for the overpayment would also provide the Postal Service with the capital it desperately needs to rationalize and efficiently restructure its system to meet the nation's communications needs into the future.

Some will undoubtedly be concerned about the "budget impact" of crediting the Postal Service for overpayment of its pension obligations. But the cost of doing this correction now will be far less than if Congress delays until the postal ship has sunk, along with much of the 8.4 million jobs and over $1 trillion in revenues associated with the mailing industry.[1] By acting now to make the Postal Service financially viable, confidence in postal distribution as an effective and affordable medium will be restored.

II. THE RATIONALE FOR EXPANDING THE USPS'S SHARE OF THE CSRS PENSION OBLIGATION IN P.L. 93-349 IS INCONSISTENT WITH THE REQUIREMENTS AND LIMITATIONS CONGRESS IMPOSED ON THE POSTAL SERVICE IN THE POSTAL REORGANIZATION ACT.

When Congress in 1970 enacted the Postal Reorganization Act (the PRA), it intended to give the Postal Service a fresh start as a financially self-sufficient, business-like, independent entity within the federal government. Forcing the Postal Service to cover obligations of the old Post Office Department (POD) – as OPM claims P.L. 93-349 (1974) requires – is inconsistent with that intent by imposing a cost on the USPS and mailers that they did not cause.[2] There may be (and is) disagreement over the intent of the precise wording of the 1974, 2003, and 2006 laws (P.L. 93-349, P.L. 108-18, and the PAEA) regarding the Postal Service's CSRS obligations, but it is clear that the OPM method of calculating them is not only inequitable and inconsistent with Postal Reorganization but also extremely damaging to the entire postal industry and its contribution to the national economy.

OPM does not deny that its approach – which absolves the federal government of any responsibility for pension obligations due to post-1971 salary increases of former POD employees – imposes old POD obligations on the Postal Service. It cites as justification the enactment of P.L. 93-349 in 1974. Yet despite the repeal of that law in 2003 by P.L. 108-18, and our expectations that a new, more reasonable approach would be forthcoming, OPM continues to rely on the old law as the rationale for its approach, citing the 1973 House Report 93-120 that accompanied the old law. That

---

1 *See* "EMA Foundation for Paper-Based Communications Institute for Postal Studies Releases 2008 Economic Jobs Study," Envelope Manufacturers Association, June 17. 2008.

2 To avoid imposing old POD burdens on the new USPS and its mailers, for example, Congress actually authorized transitional appropriations to cover the POD liabilities to the employees' compensation fund and to postal employees for earned and unused annual leave as of June 30, 1971. (P.L. 91-375, Chap. 20, Section 2004).

report rationalized shifting the full burden for salary increases onto the Postal Service on the ground that, because of postal reorganization, "the Congress *now has no control – no oversight whatsoever* – with respect to the pay machinery in the Postal Service." (emphasis added).

That Congressional rationale is contradicted by the very nature of the requirements and restrictions Congress imposed on the Postal Service in the 1970 PRA relating to employment, compensation, and benefits that directly impact the growth of the CSRS obligations but are beyond the USPS ability to manage. Chief among these was the general postal policy laid out in section 101(c) of the PRA that the Postal Service "shall achieve and maintain compensation for its officers and employees *comparable to the rates and types of compensation paid in the private sector of the economy*" and that it "shall place particular emphasis upon *opportunities for career advancements*" of all employees.

Thus, Congress in 1970 clearly anticipated *and expected* that the Postal Service would increase wages and promote employees over time, in accordance with this Congressional policy. This expectation should have been recognized and reflected in the calculation of the Federal government's share of the pension obligation for former POD employees.

In addition to this general policy, Congress in the PRA also imposed a number of other specific requirements and restrictions on the Postal Service relating to employee compensation and benefits. These included:

- Mandatory CSRS Pension Coverage. By section 1005(d) of the PRA, Congress required that all Postal Service employees be covered by the CSRS pension program. The Postal Service was forbidden from setting up its own retirement program.

- Congressional Control. The features and benefits of the mandatory CSRS program – including eligibility and vesting rules, contribution levels, pension benefit calculations and levels – are set by Congress.

- Private-Sector Pay Comparability. Congress did not give the Postal Service freedom to set employee compensation and benefits as it saw fit. Instead, by PRA §1003(a), Congress required the Postal Service "to maintain compensation and benefits of all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy."

- Collective Bargaining and Binding Arbitration. Congress also imposed constraints on the manner by which postal wages were set. In PRA §§1203 and 1207, it required that the Postal Service honor existing labor agreements and that wages be set through collective bargaining and binding arbitration.

- Promotion Opportunities. Congress required the Postal Service to establish procedures to "assure its officers and employees meaningful opportunities for promotion and career development" (§1001) and to "provide a maximum degree of career promotion opportunities for officers and employees (§1006).

- Cross-Impact of Policies. Significantly, the collective bargaining and arbitration process excludes consideration of changes to features of employee pension plans which are established by Congress. Moreover, in considering compensation issues, the negotiating parties as well as the arbitrators must take into account the Congressional policy directive of private-sector pay comparability.

Although Congress gave up *direct* control to set postal wages itself, the policies, constraints, and mechanisms it imposed on the new Postal Service in the PRA *inevitably led to wage and pension increases in the future that it could not avoid.* Yet by then enacting P.L. 93-349, Congress evaded its share of the responsibility for the impact of those increases on the Postal Service's pension liability for employees on the payroll as of the effective date of the PRA.

Having imposed on the Postal Service mandatory CSRS pension coverage with benefits set by Congress, plus pay-comparability and promotion policies, Congress's action in later shifting the POD pension-financing burden for such wage increases from the federal government to the Postal Service is a tax on the Postal Service – and on mailers – for complying with Congressional policies. These Congressionally-imposed mechanisms and restrictions inevitably led to compensation and pension-obligation increases that were as much (or more) the responsibility of Congress and the Federal government as the Postal Service.

The unfairness of OPM's approach for allocating the federal government's share of pension obligations for POD employees who continued employment with the USPS after its creation in 1971 is readily apparent. It essentially assumes that such employees retired at the point of the Reorganization, resulting in the Federal government bearing no responsibility for pension obligations resulting from pay increases after June 30, 1971 – whether related to cost of living, step increases, promotions, or general increases as a result of collective bargaining. Thus, a not-so-hypothetical POD postal clerk who later rose to an executive position with the USPS was treated as though he or she had retired at their 1971 salary and position, with the Postal Service responsible for the grossly-disproportionate remainder of that employee's actual pension based on salary-level-at-retirement.

No other postal competitor must face these management constraints or face payment of such a huge obligation not of its own making. The CSRS inequity can be rectified by adopting the OIG's approach which allocates pension responsibility based on the ratio of "years of service" – properly reflecting that such increases were expected of the Postal Service under the Reorganization policies prescribed by Congress. It is simply the right and necessary thing to do.

III. OPM Analogy to Private-Sector Spin-Offs Is Inapt.

Despite the repeal of P.L. 93-349 in 2003, OPM's defense of its methodology remains primarily legalistic: "the law made us do it." Missing is any explanation of the equitable merits of its approach to allocating the CSRS obligation between the USPS and the federal government. The closest OPM comes is its contention that this comports with the treatment of corporate "spinoffs" in the private sector. That analogy is wholly inappropriate. In the private sector, a company that is spun off from its parent is, thereafter, wholly independent of the control of its former parent. In particular, the former parent cannot:

- prohibit the spun-off company from later modifying or eliminating its pension plan either unilaterally or through collective bargaining as permitted by law (in the private sector, pension benefits are "on the negotiating table");
- impose "pay comparability" standards that will, over time, cause the spun-off company's pension liability to grow;
- dictate employment policies, such as rules on collective bargaining and binding arbitration.

Moreover, in the private sector, market forces – including the stock market and competition – provide an element of discipline and disincentive against overloading a spin-off company with excessive obligations that may impair its ability to thrive or survive. Furthermore, even if the parent overreaches by imposing an unaffordable pension liability burden on the spin-off company, that company still has potential remedies to manage and control its obligation regardless of the pension accounting arrangement – including not just modifying or renegotiating its pension plan but also, in the worst case, declaring bankruptcy and restructuring its debts and employee obligations, just as General Motors and Chrysler have recently done. Or, in the very worst case, the spun-off company will simply go out of business.

By contrast, the Postal Service has been placed in an untenable and wholly unmanageable position by the skewed methodology dictated in P.L. 93-349, a methodology that *despite the repeal of that law in 2003* is still being employed by the OPM. As a result, the Postal Service – although effectively "bankrupt" in an ordinary business sense – must still shoulder massive inequitable obligations that it simply cannot afford to pay. It cannot alter its pension plan or benefits. It cannot declare bankruptcy, and then negotiate with its creditors to pay 20¢-on-the-dollar for its debt, because the Postal Service's creditor is the federal government, requiring an act of Congress to restructure.

For its mailers, this means they must pay inefficiently high postal rates that will increasingly become unaffordable, forcing them to curtail their mailings to fit their budgets and to look for other lower-cost non-postal alternatives. The entire postal industry and its contribution to the national economy is at risk and may not recover without swift action to address this issue.

In conclusion, I would urge Congress to redress this problem promptly by adopting the methodology and fix recommended in the OIG's report. In the olden days of robust demand for postal products, the impact of this pension overfunding was every bit as inequitable but it was masked, as the costs could be spread over ever-growing mail volumes. That is no longer true. The cash cow is dry and the postal system is in great jeopardy. The simple fact is that neither the Postal Service nor mail users can afford these costs. However, even within this increasingly competitive environment, relief from these unfair burdens will go a long way toward ensuring the success of the Postal Service effort to restructure and become financially stable.

Attachment
Page 1

Background Of The CSRS Issue

A. The Original CSRS Design Flaw

The Civil Service Retirement System (CSRS) is a defined benefit plan that provides a pension based on the years that an employee serves and the average of his three highest salary years. Thus, as an employee's salary increases for whatever reason – whether due to promotions, pay-scale or grade increases, or inflation increases – his pension benefit also increases. And, the longer an employee serves, the larger the percentage of average salary used to calculate his pension. Moreover, after a retiree starts receiving a pension, he also receives annual inflation adjustments to his pension (retiree COLA).

From an efficient, dynamic actuarial point of view, the present value of a pension benefit for each year of employment (i.e., each year's dynamic "normal" pension cost) should be determined and funded on the basis of the estimated years of service, the estimated high-three average salary at retirement, and the expected cost-of-living adjustments (COLAs) on that pension.[3] For each year, this efficiently matches the total estimated pension cost generated by that year's employment with the revenue earned that year. By law, private companies are required to fund their pension programs dynamically.

Unfortunately, due to a serious design flaw in the CSRS, federal agency plus employee contributions to CSRS each year did not cover all dynamic pension benefit costs (pension obligations) associated with their annual employment. While the contributions reflected expected employee years of service, they did not include the costs of expected future benefits associated with pay scale/grade, promotion, and inflation increases. These latter costs should have been estimated and funded each year because the pension benefit for each year of employment is based on that high-three average salary and the expected annual retiree COLAs. Instead, these particular costs were largely ignored and allowed to become a growing unfunded obligation attributed to the Federal Treasury.[4] In the 1980s, the CSRS plan was discontinued for all new employees because of this design flaw and its consequent growing unfunded obligation. Its replacement, the Federal Employees Retirement System (FERS), was designed to cover all dynamic benefit costs and avoid unfunded pension obligations.

---

[3] See, e.g., "Fundamentals of Current Pension Funding and Accounting for Private Sector Pension Plans." The Pension Committee of the American Academy of Actuaries, July 2004, http://www.actuary.org/pdf/pension/fundamentals_0704.pdf

[4] For an enlightening discussion of this flaw, see General Accounting Office, "Federal Retirement System Financing," June 28, 1995, GAO-T-GGD-95-197.

Attachment
Page 2

When the Postal Reorganization Act (PRA) abolished the old Post Office Department and created the Postal Service on July 1, 1971, there remained a large unfunded POD obligation caused by the CSRS design flaw. This unfunded portion of the obligation should have been estimated and permanently attributed to the federal government in 1971 because it was caused by POD employment prior to establishment of the USPS.

The PRA required that all USPS employees be able to participate in CSRS. Initially, the USPS and its employees, like the vast majority of federal agencies, paid only CSRS "normal" contributions which did not fund all the dynamic costs of their CSRS obligations. For the Postal Service, this began to change in 1974.

B. The 1974 Correction And The USPS Overfunding It Caused

In 1974, Congress passed P.L. 93-349 to correct the CSRS underfunding associated with salary increases the Postal Service negotiated with its employees. Based on the concept of USPS self-sufficiency, a correction was required so that the Postal Service paid, over time, the CSRS costs that *its* operations caused.[5] As USPS salaries increased (for whatever reason) annually, the associated CSRS unfunded obligation for all postal employment also increased.

Unfortunately, the wording of the 1974 law was interpreted by the Civil Service Commission (now the Office of Personnel Management) to allocate to the USPS not only the increased pension obligation correctly associated with employment in USPS operations but also the increase in the *unfunded POD obligation* for POD employees that continued their employment with the USPS. In essence, for purposes of calculating the federal government's share of pension liability for those "crossover" POD employees, OPM's method assumes that they retired at their 1971 pay levels. That, of course, is the antithesis of a dynamic estimation of the federal government's share of the obligation.

By the time it passed P.L. 93-349, Congress was well aware that USPS wages levels (including those for "crossover" employees) were likely to increase substantially in accordance with the promotion and wage comparability policies it

5 The 1974 law was retroactive and the USPS was required to pay for the additional obligation costs caused by salary increases starting from July 1, 1971. Each annual increase in the obligation was amortized over 30 years but the Postal Service was released from the amortization payments that would have been due prior to 1974. Subsequently, under the Omnibus Reconciliation Acts of the late 1980s and early 1990s, the Postal Service was required to pay for the CSRS impact due to annual retiree COLAs. These also were retroactive to July 1, 1971, and each annual increase in the obligation was amortized over 15 years.

imposed on the Postal Service in the 1970 Postal Reorganization Act. Beginning in the early 1970s, the American economy experienced high price and wage inflation that continued throughout the decade. The history of civil service pay increases enacted by Congress since 1971 is instructive. According to a recent report to Congress prepared by the Congressional Research Service (CRS), federal civil service pay scales increased by 86.2% during the first decade following enactment of the PRA.[6] By the end of the second decade in 1991, civil service pay had increased by 176.4%. Of particular note, over the three years between creation of the USPS and enactment of P.L. 93-349, Congress increased civil service pay by 22.5%, thereby increasing the federal government's liabilities for CSRS pensions.[7]

Over those same periods, CRS estimated that wages in the private sector – the benchmark Congress prescribed for postal compensation – increased by 111.8% through 1981, and by 235.8% through 1991. And, consumer prices (CPI-W) increased by 124.5% and 230.0% over those periods.

Given Congress's control over federal civil service pay, and its policy directive in the PRA that the Postal Service "maintain compensation and benefits" for postal employees comparable to those paid in the private sector, Congress clearly intended and expected that the Postal Service would increase wages in line with its policy. The claim in 1974 that Congress "now has no control" over postal wage increases ignores its own directives in the PRA.[8] Indeed, the civil service pay raises that Congress enacted over time undoubtedly served as a "floor" in postal collective bargaining and arbitration deliberations, under the Congressional pay standard of private sector comparability.

This highlights another irrationality of the purported rationale behind P.L. 93-349 as interpreted by OPM. Had the Postal Service not been created in 1971, those employees of the old POD would undoubtedly have continued to receive pay increases from Congress that, over time, would surely have tracked the pay increases that Congress granted to other federal civil service employees. Yet by virtue of P.L. 93-349, Congress abrogated *any* responsibility for the pension impact of USPS pay increases for former POD employees after 1971.

---

6 CRS Report, "Federal Employees: Pay and Pension Increases Since 1969," January 20, 2010, at 8 (comparing 1981 federal civil service pay to 1971). This report is available on the web in pdf format at: http://assets.opencrs.com/rpts/94-971_20100120.pdf.

7 See the CRS report cited above, January 8, 2008, at 8, comparing 1974 to 1971.

8 House Report 93-120 (April 11, 1973) issued by the House Committee on Post Office and Civil Service on the PL 93-349, at 4.

Attachment
Page 4

C. The OIG's Correction For The Overfunding

The inappropriate allocation to the USPS of those POD obligation increases must be corrected. From an economic efficiency perspective, the original obligation as well as any subsequent increases in that obligation were caused by POD operations and employment, and should have remained with the federal government. However, the Civil Service/OPM allocation methodology absolved the federal government of any responsibility for obligation increases for POD employees that continued their employment with the USPS. It did this by incorrectly assuming those POD employees retired in 1971 at their 1971 salary level and years of service when, in fact, those employees, by PRA mandate, continued to earn benefits by participating in the CSRS.

The more efficient and equitable approach should have been to estimate the federal government's share of the pension obligation based on dynamic actuarial assumptions for salary and inflation increases over an employee's estimated years of service. Under that approach, as those estimated assumptions are revised over time (based on more recent data), the estimate of the size of the obligation could change. But, the original responsibility for (the cause of) the obligation never changes.

The USPS payment for POD obligations it did not cause is the source of the $75 billion overfunding identified by the OIG/Hay Report.[9] That report's recommendation – that the share of the obligation should have been allocated between the USPS and the federal government on the basis of "years of service" – is sound and equitable, and in line with accepted dynamic principles for estimating and allocating pension obligations.[10] Properly, that $75 billion is the responsibility of the federal government, and a corresponding credit is owed to the Postal Service.

---

[9] The $75 billion represents a Postal Service overfunding of its entire CSRS obligation, including the obligation for retiree COLAs.

[10] In fact, the OIG Report notes that "OPM uses a years-of-service methodology to allocate the cost of retiree *health care* premiums for retirees who split their careers between the Post Office Department and the Postal Service," and that applying the same years-of-service approach to pension obligations would align it with the treatment of health care obligations. OIG Report Summary at 2.

Post-Hearing Questions for the Record
Submitted to John E. Potter
From Senator Thomas R. Carper
"The Future of the U.S. Postal Service"
April 22, 2010

1. I have long been an advocate of the Postal Service thinking outside the box and finding creative ways to increase access to the services it provides. It's just common sense, I would think, to increase the use of cheaper retail options such as the Internet, retail kiosks and co-location with existing businesses such as pharmacies, grocery stores and partner store where people already go every day. Could you take a minute, General Potter, to describe how you plan to execute your vision in this area? How, in your view, can this alternate retail initiative actually increase retail access, even if it involves the closing of some post offices?

   In addition to online services, the Postal Service currently offers products through more than 60,000 retail partner locations. We know that many of our customers value the convenience of being able to conduct postal transactions where they shop. Because our retail partners, who include drug, grocery, convenience and department stores offer a much wider range of products and have more foot traffic than a Post Office, they can often offer longer hours and more convenient store locations.

   If we add to this network, we believe we can improve the availability of postal products and services, and enhance our customers' experience even if some postal-owned locations close. We have conducted customer research to understand where our customers want to do business with us, and in the coming months we plan to test different retail environments and partnership models to identify which locations best fit customers' needs.

2. You call in your testimony for the elimination of the language currently on the books that prohibits the Postal Service from closing a post office solely for economic reasons. Why is this a necessary part of your plans on alternate retail? Can you make a commitment to your customers that, if this prohibition is eliminated, communities in which alternate retail isn't an option can continue to depend access postal services?

   In thousands of Post Offices, stations and branches, there is not enough revenue to cover the costs of keeping the office open. And because the Postal Service is constrained in its ability to add new revenue streams, that condition will persist for many of these offices.

   We know from our existing alternate access programs that many customers welcome the ability to conduct postal transactions in private retail locations, and we believe that in many locations where a postal facility is not self-sufficient an alternate access location could be found to

meet the needs of the local community. However, if we are prevented from closing offices when transactions move to alternate locations, we may end up increasing the cost of our retail network.

Our retail partners, who include drug, grocery, convenience and department stores offer a much wider range of products than a Post Office, so they can often offer longer hours and more convenient store locations. And we expect to give customers equal – and in many cases better – access to our services than they have today.

3. In the past, I have discussed the prospect of the Postal Service taking advantage of its footprint across the country and leveraging its presence in every community to generate new revenue, including in non-postal areas. Can you explain what you and those you have consulted think about the prospect of successfully raising new revenue in this way?

   We continuously explore new revenue opportunities that leverage our retail network. We have had success with some opportunities, such as the strategic alliance with FedEx for placement of their collection boxes at 5,000 Post Offices. However, opportunities such as banking or digital advertising in retail lobbies are limited by high operating costs and the relatively light customer traffic of Post Offices compared to commercial retailers in addition to strict legislated limitations to only offer postal products.

4. At one point in the report it released on April 12, GAO says that a Postal Service official had told them that the Postal Service could eliminate about 70 processing facilities if local First-Class mail were delivered in two days rather than overnight. Is this accurate? Have you considered making this change? Whether you have or have not, can you describe how the Postal Service weighs the potential cost savings associated with changing service standards such as the local First-Class mail standard against the potential loss in business the change could bring?

   The Postal Service considered this as a potential option as part of its future business model. In evaluating all options as part of that strategy, the Postal Service determined there were other initiatives that better met our future business needs.

   As a result, no definitive study has been performed on this concept. A rough order of magnitude calculation based on current capacities and utilization levels was performed for the estimate provided. It is premature to estimate the exact number of facilities that could be closed under such a scenario.

   If such a scenario were to be fully explored, the Postal Service would look to understand how such a change could impact not only cost and service, but also revenue. The Postal Service has utilized surveys and econometric

modeling to understand how a change to postal operations could impact business and how consumer and business behavior may change under various scenarios. If such a scenario were to be more fully evaluated, these types of techniques would be utilized.

5. I understand that the Postal Service closed 1 of its 9 Area Offices and 6 of its 80 District Offices in 2009. Are there plans in place to further study the potential closure or consolidation of Postal Service administrative offices or to eliminate layers of management?

   The Postal Service continues to review its management structure to take advantage of opportunities to reduce its management complement. The Postal Service has reduced its non-bargaining ranks by over 6,600 positions in the past year.

6. I understand that the Postal Service will soon file a so-called "exigent" rate case in the coming weeks to seek permission to raise rates above the inflation-based rate cap sometimes in 2011. I'll leave it to your lawyers and the Postal Regulatory Commission to argue whether or not your current situation meets the test we wrote into the law in 2006 to determine when it was appropriate to raise rates in this manner. I fear, however, that this action could worsen your current financial condition by encouraging your customers – many of whom have been hit hard by the recession – to hasten their efforts to leave the mail system. Can you take a few minutes to talk to us about why you think the Postal Service must take this step and – if possible – to allay my fears about the loss of business a large rate increase might cause?

   Due to its current financial crisis, and long-term revenue and cost projections, the Postal Service is considering possible moderate price increases. We are very aware of and sensitive to our customers' business needs and the many challenges they face in the current economic environment. This was the underlying reason that we committed to not raising prices on Market Dominant products (which comprise approximately 90 percent of all postal revenue) in calendar year 2010, despite our own poor financial position. Our focus in 2010 continues to be on helping maintain and grow mail volumes through programs such as the 2010 *Summer Sale* which will offer postage incentives to retain and grow mail volume.

   In the Postal Service's Action Plan for the Future, we described the actions necessary to move the organization towards long-term financial viability. These include substantial cost reductions including a reduction of $3.8 billion in FY 2010, modification of the current requirement to pre-fund retiree health benefits, a five-day delivery schedule and an exigent price increase. While the Postal Service believes that the decision not to increase prices in 2010 was the right response to the difficult economic conditions facing our customers, we believe that, under the present

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00101 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.061

circumstances, there is no other choice but to increase prices using the exigent price change mechanism in early 2011. We are continuing to pursue as many avenues as possible to resolve our financial difficulties and recognize that a price increase will reduce mail volumes. We intend to keep our average price change requests modest to mitigate the effect on our customers. We share your concern that higher prices could further the erosion of mail volumes which has been evident in recent years. However, on net, a price increase will result in an increased ability to pay for the Postal Service's institutional (overhead) costs.

We have removed significant costs from our system, but no amount of cost-cutting will enable us to maintain the current six-day delivery schedule and make the statutorily mandated prefunding of retiree health care benefits while keeping prices at or below the inflation cap. As you know, we are seeking Congressional action to address our current obligation to prefund our current employees' retiree health benefits, and to eliminate the six-day delivery schedule requirement.

The Postal Service does not look at the exigent price change process as an easy and quick fix for our financial problems and volume declines, which stem from a variety of complex factors discussed in our recently released ten-year Action Plan. As pending and future pricing options are evaluated, their impact on customers will continue to be in the forefront of our considerations.

7. There was some discussion at the hearing about the length of time the Postal Regulatory Commission plans to take to review the Postal Service's proposal to eliminate Saturday delivery. There are strict timelines in place in the law regarding the Commission's consideration of certain matters, such as exigent rate cases. There is not, to my knowledge, a similar timeline in place for proposals such as the one made with respect to Saturday delivery. Do you think there is a need for Congress to revisit the law governing Commission procedures to ensure that issues considered there are handled expeditiously? If so, can you provide me some specific proposals for changes you think should be made?

Section 3661 of Title 39, United States Code, which governs nationwide changes in service like the Saturday delivery proposal currently before the Postal Regulatory Commission (PRC), does not contain a timeline for PRC review comparable to other provisions of the statute. Section 3661 does provide that the Postal Service must file its proposed change with the PRC "within a reasonable time prior to the effective date of such proposal." In its procedural rules (39 C.F.R. § 3001.72), the PRC has construed this to mean that the Postal Service must file a proposal "not less than 90 days in advance of the date on which the Postal Service proposes to make effective the change in the nature of postal services involved." Barring any other constraint on the Postal Service's authority to make the proposed change, neither the statute nor the PRC's rules prevents the Postal Service from implementing the proposed change after 90 days, even if the PRC has

not yet issued an advisory opinion. In practice, the PRC has tended to take well more than 90 days in which to issue advisory opinions under 39 U.S.C. § 3661. Nevertheless, the Postal Service has tended to await advisory opinions from the PRC before implementing a proposed change, in the interest of comity.

The current proceeding on Saturday deliveries is unusual, in that it concerns a change that would require Congressional action before the Postal Service could implement it. Unless Congress were somehow to nullify the appropriations rider that currently requires Saturday delivery, there is no possibility that the Postal Service could implement the proposed change after 90 days, with or without a PRC advisory opinion. Therefore, whatever prudential constraint that the 90-day implementation period might presumably impose on PRC review does not apply to the ongoing proceeding. Here the PRC has issued a procedural schedule that extends its review for over eight months, until well into the next fiscal year, and after the likely end of the FY 2011 appropriations process. If the proceeding were subject to a 90-day deadline, however, the PRC's advisory opinion would be available at the end of June, which would allow Congress three months to consider the advisory opinion and decide whether to relieve the six-day delivery obligation before the end of the current fiscal year, instead of having to wait until the FY 2012 appropriations cycle. Because of the Postal Service's current financial strain, the delay caused by the PRC's procedural schedule is unfortunate.

The Postal Service agrees that the governing statute could be amended so as to streamline the prerequisites for service changes in various ways. Alternatively, the entire process requiring PRC review of service changes could be replaced while maintaining the type of transparency, public input, and accountability afforded by the current process. For example, with regard to changes like the proposed move to five-day delivery, the law could require that the Postal Service publish a notice of its plan in the *Federal Register* and solicit public comment on its proposal: without sacrificing the public's involvement in the process, this would eliminate the requirement of lengthy, costly, and burdensome evidentiary hearings that delay the ability of the Postal Service to quickly and effectively implement needed operational changes. The Postal Service's Inspector General already audits significant initiatives of this type, and the Postal Service's Governors are expressly charged with acting in the public's interest, so review by the PRC is redundant. A change of this nature would be a positive step in enabling the Postal Service to act in a more businesslike fashion, while still maintaining safeguards consistent with its governmental mission and status.

Short of this type of more fundamental change, the Postal Service would propose four specific changes.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00103 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.063

First, the Postal Service would recommend requiring the PRC to issue its advisory opinion no later than 90 days after the date of the request. In the Postal Service's opinion, this timeframe is reasonable and conforms to that employed for other complex matters before the PRC, such as the Annual Compliance Determination (39 U.S.C. § 3653(b)) and a change in Market-Dominant product prices due to exigent or extraordinary circumstances (39 U.S.C. § 3622(d)(1)(E)).

Second, rather than requiring a hearing on the record in accordance with the Administrative Procedure Act (5 U.S.C. §§ 556-557), the statute could streamline the procedure by converting it into one based on written comments. This would remove several time-consuming deadlines from the procedural schedule, while ensuring interested parties adequate due process in keeping with other types of proceeding before the PRC. This would also be consistent with the Postal Accountability and Enhancement Act of 2006 (PAEA), which streamlined the time-consuming and burdensome on-the-record proceedings for price changes. To be clear, however, the Postal Service should note that nothing in the APA necessitates the protracted nine-month schedule that the PRC has proposed in this matter.

Third, the PRC could be required to give primary regard to the Postal Service's need to reduce costs through rationalization of its assets. While specific customers' needs are undeniably a significant consideration, the Postal Service's proposed changes in service should be evaluated in light of their benefit to the postal system's efficiency as a whole, particularly given Congress's encouragement of the Postal Service's network rationalization efforts in Section 302 of the Postal Accountability and Enhancement Act.

Finally, the Postal Service would recommend that PRC review of nationwide service changes be restricted to those with an impact on Market-Dominant products. The Postal Accountability and Enhancement Act divided the Postal Service's portfolio into Market-Dominant products and competitive products. Several provisions of the law, taken together, indicate Congress's desire to afford consumers of Market-Dominant products certain protections, given the lack of competition that could serve as an independent check on the service provided to those products. Therefore, it may be appropriate that the PRC play an advisory role, after considering input from consumers and other interested parties, on the Postal Service's changes to its service for market-dominant products. With respect to competitive products, however, the Postal Service is by definition subject to market constraints. Therefore, when adjusting its service for Competitive products, the Postal Service is compelled to account fully for customer needs or else face the loss of business to competitors; further review of customer impact by the PRC is thus

ph44585 on D330-44585-7600 with DISTILLER
VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00104 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
57329.064

redundant, and is inconsistent with the PAEA's goal of allowing the Postal Service greater freedoms on the competitive side.

As requested, the Postal Service has prepared an example of legislative changes to 39 U.S.C. § 3661 that reflect these four recommendations:

§ 3661. Postal services relating to market-dominant products

(a) The Postal Service shall develop and promote adequate and efficient postal services with respect to its market-dominant products.

(b) When the Postal Service determines that there should be a change in the nature of ~~postal services~~ postal service provided to market-dominant products which will generally affect such service on a nationwide or substantially nationwide basis, it shall submit a proposal~~, within a reasonable time prior to the effective date of such proposal,~~ to the Postal Regulatory Commission requesting an advisory opinion on the change.

(c) The Commission shall ~~not issue its opinion on any proposal until an opportunity for hearing on the record under sections 556 and 557 of title 5 has been accorded to the Postal Service,~~ provide users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public, with the opportunity to comment on the proposal prior to issuing its advisory opinion. The opinion shall be in writing and shall include a certification by each Commissioner agreeing with the opinion that in his judgment the opinion conforms to the policies established under this title.

(d) The advisory opinion shall be issued within 90 days of the date upon which the Postal Service files its proposal with the Commission. The Postal Service shall not implement the proposed change prior to its receipt of the Commission's advisory opinion.

(e) In considering any proposal filed by the Postal Service, the Commission shall give primary regard to the need of the Postal Service to reduce costs, promote efficient and economical management, and rationalize its use of available assets, in light of prevailing economic and market conditions and the Postal Service's financial condition.

8. During the implementation of the Postal Accountability and Enhancement Act, the Postal Regulatory Commission ruled on whether the Postal Service's various so-called "non-postal" products could continue to be offered. Among those that were permitted to continue was the Electronic Postmark. Delaware among a handful of states that now treat the Electronic Postmark in the same manner as physical postmarks affixed to hard-copy mail. I'm interested, then, to learn some more about the status of this product. Is it currently part of the Postal Service's revenue generation plans?

Over the past few years, USPS has gained experience in how to improve our management of the Electronic Postmark (USPS EPM) business. Events over the past year have dramatically escalated the market need for a USPS EPM – from the financial meltdown that highlighted the need for trust in communication, to the passing of healthcare legislation that opens new doors for electronic transmission of health records. To take advantage of this opportunity, USPS is developing EPM 2.0. With EPM 2.0, we will focus on sectors with high potential for EPM – Healthcare, Financial, Secured Communications, Government, and Critical Infrastructure and Supply Chain. We are beginning conversations with a wide range of interested potential licensees to bring our more focused business model to the marketplace.

###

Post-Hearing Questions for the Record
Submitted to Post Master John Potter
From Senator Daniel K. Akaka

"The Future of the U.S. Postal Service"
April 22, 2010

1. The Postal Service's flat-rate priority box is a great example of a successful product. In Hawaii, shipping inter-island or to the mainland with your competitors can cost two or three times as much. This is just one example of how vital your services are to areas with less service. How much is the Postal Service investing in research and development of other innovations and new products, and how does this compare to past spending?

The Postal Service reports research and development (R&D) costs in the Cost and Revenue Analysis Cost Segment and Component Report in cost segment 17. The totals from 2006 to 2009 have been $41,093,000; $19,792,000; $18,084,000; and $15,451,000 respectively. This segment covers the accrued costs for materials, equipment, and contract services relating to Postal Service research and development. R&D expenditures are incurred primarily for development efforts to improve mail processing technology, construction engineering and field industrial engineering.

The Postal Service does not separately track product development expenses. Product development and innovation typically takes place in the Mailing and Shipping Services function. The Postal Service's Mailing and Shipping Services groups do not have a separate line item budget for research and development. Instead, each Business Unit and Channel owner has a budget, which assumes product innovation activities in addition to ongoing product and channel maintenance expenses. It would be difficult to isolate product development expenses. For example, as product innovation initiatives are identified, the Business Unit undertakes a process to develop an assessment of the opportunity and then creates a business case for the most promising ideas. Depending on the strength of the business case, product development may continue with market research and in-market tests as the Business Unit progresses to build a product or channel enhancement for eventual launch in the market place. Once launched, Business Unit leaders seek feedback to continue to innovate and improve the product or service. This process has lead to a variety of new products and innovations for the Postal Service, such as the Summer Sale, the Saturation Mailer Incentive and the current market test of the Sample Showcase.

Since the 2008 creation of the Mailing and Shipping Services division, there has been a significantly increased focus on new products and services, and the identification of a pipeline of incremental revenue generating projects that are being designed, researched and test- marketed for national expansion over the next several years.

2. There are reservations about the possibility of implementing five-day delivery. You have testified that some polls have found that people would rather reduce delivery than to substantially increase postal rates.

a. What kind of rate increase, on average, would be needed to increase revenue by the amount you expect to save through five-day delivery?

b. Can you provide a copy of the polling results for the record, including what questions were asked, and demographic information?

a. Moving to five-day delivery is only a part of closing the revenue gap. It would take between a 6 and 6.5 percent across the board price increase to generate sufficient contribution to makeup the $3.1 billion net cost savings that would be realized by implementing the five-day delivery operations plan.

b. The following sets forth a summary of the independent polls conducted in 2009 and 2010 that the Postal Service has knowledge of: Each poll asked in essence, do you favor eliminating Saturday delivery and other cost cutting options to ensure the financial stability of the Postal Service. Each poll asked 1,000 or more individuals what option they preferred.

<u>Gallup poll — February 2009</u>
Results of a national survey conducted in February 2009, following testimony by the Postmaster General before a U.S. House subcommittee, suggest that 57 percent of Americans favor cost-cutting measures by the Postal Service (elimination of Saturday delivery, Post Office closures), compared to 27 percent who favored government assistance, and 14 percent who favored a significant increase in the price of postage.

<u>Rasmussen Reports survey — February 2009</u>
A February 2009 national telephone survey conducted by Rasmussen Reports found that a majority of Americans (69 percent) would rather cut mail delivery to five days a week than pay more for postage. Twenty-six percent said they would rather pay more for stamps, and 5 percent were undecided.

<u>Rasmussen Reports survey — July 2009 survey</u>
A July 2009 survey found that 50 percent of Americans would rather cut the number of days mail is delivered than have the government subsidize the Postal Service to maintain its current level of service (34 percent).

<u>USA Today/Gallup poll — March 2010</u>
In a telephone survey of 999 adults conducted March 16, 2010, a USA Today/Gallup poll found support for five-day delivery across all age groups from 58 percent in the 18-34 bracket to 73 percent among those 55 or older. The survey found that 71 percent favor ending Saturday delivery as a way to ensure the Postal Service's financial stability; 35 percent favor closing Post Offices; 44% favor additional federal funding; 44 percent favor raising stamp prices.

<u>MTAC/Postal Service business customer survey</u>
The Postal Service-sponsored a survey of businesses in August 2009 that are associated with the Mailers' Technical Advisory Committee (MTAC) to solicit their comments about five-day delivery. Of the 4,100 responses, 65 percent favor going to five-day delivery, while 32 percent oppose it. Seventy-six percent of respondents were very or somewhat optimistic that their business will be able to adjust to five-day delivery.

<u>Maritz Research on Behalf of the Postal Service</u>
On behalf of the Postal Service, Maritz Research conducted a survey of more than 1,000 residential and 1,100 small businesses (businesses of 250 employees or less) in August 2009 to determine customer reaction to the five-day plan, and to understand if its implementation would affect their willingness to do business with the Postal Service.

The overwhelming majority of residential customers surveyed (98 percent) said that it is important for the Postal Service to remain in business. Two-thirds of residential customers (68 percent) are in favor of five-day delivery, and 60 percent feel that the five-day delivery plan would have no impact on them.

Two out of five of the residential customers surveyed (43 percent) said that Saturday delivery is not important, while 37 percent said that it is. More than half of the residential customers (56 percent) said it is important for Post Offices to stay open on Saturdays.

The overwhelming majority of small business customers surveyed (97 percent) said that it is important for the Postal Service to remain in business. Two-thirds of small businesses (68 percent) are in favor of the five-day delivery plan. Two-thirds (69 percent) said the five-day delivery plan will have no impact on their business.

Half of small businesses (55 percent) said Saturday delivery is unimportant. Half (51 percent) also said it is important that Post Offices stay open on Saturdays.

<u>Opinion Research Corporation on Behalf of the Postal Service</u>
From August to October 2009, Opinion Research Corporation, on behalf of the Postal Service, conducted qualitative and quantitative market to gain insights into their reactions to the five-day delivery concept, to discuss the impact it would have on them, how they could adapt to the change and to quantify how much volume would be lost if five-day delivery operations were implemented.

###

QUESTIONS FOR THE RECORD – SENATOR JOHN MCCAIN

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

Hearing on "The Future of the U.S. Postal Service"

Mr. John Potter

1) The Postal Service has proposed moving to a 5-day delivery schedule, which is estimated to save in excess of $3 billion annually.
   a. Specifically, what are the changes that will be made to postal operations with this proposal?
   b. What impact will 5-day delivery have on mail processing?
   c. What reduction in labor will result from the implementation of 5-day delivery?

a) The five-day delivery plan (see http://www.usps.com/communications/five-daydelivery/plan/welcome.htm) includes a summary of the changes in postal operations that would occur:
- **Mail will not be delivered to street addresses on Saturday, and mail will not be collected from blue street collection boxes or Post Offices on Saturday. Also, there will be no Saturday pickup of mail from homes and businesses.**
- **Mail addressed to Post Office boxes will continue to be delivered on Saturday.**
- **Post Offices will remain open on Saturdays. No Post Office will be closed as a result of the change to five-day delivery.**
- **Express Mail will continue to be delivered seven days a week.**
- **Outgoing mail may still be dropped off at a Post Office or in a collection box on Saturday, and will be canceled and processed on Monday.**
- **Bulk mail acceptance that now takes place on Saturday and Sunday will continue.**

Here are the services which would change:
- **There will be no Saturday mail delivery to street addresses.**
- **There will be no Express Mail or Priority Mail pickup from street addresses on Saturday.**
- **Mail will not be picked up from collection boxes or Post Offices on Saturday. Mail deposited in collection boxes (including Post Office lobby collection boxes), accepted across a Post Office counter, or put in**

Automated Postal Centers on Saturday will be processed on the following Monday.

- **Outgoing mail will be processed only Monday through Friday.**

Here are the services which would remain the same as they are now:

- **Post Offices will remain open on Saturdays and will accept outgoing mail.**
- **Post Office box-addressed mail will be delivered on Saturday.**
- **Express Mail will be delivered seven days a week, and will continue to be collected from dedicated Express Mail boxes on Saturday.**
- **Plants and distribution centers will continue to process incoming mail seven days a week to support street address delivery Monday through Friday, Post Office box delivery Monday through Saturday, and Caller Service pickup Monday through Sunday.**
- **Outgoing mail will continue to be transported Monday through Friday.**
- **Transportation will generally continue as it currently does between plants on Saturday and Sunday.**
- **Mail will be accepted on Saturday, with processing and start-the-clock activities starting on Monday.**
- **Business mail entry units (BMEUs) will be open on Saturdays and/or Sundays. The start-the-clock day will generally be Monday, except that mail entered at a destination facility will have the option of a Saturday start-the-clock day.**
- **Detached mail units will be open on Saturdays and/or Sundays. The start-the-clock day and mail makeup requirements will continue to be governed by customer/supplier agreements.**
- **Incoming drop shipments will continue at facilities accepting this mail. The start-the-clock day will be the day the mail is entered. This mail will be processed as incoming mail on the entry day.**
- **Destination delivery units (DDU) will generally accept drop shipments during the hours retail counters are open.**

b) Under five-day delivery, the processing of outgoing or originating mail would change from a six-day a week operation to a five-day a week (Monday – Friday) operation. The processing of incoming or destinating mail would continue as it does now, up to seven days a week.

c) Discontinuing Saturday delivery and collections would result in significant savings by eliminating work performed by city and rural carriers. These savings account for the majority of the $2.7 billion of the estimated $3.3 billion total.

City carrier savings will result from no longer needing the carriers who handle the sixth delivery day. This work is primarily performed by carrier technicians employed specifically for this purpose. These nearly 25,000 positions would no longer be needed. Other part-time and full-time assignments used to replace the regular carrier on the sixth day would also no longer be needed.

If five-day delivery had been in effect throughout FY 2009, the estimated city carrier work hour reductions would have been 47 million, or about 12 percent of FY 2009 city carrier hours. Over the long term, attrition will result in fewer carrier technicians or other full-time carriers. Initial savings would come from reducing the number of non-career transitional employees.

The estimated work-hour savings for the four types of rural routes are based on the current rural carrier compensation rates. Estimated savings are 18 million work hours, nearly 10 percent of FY 2009 rural carrier hours.

The bulk of the rural carrier savings would come from work-hour reductions for non-career rural carrier associates (RCAs). The wage rate for RCAs is about half that for regular rural carriers.

Eliminating Saturday delivery also would result in supervisor work reductions. However, these work reduction savings have been offset to reflect the cost of continuing to deliver Express Mail on Saturday. Given the attrition rates and current non-career employees, there would be no lay-offs for career employees.

About $200 million in annual savings could be realized because of lower processing costs at plants and Post Offices. Moving outgoing sorting from Saturday to Monday would allow savings in plant clerks, mail handlers and supervisors, and reduced maintenance.

Further, eliminating Saturday delivery and collections would reduce the need for clerk staffing at Post Offices. While much of the work formerly performed on Saturday would need to be done Monday through Friday instead, there would still be savings from the activities for which costs are driven by the number of routes and days of delivery.

About $380 million in annual transportation savings would be realized by eliminating Saturday delivery via highway contract, postal vehicle drivers,

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00113 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.073

and contract delivery. Highway contract savings would result from a reduced need for highway transportation on Saturday and Sunday. Also, eliminating Saturday carrier delivery and collection reduces the need for vehicle service drivers to transport mail between Post Offices and plants on Saturday.

2) A Gallup survey and polls conducted by the *Washington Post* and *USA Today* indicate that Americans are generally favorable toward 5-day delivery to ensure the survival of the Postal Service. However, the mailing community is impacted differently than mail recipients.
   a. What kind of reception have you received on the 5-day delivery proposal from the mailing community?
   b. What are the biggest challenges the mailers face with a 5 day delivery?
   c. What is the cost to the mailing community to adjust its business operations to a 5-day delivery schedule?

a) **The Gallup survey and polls conducted by the *Washington Post* and *USA Today* are consistent with other independent polls and market research conducted on behalf of the Postal Service. Consumers and small, medium and large businesses are all generally favorable to five-day delivery to ensure the survival of the Postal Service.**

The following sets forth a summary of the independent polls conducted in 2009 and 2010 that the Postal Service has knowledge of: Each poll asked in essence, do you favor eliminating Saturday delivery and other options as cost cutting measure to ensure the financial stability of the Postal Service. Each poll asked approximately 1,000 or more individuals which option they preferred.

<u>Gallup poll — February 2009</u>

Results of a national survey conducted in February 2009, following testimony by the Postmaster General before a U.S. House subcommittee, suggest that 57 percent of Americans favor cost-cutting measures by the Postal Service (elimination of Saturday delivery, Post Office closures), compared to 27 percent who favored government assistance, and 14 percent who favored a significant increase in the price of postage.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00114 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.074

Rasmussen Reports survey — February 2009

A February 2009 national telephone survey conducted by Rasmussen Reports found that a majority of Americans (69 percent) would rather cut mail delivery to five days a week than pay more for postage. Twenty-six percent said they would rather pay more for stamps and 5 percent were undecided.

Rasmussen Reports survey — July 2009 survey

A July 2009 survey found that 50 percent of Americans would rather cut the number of days mail is delivered than have the government subsidize the Postal Service to maintain its current level of service (34 percent).

USA Today/Gallup poll — March 2010

In a telephone survey of 999 adults conducted March 16, 2010, a USA Today/Gallup poll found support for five-day delivery across all age groups from 58 percent in the 18-34 bracket to 73 percent among those 55 or older. The survey found that 71 percent favor ending Saturday delivery as a way to ensure the Postal Service's financial stability; 35 percent favor closing Post Offices; 44 percent favor additional federal funding; 44 percent favor raising stamp prices.

MTAC/Postal Service business customer survey

The Postal Service sponsored a survey of businesses in August 2009 which are associated with the Mailers' Technical Advisory Committee (MTAC) to solicit their comments about five-day delivery. Of the 4,100 responses, 65 percent favor going to five-day delivery, while 32 percent oppose it. Seventy-six percent of respondents were very or somewhat optimistic that their business will be able to adjust to five-day delivery.

Maritz Research on Behalf of the Postal Service

On behalf of the Postal Service, Maritz Research conducted a survey of more than 1,000 residential and 1,100 small businesses (businesses of 250 employees or less) in August 2009 to determine customer reaction to the five-day plan, and to understand if its implementation would affect their willingness to do business with the Postal Service.

The overwhelming majority of residential customers surveyed (98 percent) said that it is important for the Postal Service to remain in business. Two-

thirds of residential customers (68 percent) are in favor of five-day delivery, and 60 percent feel that the five-day delivery plan would have no impact on them.

Two out of five of the residential customers surveyed (43 percent) said that Saturday delivery is not important, while 37 percent said that it is. More than half of the residential customers (56 percent) said it is important for Post Offices to stay open on Saturdays.

The overwhelming majority of small business customers surveyed (97 percent) said that it is important for the Postal Service to remain in business. Two-thirds of small businesses (68 percent) are in favor of the five-day delivery plan. Two-thirds (69 percent) said the five-day delivery plan will have no impact on their business.

Half of small businesses (55 percent) said Saturday delivery is unimportant. Half (51 percent) also said it is important that Post Offices stay open on Saturdays.

Opinion Research Corporation on Behalf of the Postal Service

From August to October 2009, Opinion Research Corporation, on behalf of the Postal Service, conducted qualitative and quantitative market research to gain insights into their reactions to the five-day delivery concept, to discuss the impact it would have on them, how they could adapt to the change and to quantify how much volume would be lost if five-day delivery operations were implemented.

This qualitative market research shows that most consumers and small businesses said that elimination of Saturday delivery to street addresses and the collection of mail on Saturday would have little impact on their use of the mail. They said they would adapt to the change. This is not to imply it would have no impact. Rather, they will adapt by mailing on days other than Saturday. Or they will use alternatives, including the Internet. Most felt that as long as Post Offices were open on Saturday, they would be able to adapt.

Most small businesses said that they had a regular routine for receiving and sorting mail Monday through Friday when they are open or when they normally handle mail. Elimination of Saturday delivery would not affect these small businesses. Most small businesses said they would adapt by mailing on Friday or Monday.

ph44585 on D330-44585-7600 with DISTILLER
VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00116 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
57329.076

Almost all larger businesses said that they would accept five-day delivery operations as being necessary to help solve the Postal Service's financial problems. They said they would be able to adapt if given a sufficient lead time of up to six months.

That customers would adapt to five-day delivery operations is confirmed in the quantitative market research. It shows that the impact of implementing five-day delivery operations would be a reduction of 0.7 percent of total volume or 1.238 billion pieces, most of it First-Class Mail. The loss in contribution resulting from this loss of volume would be almost $200 million.

The mailing community in general has echoed what the large businesses said in our research. They are willing to accept five-day delivery so long as they have sufficient lead time to adapt to this change.

b) **Mailers have told us that the biggest challenge with implementation of five-day delivery is the lead time to make the changes to their operations. The operational changes include production schedules, targeted delivery days (Friday or Monday in lieu of Saturday), IT support and transportation contracts. We have committed to providing a six-month implementation process including extensive communications.**

c) **Mailers have not told us the cost of making the changes to their operations of implementing five-day delivery.**

3) In its study of the USPS, McKinsey & Co. found that mail volume is expected to decline to 150 billion pieces by 2020. With the continued evolution of electronic communication and e-commerce, do you anticipate further mail volume reduction, or does it bottom out in 2020?

The USPS asked The Boston Consulting Group to forecast mail volume through 2020, which McKinsey & Company used as a baseline. All the parties recognized the increasing level of uncertainty that is present in forecasts as they extend further into the future. We were, however, comfortable with estimating the future for the next 10 years as that seemed a reasonable period to assess current trends in both mail and communications overall. Forecasting mail volume beyond that point more than 10 years away would be increasingly difficult due to the rapid pace of change in digital communications and e-commerce.

Notwithstanding the above, we believe mail volume will continue to decrease beyond 150 billion pieces in 2020, as society continues to embrace and

expand digital means of communication and commerce, thus offsetting organic growth from increasing numbers of American households. Even more distressing than the overall volume decline is that First-Class Mail, which provides the highest level of financial contribution to our institutional revenues, is expected to decline the most over the next decade and into the future. All the above assumes, however, there are no exceptional events in the future, such as a catastrophic internet security failure (which would likely increase mail volume) or another mail-borne terror attack or recession (which would decrease mail volume).

4) In Ms. Ruth Goldway's written testimony, she admonishes the Postal Service and its consultants for failing to explore what it would take to keep open as many post offices as possible, how to keep delivery at 6 days, what new products the public needs, and how to determine the service levels that are most advantageous to its future success. What is the Postal Service's response to this criticism?

The Postal Service in fact took a comprehensive approach to addressing the current situation. Given the fact that the challenges facing the Postal Service are both short-term (due to the "perfect storm" created by the combination of declining mail volume, rising costs, falling revenue, and economic instability) and long-term (due to the fact that over time more and more communications and transactions will take place electronically), the Postal Service's goal was to pursue a plan that would keep America's postal system viable both now and in the future, rather than to simply focus on what it would take to continue business as usual. To ensure that all options were explored, it sought the assistance of globally respected business consulting firms to help in developing an action plan that not only responds to its current crisis, but that also lays the foundation for a leaner, more market-responsive Postal Service that will meet the changing needs of the American public and thrive well into the future.

It is clear that the status quo is no longer a sustainable option. As a self-supporting government enterprise funded by its paying customers, not taxpayers, the Postal Service must live within its means. Given the Postal Service's current situation, this is an extraordinary challenge. It is experiencing unprecedented volume declines and revenue is not keeping pace with costs. In recent years, mail volume has precipitously declined, driven by the recession, as well as by an acceleration of the diversion of First-Class Mail and other communications to electronic media. At the same time, delivery addresses continue to increase every year, resulting in the delivery of considerably less mail to more addresses at a time when the evolving mail mix is generating less revenue and contribution to overhead per piece. By 2020,

real daily revenue per delivery point is projected to fall by 44 percent from what it was in 2000, declining from $1.80 in 2000, to $1.40 in 2009, to $1.00 in 2020. Postal finances have been strained even further by the accelerated Retiree Health Benefits Fund payments imposed by law, and for almost a year now the Postal Service has been on the Government Accountability Office's "high risk" list.

To help it address these challenges, the Postal Service engaged the services of three world-class business consulting firms: Accenture, The Boston Consulting Group (BCG), and McKinsey & Company, all of whom were told that "everything is on the table." They conducted extensive research, examined revenue, volume and customer trends, and analyzed product and revenue opportunities used by foreign posts. They also examined more than 50 possible actions to address the Postal Service's challenges. Among the actions examined were, for example, offering financial services, commercializing network assets, and privatizing all or parts of the business. These possible actions were filtered based on their feasibility, as well as their potential impact on consumers and businesses. This resulted in a narrowed list of strong options, all of which are discussed in the plan presented by the Postal Service on March 2, 2010, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* ("Action Plan"), available at *www.usps.com/strategicplanning/ pdf/ActionPlanfortheFuture March2010.pdf*. The plan includes aggressive actions that the Postal Service can take now—including increased productivity and revenue growth—as well as legislative and regulatory changes necessary to maintain a viable Postal Service.

Moving to five-day delivery is a solution that can be accomplished relatively quickly, compared to how long it is likely to take to bring to market "new, higher profit products." Moving to five-day delivery also addresses some of our fixed infrastructure costs—costs that do not vary with volume. For example, 50 percent of carrier costs are fixed; it costs the same for a carrier to deliver one piece of mail to a residential address as it does to deliver 10 pieces. And, by over 70 percent, customers prefer this option to those involving the use of tax dollars to subsidize the Postal Service, or dramatically raising postage costs.

The research also supports closing some Post Offices. The research found that the cost per $1 of revenue at some Post Offices is $10, and that given declines in demand, the foot traffic at some offices is less than 10 customers per day. This is not sustainable, as customers will continue to move online.

Finally, to illustrate the size of the Postal Service's challenge to sufficiently increase revenue to cover its $7 billion annual net income gap, consider it would need to generate $50 billion in new revenue to close the gap—an amount larger than FedEx's total annual revenue.

5) Ms. Ruth Goldway also suggests eleven ideas for positive change for inclusion in the Postal Service's target plans for 2020. Has the Postal Service considered each of these ideas and what is its assessment of each?

The Postal Service welcomes ideas for positive change. The responses provided below to the specific ideas Ms. Goldway enumerated in her testimony demonstrate that they have been considered and evaluated. The Postal Service's March 2010 Action Plan contains new and important ideas with large potential financial benefits. The Postal Service would like to act on these ideas as soon as possible; however, a number of them cannot be fully pursued without legislative and/or regulatory changes. The necessary legislative and regulatory changes are outlined in the Action Plan.

1. Fourteen Market Dominant products do not cover attributable costs, amounting to $1.7B. Thirty workshare discounts exceed avoided costs. Come up with new, higher- profit products.

The Postal Service routinely reaches out to customers to gauge interest in potential new products and services, and actively pursues those ideas that are within its authority under current law and that hold the prospect of being profitable. Other posts are offering products with high margins, such as banking services.

To quote from the Postal Service's March 2010 Action Plan:

The Postal Service plans to expand products and services across targeted mail and package segments to increase profits by $2 billion by 2020. For example, it will work to increase direct mail use among small and medium-sized businesses, and to increase volumes in both First-Class Mail and advertising mail through targeted promotions. It will continue to leverage its last-mile network to deliver packages to all households, forming partnerships with others serving the growing e-commerce industry. It will also continue to grow other retail services, such as passports and Post Office Box rentals.

To address the products not covering attributable costs, we are looking both at reducing operational costs and at judiciously raising prices for these products.

In addition, while the Postal Service has been criticized for having discounts that exceed estimated cost savings, looking only at this one aspect of workshare discounts distorts the true story. For example, some of the discounts that are higher than the estimated costs savings are for First-Class Presort letters, a highly profitable product. In FY2009, First-Class Presort letters had a 291 percent cost coverage, the highest cost coverage of any product.

2. *Convert fleet to electric vehicles.*

The Postal Service has led the way in testing alternative fueled vehicles (AFVs), which can use clean fuels such as, ethanol, compressed natural gas (CNG), liquefied propane gas, electricity, and bio-diesel. With currently over 44,000 AFVs, it has the largest civilian fleet of such vehicles.

In 2000, the Postal Service awarded a contract to a major American manufacturer to build 500 electric vehicles with a body similar to that of Long Life Vehicles (LLVs), the familiar boxy white delivery trucks. Two years later, that manufacturer decided to cancel its electric vehicle program for a variety of reasons: a lack of replacement batteries, diminished battery range in cold weather, and a lack of consumer interest in electric vehicles. Due to the supply chain collapse, the Postal Service was forced to discontinue this effort.

In the Postal Service's experience with electric vehicle technology over the past two decades, a key issue is the availability of replacement components throughout the lifecycle of the vehicles. The long-term ability of original equipment manufacturers to supply parts and services, and long-term availability of parts, are critical considerations because the Postal Service needs to be able to maintain these vehicles beyond the initial production warranty period. In addition, the cost of storing batteries, battery shelf life, and the cost of labor required for battery replacement are major issues that must be evaluated in a pilot demonstration before large quantities of replacement batteries are purchased.

The Postal Service continues to explore electric and other vehicle technologies in its quest to procure cost-efficient, environmentally friendly vehicles that will get the job done reliably and effectively, based on the long-term, total cost of ownership. Multiple vehicle prototypes are being tested in support of cutting petroleum fuel use and increasing alternative fuel use by 10 percent. Testing now includes all-electric, gas/electric

ph44585 on D330-44585-7600 with DISTILLER

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00121 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

57329.081

hybrids, compressed natural gas and propane, and three-wheel electric vehicles.

In December 2009, the Postal Service awarded contracts to five companies to evaluate the feasibility of converting LLVs to battery-powered electric vehicles. Each company will develop its own prototype for testing this summer. The prototype vehicles will be put into service in the Washington, DC, area to evaluate performance during a one-year test period.

3. Have range of products that are fully trackable and comparable with those of private package companies.

The Postal Service currently offers an entire suite of Track and Confirm letters and flat mail (e.g., catalogs and magazines) using Intelligent Mail barcodes. Intelligent Mail provides mailers insight into the entire value stream, including printing and transportation, even before mail is provided to the Postal Service. The range and capabilities of these products are described at *http://www.usps.com/shipping/trackandconfirm.htm* and *http://www.usps.com/business/intelligentmail/welcome.htm*, respectively. In addition, the Postal Service continuously seeks to improve and enhance its mail tracking capabilities for letters, flats, and parcels, and has recently reorganized its operational structure so that there is a Vice President specifically tasked with developing innovations in technologies and tracking systems.

4. One stop shop for government services – national park passes, EZ passes, identity cards.

The Postal Service provides passport services and other government services (such as the sale of duck stamps.) However, the "one-stop shop for government services" idea appears to be better for the Postal Service in theory than it would be in practice. Research conducted by the consulting firms engaged to evaluate potential business options and strategies for the Postal Service showed that these ventures are highly unlikely to prove sufficiently profitable. That is consistent with the Postal Service's experience to date in discussions with other government agencies, many of whom offer a variety of services online, though this will not prevent the Postal Service from continuing to work with them to explore potential opportunities that meet a public need, while also ensuring sufficient revenue for the Postal Service.

The Postal Service is unable to effectively compete with the prices offered by private sector companies for handling time-sensitive materials and package delivery. Additional pricing flexibility is necessary to address this issue.

5. Full partner in 2020 census, saving the country hundreds of millions of dollars.

The Postal Service is proud to have partnered with the U.S. Census Bureau in the 2010 Census through nationwide mailings that used the Intelligent Mail barcode tracking technology.

However, it is impossible to be certain whether—and how—the country would save hundreds of millions of dollars in the 2020 Census as a result of the Postal Service's "full partnership" in that effort. Census Bureau Director Robert Groves has been quoted as saying he cannot imagine doing the 2020 Census without an Internet option because that option would reduce the amount of manpower and the cost to carry out the Census, and would provide a way to reach people who are at home infrequently and difficult to contact in person. Groves also said that the Census would not move entirely on line, because an Internet-only effort would make it difficult to count people in rural areas and people who are illiterate. Assuming the 2020 Census is not conducted primarily on line, there are important issues and questions that would need to be considered when contemplating a "full partner" role for the Postal Service:

- **If "full partnership" would require postal employees to take on additional tasks, the Postal Service would expect to be compensated by the Census Bureau for actual costs.**
- **Would postal carriers, for example, have the time to perform these duties in addition to their normal work? Would additional tasks impact service?**
- **What is the rate of pay for temporary Census workers and how does it compare to the pay and benefits of carriers?**
- **Would this additional work be subject to collective bargaining with carrier unions?**

6. Building on money order services now offered, introduce and implement a system to provide assistance to the unbanked.

To quote from the Postal Service's March 2010 Action Plan:

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00123 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.083

Additional revenue opportunities will continue to be considered in the future. Some product ideas were drawn from international posts, which take a broad-based approach to product diversification. Ultimately, five areas stood out — parcel services, logistics, banking, integrated marketing, and document management. Building a sizeable business in any of these areas requires time, resources (primarily capital), new capabilities (often with the support of acquisitions or partnerships), and profound alterations to the postal business model. Accenture research shows that while international posts are still building these businesses and implementing the necessary steps to make them succeed, these lines of business tend to generate below average profitability compared to industry benchmarks. [Details about this research are available at: *www.usps.com/strategicplanning/ pdf/Accenture.Presentation.pdf*]. However, the other product areas examined are currently not viable for the Postal Service because of its net losses, high wage and benefits costs, and limited access to cash to support necessary investments. Opportunities to leverage the Post Office network to enter new markets, such as banking or consumer goods, are similarly limited by high operating costs and the relatively light customer traffic of Post Offices compared to commercial retailers.

The number of money orders sold in Post Offices has declined over the years given the growth in lower cost alternatives. From Fiscal Year 2006 to Fiscal Year 2009, money order volumes declined 23 percent.

It is important to note that banking services are, by law, outside of the scope of products and services the Postal Service is able to offer. In order for the Postal Service to be able to offer these services, Congress would need to change the law to provide product flexibility to the Postal Service.

The Post Office Department offered government-backed savings services to American residents for over half of the twentieth century. The postal savings system began accepting deposits from individuals in 1911. It allowed for incremental savings as small as a ten-cent stamp and for conversion to interest-bearing certificates or bonds. It offered account holders the post office's security of depositing funds in a federal institution. Savings grew to $1.2 billion during the 1930s and jumped again during World War II, peaking in 1947 at almost $3.4 billion, with more than four million depositors using 8,141 postal units. Congress abolished the postal savings system in 1966 and the Post Office Department stopped accepting deposit on April 27th of that year.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00124 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.084

7. Commit to having a network of post offices open more hours, open on Sundays, and have at least one 24/7 post office in every big city.

If "a network of post offices" refers to actual brick-and-mortar Post Offices, there are good reasons not to commit to this idea. The Postal Service *is*, however, committed to providing postal services in many other ways and through many other venues, and a wide variety of postal services are already available to customers 24/7. Access to postal services has expanded though the Postal Service's enhanced online presence, partnerships, and kiosks.

Only approximately 29 percent of postal revenue comes from retail sources (which not only includes Post Offices, but also alternate retail access sources such as usps.com, PC Postage, and Automated Postal Centers). The rest of postal revenue is derived from commercial sources. Maintaining the Postal Service retail network is increasingly costly. The average Post Office is far more expensive to operate than other means of serving customers, and the average Post Office transaction costs 23 cents per dollar of revenue, compared to 13 cents per dollar of revenue for the average transaction at a contract postal unit. In the past, Post Offices generated almost all postal retail revenue. Today, about 29 percent of postal retail revenue is generated through *usps.com* and other alternative channels. Certainly this reflects customers' willingness and interest in transacting their postal business through venues other than traditional Post Offices.

Managing the retail network is not just about cost, but also about customer demand. As noted in the Postal Service's March 2010 Action Plan, customer preferences have rapidly evolved in recent years, and new technology has changed how Americans communicate and transact business. The Postal Service must adapt to these changes, and provide both the access and services that today's customers want while responsibly managing its costs.

These and related issues are addressed in more detail in the Postal Service's Action Plan, and in materials outlining the Postal Service's five-day delivery proposal at *http://www.usps.com/strategicplanning/futurepostalservice.htm?from=home&page=EnvisionFuturePostalService* and *http://www.usps.com/communications/five-daydelivery/*.

8. Implement a comprehensive vote-by-mail system.

The Postal Service fully supports voting by mail at all levels of government and has worked for many years with election officials. Mail plays a vital role in the American democratic process, and the Postal Service has long been committed to providing election officials nationwide with the information necessary to meet their Election Mail™ needs. Only Congress and state and local governments, however, can require that voting by mail be offered as an option to their citizens.

The Postal Service's comprehensive election mail resource guide—the product of its collaboration with many of the country's Secretaries of State—is available *at http://www.usps.com/electionmail/*.

9. Reinvent the letter carrier.
AND
10. Reorganize the workforce.

Carriers already provide a full range of services, but some customers may be unaware of what carriers provide. Today, rural carriers are a veritable "Post Office on wheels," offering letter and package pick-up and selling postal products. City carriers also pick up outgoing letters and packages from homes as well as businesses—for free. And all postal employees, including carriers, are encouraged to submit revenue leads based on their customers' needs and interests.

We have worked with several organizations to review and in some cases test potential additional opportunities to use the postal carrier workforce. However, currently there has been limited interest primarily due to the costs involved (mainly because outfitting over 200,000 routes with any technology adds up to tens of millions of dollars very quickly. Regarding Ms. Goldway's "reorganize the workforce" idea, the March 2010 Action Plan and the five-day delivery plan both stated that continued attrition due to retirements will provide opportunities for the Postal Service to establish a more flexible workforce better aligned with changing customer demand. Over the next 10 years, over 300,000 postal employees—more than half the current workforce—will be eligible to retire, providing an excellent opportunity to make the workforce even more efficient by increasing use of flexible and part-time employees.

The Postal Service must become a leaner organization. This can be accomplished in part through expected retirements and the orderly

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00126 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

pht44585 on D330-44585-7600 with DISTILLER

57329.086

process of attrition, and by establishing more flexible work rules through the collective bargaining process. Annually, approximately 5 percent of employees are eligible and expected to retire. It makes no sense to replace them with full-time employees if demand is moving in a direction better suited to a part-time workforce. Although the Postal Service would prefer to manage this change through collective bargaining, interest arbitration is always a possibility under existing law. The financial health of the Postal Service and the affordability of postal products should be key considerations in any interest arbitration ruling. As stated in its Action Plan, the Postal Service supports Congressional action requiring interest arbitrators to take into account its financial condition before making any interest arbitration decision.

When benchmarked against other large posts and private sector parcel couriers, the Postal Service employs the most full-time workers as a percentage of its total workforce. For example, while part-time employees at the Postal Service make up approximately 13 percent of the workforce, part-time employees represent 22 percent of Royal Mail's workforce (U.K.), and 40 percent of the Deutsche Post workforce (Germany). Providing increased workforce flexibility will help to continue to improve service levels while reducing costs.

11. Have 10 other ideas in place within the decade.

The Postal Service is constantly looking at new ideas and actions to meet changing customer needs, improve service, minimize costs, and enable it to continue to be self-sustaining. It has more than 10 revenue-generating ideas ready to go now, in addition to the seven proposals—many of which encompass more than just one new idea or action—presented in the Postal Service's March 2010 Action Plan. The Postal Service has shared these ideas with the Postal Regulatory Commission (PRC) over the last year. Those within postal management's control under the current law are already being pursued, such as consolidating the network to improve service, and enhancing mail's value by using information from Intelligent Mail barcodes. Others, however, require legislative and regulatory changes before the Postal Service can act on them:

1. **Retiree Health Benefits Prefunding. Restructure retiree health benefits payments and address overpayments to the Postal Service's Civil Service Retirement System pension fund.**

2. **Delivery Frequency. Adjust delivery days to better reflect current mail volumes and customer usage. Survey data show that the public favors five-day delivery over using taxpayer funds and other alternatives.**

3. **Expand Access. Modernize customer access by closing small, unprofitable Post Offices and bringing our services to our customers. Increase and enhance customer access through partnerships, kiosks, and improved online offerings, while reducing costs.**

4. **Workforce. Establish a more flexible workforce that is better-positioned to respond to changing demand patterns as over 300,000 employees become eligible to retire in the coming decade.**

5. **Pricing. Ensure that prices of Market Dominant products can be based on the demand for each individual product and its costs, rather than capping prices for every class at the rate of inflation. In addition, pursue a moderate exigent price increase (as allowed by the PAEA) effective in 2011.**

6. **Expand Products and Services. Permit the Postal Service to evaluate and introduce more new products consistent with its mission, allowing it to better respond to changing customer needs.**

7. **Oversight. Reinforce these changes with more clearly defined, appropriate, agile oversight roles and more streamlined processes.**

6) The evolution in the digital world has led to a significant decline in the use of physical mail. The Postal Regulatory Commission gave the Postal Service the authority to use electronic postmarks a couple of years ago. Given the continued growth of electronic communication, what are you doing to capitalize on this opportunity?

Over the past few years, USPS has gained experience in how to improve our management of the Electronic Postmark (USPS EPM) business. Events over the past year have dramatically escalated the market need for a USPS EPM — from the financial meltdown that highlighted the need for trust in communication, to the passing of healthcare legislation that opens new doors for electronic transmission of health records. To take advantage of this opportunity, USPS is developing EPM 2.0. With EPM 2.0, we will focus on sectors with high potential for EPM – Healthcare, Financial, Secured Communications, Government, and Critical Infrastructure and Supply Chain. We are beginning conversations with a wide range of interested potential licensees to bring our more focused business model to the marketplace.

7) The GAO recommends that Congress mandate that any binding arbitration between the Postal Service and its unions should take the Postal Service's financial condition into account. Employee union groups argue that arbitrators already take financial condition into account, so it does not need to be set in statute. With respect to this issue, what has been your experience with the arbitration process?

Evidence on the financial condition of the Postal Service has been presented in past interest arbitrations. However, the extent to which arbitrators' awards have been influenced by that evidence is unclear. Generally, arbitrators' decisions do not expressly indicate the extent to which, if any, that the USPS' financial condition impacted the outcome of their awards. A change in the law to direct arbitrators to consider such a factor would bring clarity to this issue and, in all likelihood, increase the emphasis on this consideration as a factor impacting the ultimate outcome.

8) Last year mail volume declined so much that idle Postal employees were placed in stand-by rooms at various processing plants. While there was work to be done, the tasks were not within the idle employees' craft. How much in productivity is lost by this restriction that an employee must stay within his craft? How much in stand-by costs were incurred by the Postal Service last year?

Stand-by time in mail processing operations was approximately 1.2 million hours in FY 2009, or around 0.5 percent of total mail processing work hours. Stand-by time costs for FY 2009, based on fully-loaded wage rates, are estimated at $49 million. The primary driver of stand-by time is the difficulty in adjusting the workforce within certain processing plants to a large and rapid decline in mail volume. While working employees across craft boundaries could help lessen the amount of stand-by time, employees of the various crafts are recognized as being in separate bargaining units and are represented by different bargaining representatives. The entitlement of employees to perform the work within their respective crafts and their recognized bargaining units cannot legally be disregarded.

9) The Postal Service is limited to a certain percentage of part-time employees at any given time, thus requiring that a set number of full time employees be present regardless of workload. What impact has this had on labor costs and benefits?

The number and percentage of part-time employees (part-time flexibles, casuals and transitional employees) and the conditions under which they may be used varies by collective bargaining agreement. In addition, the cost of part-time employees also varies, with some being career employees with per hour wages similar to that of full-time employees and others being noncareer employees who are paid substantially less. A higher number of full-time employees increases overall labor costs.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00129 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

pH44585 on D330-44585-7600 with DISTILLER

57329.089

Responses to Post-Hearing Questions for the Record
The Future of the U.S. Postal Service
April 22, 2010 Hearing
Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security
Committee on Homeland Security and Governmental Affairs
United States Senate

Questions for Phillip Herr, Director
Physical Infrastructure Issues
U.S. Government Accountability Office

Questions from Senator McCain

1) **The Postal Service estimates that mail volume will continue to decline during the economic recession but rebound slightly in 2013 and maintain mail volume of between 150 million to 170 million through 2020.**

   a. **Have you conducted an independent assessment of anticipated mail volume through 2020?**
      a. **If so, how comparable are your estimates to those of the Postal Service?**
      b. **If not, do you believe the Postal Service's estimates are realistic?**

We did not conduct an independent assessment of U.S. Postal Service's (USPS) mail volume projections as part of our recent work on USPS's business model.[1] In performing this work, however, we did discuss these projections with USPS and its consultants. We also did our own outreach with mailers and other stakeholders (including business mailers who generate significant amounts of volume and revenue for USPS) that confirmed they do not expect volume to return to former levels when the economy recovers. Specifically, some stakeholders reinforced the conclusion that the recent recession was a "tipping point" that has accelerated the diversion of mail to electronic alternatives.

The use of electronic alternatives for communications and payments, including broadband and mobile technology is expected to continue to grow and continue influencing volumes—particularly for USPS's two largest mail classes, First-Class Mail and Standard Mail. First-Class Mail volume, which has decreased by 19 percent since it peaked in fiscal year 2001, is projected by USPS to decline by 37 percent over the next decade. Similarly, Standard Mail (primarily advertising) volume is unlikely to return to former levels. Standard Mail was affected by large rate increases in fiscal year 2007 for flat-sized mail, such as catalogs, and by the recession that affected advertising, such as mortgage, home equity, and credit card solicitations. USPS

---

[1]GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability,* GAO-10-455 (Washington, D.C.: Apr. 12, 2010).

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00130 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.090

projects that Standard Mail volume will decline in fiscal year 2010 and then remain roughly flat over the next decade, including small increases over the next 3 fiscal years as the economy recovers and no further increases in the next 7 years. As we reported, Standard Mail faces growing competition from electronic alternatives, increasing the possibility that its volume may decline in the long term.[2]

Thus, while we have not fully assessed the volume estimates put forth by USPS, we continue to believe that mail volumes are at risk, particularly as consumer preferences change and the availability of electronic alternatives increases. Continued volume declines would pose significant challenges to USPS's financial condition and outlook and would require major efforts by USPS to prepare for, and thus attempt to mitigate, these declines.

b. Do you believe that the Postal Service's plans for cost reduction are flexible and aggressive enough in the event that mail volume continues to decline indefinitely? Why or why not?

It is unclear whether USPS's plans will be sufficient to make the necessary progress on cost reductions in the event that mail volume continues to decline indefinitely. First, as part of USPS's *Action Plan,*[3] it identified billions in potential cost savings that it could achieve under its current authority. Our past work has recognized difficulties USPS has faced in achieving these results. For example, USPS has made limited progress in optimizing its networks, particularly in facilities that include public access to retail operations. USPS's *Action Plan* also says that it plans to expand retail access using alternatives to traditional USPS retail facilities and, as customers shift to these services, that it will reduce redundant retail facilities. However, it is unclear what specific changes would be made, how long it would take to make these changes, and how much annual cost savings could be achieved. Further, USPS's *Action Plan* does not address possible closures of mail processing facilities to reduce the excess capacity in its mail processing network. USPS has reported that it has 50 percent excess plant capacity in its First-Class Mail processing operations, but has closed only 2 of its 270 processing and distribution centers since 2005. USPS no longer needs—and can no longer afford—to maintain all of its retail and mail processing facilities. As we reported, USPS may be able to improve its financial viability if it takes more aggressive action to reduce costs, particularly compensation and benefit costs that comprise 80 percent of its total costs. To make the necessary progress, USPS and its unions need to use the collective bargaining process to address wages, benefits, and workforce flexibility.

USPS's *Action Plan* and our work on USPS's business model also concluded that actions by USPS are not likely going to be enough to offset future losses. As such, USPS's plan identified actions that Congress and others can take that would alleviate some of its cost pressures. These actions entailed both operational changes (considering that USPS faces formidable resistance to closing facilities) as well as other statutory and regulatory modifications. For example, USPS suggested that

[2] GAO-10-455.

[3] United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C.: March 2010).

Congress modify its current retiree health benefit funding requirements and allow it to move to 5-day delivery. In addition to these areas, our report said that Congress should consider revising the statutory framework for collective bargaining to ensure that any binding arbitration takes USPS's financial condition into account.

Going forward, participation by USPS, Congress, and other stakeholders, including the Postal Regulatory Commission (PRC), postal unions, and mailers, will be key to responding to potential volume declines and successfully taking advantage of certain cost saving opportunities.

2) Has the GAO looked into the Postal Service's possible $75 billion overpayment into the CSRS plan? If so, what is GAO's conclusion?

We reviewed the January 2010 report issued by USPS's Office of Inspector General (OIG) and its April 2010 testimonies before the U.S. Senate and House of Representatives on the future viability of USPS.[4] In the January report, the OIG asserted the current method employed by the Office of Personnel Management (OPM) for allocating the pension costs for post-1971 Postal Service employee pay increases to USPS, for payment from the Postal Fund into the Civil Service Retirement System (CSRS) Fund, has resulted in an inequitable overpayment to the CSRS Fund. The OIG asserted in the April testimonies that the current method for allocating the pension costs is inconsistent with the Postal Civil Service Retirement System Funding Reform Act of 2003.[5] We believe that OPM acted within the authority and direction it was given by the 2003 act to allocate pension costs for post-1971 pay increases of USPS employees. This methodology has been employed consistently by OPM since a 1974 law mandated USPS to pay for the pension costs associated with post-1971 pay increases.

On May 10, 2010, OPM provided a letter response to the assertions made by the OIG, in which OPM stated its conclusion that it is not permitted to change its allocation methodology. As authorized by the review process set forth in the Postal Accountability and Enhancement Act of 2006,[6] USPS, in response to the OIG's assertions, requested a formal review of OPM's methodology by the Postal Regulatory Commission (PRC). That review is now ongoing and the PRC will submit a report to USPS, OPM, and Congress. After OPM receives this report, it is required to reconsider its determination in light of such report and make any appropriate adjustments. OPM is then required to submit a report containing the results of its reconsideration to the PRC, USPS, and Congress.

---

[4]USPS Office of Inspector General, *The Postal Services's Share of CSRS Pension Responsibility,* RARC-WP-10-001 (Arlington, VA: Jan. 20, 2010). The Postal Service Inspector General testified on April 15, 2010, before the Committee on Oversight and Government Reform and its Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, House of Representatives, and on April 22, 2010, before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security, Committee on Homeland Security and Governmental Affairs, U.S. Senate.

[5]Pub. L. No. 108-18, 117 Stat. 624 (Apr. 23, 2003).

[6]Pub. L. No. 109-435, § 802(c), 120 Stat. 3198, 3250 (Dec. 20, 2006).

3) What is your opinion of the Postal Service's proposal to transfer the $75 billion CSRS overpayment to finance the Postal Service's Retiree Health Benefits Trust Fund?

Determining whether any amount should be transferred from the CSRS Fund to the Postal Service's Retiree Health Benefits Fund, as a result of changes in pension funding, cost allocation, or other requirements, is ultimately a policy choice for Congress to consider.

4) In its report entitled *USPS: Strategies and Options to Facilitate Progress toward Financial Viability*, the GAO strongly supports the principle that the Postal Service continue to fund its retiree health benefit trust obligations to the maximum extent possible. Given that no other federal agency pre-funds retiree health benefits, many private sector companies don't pre-fund retiree health benefits, and the ones who do pre-fund it, do so to the tune of approximately 30% of liability, why do you believe that the Postal Service should pre-fund its retiree health benefits significantly more – up to 100%?

We believe that USPS should prefund its retiree health obligations to the maximum extent that its finances permit. In comparing USPS to the rest of the federal government, it is important to recognize that, unlike most of the federal government which is funded through direct appropriations, USPS operates under a fundamental principle that it be financially self-supporting. Thus, it strives to generate enough revenues from products and services to cover its costs. While certain military retiree health costs are prefunded through appropriations made to the Department of Defense, Congress has not required the same of civilian agencies. Further, private sector companies can typically modify or terminate their retiree health plans at their discretion, which is a common practice when a company is experiencing financial difficulties. However, USPS cannot do this, as its retirees' health plans are part of the federal government's Federal Employees Health Benefits Program (FEHBP). Thus, if USPS cannot make its required payments, the U.S. Treasury, and hence taxpayers, would still have to meet the federal government's obligations. Requiring USPS to prefund its retiree health obligations to the maximum extent its finances permit will help ensure that funds generated from ratepayers, not taxpayers, will be available to pay for the benefits of USPS retirees.

It will become increasingly burdensome for USPS to fund its share of retiree health insurance premiums on a pay-as-you-go basis from postal revenues that, according to USPS, are projected to remain relatively flat over the next 10 years. Deferring payments or some portion into the future increases the risk that USPS may have difficulty in making the future payments, particularly if mail volumes continue to decline.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00133 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.093

Question from Senator Akaka

1) **Reducing the burden of retirement health payments on the Postal Service triggers a Congressional Budget Office score, assuming reduced motivation to continue cost-cutting measures resulting in a larger deficit. Any score with a negative impact on the deficit creates budgetary problems in eliminating payments, even in the event that retiree health benefits are prefunded earlier than anticipated. Understanding the Government Accountability Office's expertise in government management and the Postal Service, do you believe this kind of behavioral scoring is reflects reality?**

As a general rule we do not comment on the estimates prepared by the Congressional Budget Office (CBO). We believe Congress is best served by having a single source of budgetary estimates and that CBO is the best source of information on the estimates it develops. We do note that CBO has, when it deemed it appropriate, taken into account changes in behavior directly related to a piece of legislation when producing a cost estimate. For example, if legislation is proposed to significantly increase a program's fees, CBO would likely assume that some consumers may choose not to pay the increased fee and that this would negatively affect revenues.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00134 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.094

Post-Hearing Questions for the Record

Submitted to Inspector General David Williams

From Senator Daniel K. Akaka

"The Future of the U.S. Postal Service"

April 22, 2010

As mentioned in my opening statement, I still have questions about the overall savings generated from switching to five-day delivery. The Postal Service has estimated around 3 billion savings. Has the Inspector General's Office independently examined the Postal Service's savings estimate?

The Office of Inspector General has not performed an independent examination to validate the Postal Service estimated $3 billion savings from switching to five-day delivery. The Postal Regulatory Commission plans to ask Postal Service about the estimated savings figures. The Office of Inspector General is currently assessing aspects of the Postal Service's operational capability to implement five-day delivery.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00135 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.095

QUESTIONS FOR THE RECORD – SENATOR JOHN MCCAIN

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

Hearing on "The Future of the U.S. Postal Service"

Mr. David Williams

1) **Last year the Postmaster General testified that an additional $3.5 billion in cost reductions can be achieved in FY 2010 through management actions. In your review of the Postal Service, do you believe that the Postal Service can achieve its goal?**

   The Office of Inspector General (OIG) believes the Postal Service is on track to achieve its projected cost reduction goals of $3.5 billion for FY 2010. Most of these savings are associated with work hour reductions. As of April 30, 2010, the Postal Service reported it had reduced 55 million work hours, nearly 60 percent of the 92 million projected. However, additional work hour reductions, while attainable, may become increasingly more difficult during the remainder of FY 2010.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00136 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT
ph44585 on D330-44585-7600 with DISTILLER
57329.096

2) **The Postal Service estimates that mail volume will continue to decline during the economic recession but rebound slightly in 2013 and maintain mail volume of between 150 million to 170 million through 2020. Have you conducted an independent assessment of anticipated mail volume through 2020?**
   a. **If so, how comparable are your estimates to those of the Postal Service?**

      The OIG has not conducted an independent assessment of anticipated mail volume through 2020.

   b. **If not, do you believe the Postal Service's estimates are realistic?**

      The Postal Service estimates appear to be reasonable; however, it is inherently difficult to forecast mail volume for a number of reasons. Forecasting may be most complicated by the current highly volatile economic climate, where it is difficult to separate the effects of the economic downturn from the effects of an accelerating migration to digital and wireless technologies.

   c. **Do you believe that the Postal Service's plans for cost reduction are flexible and aggressive enough in the event that mail volume continues to decline indefinitely? Why or why not?**

      The Postal Service has undertaken aggressive and unprecedented cost reductions. In 2009 alone, the Postal Service reduced work hours by 8 percent — eliminating 115 million work hours — and cut its career workforce by more than 40,000 people. The Postal Service's efforts may not be enough, however, to chase an indefinite decline in mail volume since a significant share of the Postal Service's costs are fixed and will not decline when volume declines. For example, the cost of a carrier walking to a mailbox with 3 letters is not much less than the cost of the carrier walking to the mailbox with 6 letters. The Postal Service also faces institutional barriers both in managing labor costs and in streamlining the plant and retail networks, which limit its ability to respond with agility to market factors.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00137 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.097

3) The Postal Service Inspector General released a report concluding that the Postal Service has been overcharged $75 billion for contributions into the Civil Service Retirement Security Plan. Could you please explain how you came to this conclusion?

We examined the issue and found that the formula the Office of Personnel Management (OPM) uses to split the share of pension costs for employees with service both before and after July 1, 1971, is inconsistent with the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18). The formula under which OPM is operating assumes that all salary inflation after 1971 should be paid by the Postal Service instead of being divided with the federal pension fund and associated with the respective years of service. In essence, for almost 40 years, the Postal Service has paid its share plus the federal government's share of inflationary salary costs. For example, for an employee who worked 15 years for the Postal Service and 15 years with the Post Office Department, the Postal Service could be responsible for 70 percent of the pension costs under the current methodology. The current methodology is also not consistent with the 2003 Act or the congressional intent behind the 2003 Act, both of which anticipate the use "dynamic assumptions" that account prospectively for the effects of inflation and pay increases. OPM did not use a dynamic methodology when calculating the federal share of pension costs. Instead, OPM's methodology allowed the federal government to escape the effect of salary increases on pension costs. A fairer and more consistent methodology is one that splits pension costs based on years of service.

To calculate the amount the Postal Service has been overcharged under the current methodology, we used OPM's own calculation of the Postal Service's pension fund balance. This calculation was based on how much the Postal Service and its employees contributed to the pension fund and the amount the fund was charged each year for the Postal Service's share of payouts to retirees. We then adjusted the Postal Service's share of the payments to retirees to reflect a fairer and more consistent years-of-service methodology. Our calculations have shown that the Postal Service's pension fund balance would be $75 billion higher under this methodology. Therefore, we concluded that the Postal Service was overcharged by $75 billion from 1972 to 2009.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00138 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.098

4) Why does the Office of Personnel Management believe that the federal government should not be responsible for future salary increases when credit for years of service was earned when the Postal Service was still a federal government agency?

To the best of our knowledge, OPM believes that it is pursuing Congress's intent based on the 1974 law that required the Postal Service to pay the pension costs of salary increases (P.L. 93-349). That was true until 2003, when the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18) repealed the 1974 provision and stipulated new guidance. We believe that the 2003 Act mandated that funding should be accomplished using dynamic assumptions for both the Postal Service and the federal government.

ph44585 on D330-44585-7600 with DISTILLER

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00139 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

57329.099

5) **The GAO report entitled *USPS: Strategies and Options to Facilitate Progress toward Financial Viability* suggests that that the stream of payments into the Postal Service's retiree health benefit trust fund be altered to provide some relief to the Postal Service's financial situation, but the Postal Service should continue to fund its obligations to the maximum extent its finances allow. The GAO also gives two possible options to revising the current approach: 1) Pay as you go approach to funding retiree health benefits; and 2) actuarial approach to funding retiree health benefits.**
   a. **How do you believe the stream of payments to the retiree health benefit trust fund should be adjusted, if at all?**
   b. **How do you view each of the proposed options as an alternative?**

   Unified response to a. and b.: We believe the stream of payments should continue to flow to the retiree health benefit trust fund from prefunding. We believe prefunding is more prudent than pay-as-you-go financing, but it should be done according to actuarial principles.

   The pay-as-you-go approach is used by the federal government and other private and public-sector entities, but it may not be the most advantageous for the Postal Service, which may shrink in the future. Under pay-as-you-go, the Postal Service premium payments would continue to increase each year as the number of retirees grows, even though the Postal Service's own workforce and revenues may decline.

   Instead, an actuarial approach, coupled with the return of the Postal Service's $75 billion overpayment of its CSRS liability, would fund past liabilities immediately and limit annual prefunding to additional payments for retirement health benefits earned by employees that year. This option would also have the benefit of charging users of the mail the cost of the retiree health care benefits earned by employees processing and delivering their mail.

VerDate Nov 24 2008 13:45 Dec 01, 2010 Jkt 057329 PO 00000 Frm 00140 Fmt 6601 Sfmt 6601 P:\DOCS\57329.TXT SAFFAIRS PsN: PAT

ph44585 on D330-44585-7600 with DISTILLER

57329.100

Questions and Answers for the Record
Submitted by Ruth Goldway

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

Hearing on "The Future of the U.S. Postal Service"

April 22, 2010

Senator McCain Questions:

1) The Postal Service estimates that moving to 5-day delivery will save approximately $3.1 billion annually, while the PRC estimates that it will achieve cost savings of closer to $2.2 billion. Where and why do the Postal Service and the PRC diverge on the cost savings?

The Commission first presented an estimate from eliminating one day of delivery as part of its Universal Service Obligation study mandated by the PAEA and sent to Congress on December 19, 2008. The Commission's contractor for that study, George Mason University (GMU), initially developed the estimated savings as $1.9 billion. The Postal Service also presented an estimate of cost savings of $3.5 billion developed by its contractor IBM. Both estimates were developed with FY 2007 costs. The Commission's Annual Report for FY 2009 updated both estimates with FY 2008 numbers. The results and an identification of the differences are as follows.

Estimates Based on FY 2007 costs:

- Both use a simple model based only on carrier costs (direct labor and indirect costs)
    - Eliminate 1/6th fixed delivery costs
    - Transfer variable delivery costs to remaining 5 delivery days
- Savings estimates
    - PRC: $1.9 billion
    - USPS: $3.5 billion
    - Difference: $1.6 billion
- Sources of difference
    1. $0.5 billion from volume impact assumptions:
        - PRC: 2 percent reduction as result of reduction in service
        - USPS: 0 percent reduction
    2. $0.9 billion from delivery cost of transferred mail (carrier productivity and volume transferred):
        - PRC: no change in carrier's marginal delivery costs; use 1/6 of weekly volume
        - USPS: 50 percent reduction in marginal costs (subsequently changed to approximately 25 percent with a difference of only $0.3 billion); uses Saturday specific volume

3. $0.2 billion from different indirect carrier cost estimates
   - PRC indirect costs were from published Cost and Revenue Analysis
   - USPS used slightly higher internal cost information on indirect costs

The Commission's 2009 Annual Report updated both estimates with FY 2008 data and assumes:

1. Volume: PRC: 2 percent reduction; USPS: 0 percent
2. Productivity: PRC: constant marginal delivery costs; USPS: 25 percent reduction
3. Indirect carrier cost estimates: Same as USPS)
4. Total Estimated Savings:
   - PRC: $2.2 billion
   - USPS: $3.2 billion
   - Difference: $1.0 billion
5. Sources of difference:
   i. $0.6 billion from volume impact assumptions:
   - PRC: 2 percent reduction as result of reduction in service
   - USPS: 0 percent reduction

   ii. $0.4 billion from delivery cost of transferred mail (carrier productivity and volume transferred):
   - PRC: no change in carrier's marginal delivery costs; use 1/6 of weekly volume
   - USPS: approximately 25 percent reduction in marginal costs (originally 50 percent with a difference of about 1.0 billion); uses Saturday specific volume

With the filing of the request for an advisory opinion on 5-day delivery, the Postal Service presents a specific proposal for eliminating Saturday delivery and modifying mail processing operations while maintaining some features of Saturday operations, such as retaining delivery to post office boxes on Saturday. The Postal Service proposal also contains a new operations based analysis to estimate the cost savings from eliminating Saturday delivery. The proposal is contained in PRC Docket No. N2010-1 available at *www.prc.gov.* The Postal Service's estimated savings are $3.1 billion. *See* Docket No. N2010-1, USPS-T-7, Table 6, page 18.

In Docket No. N2010-1, the Commission is developing a record on the Postal Service's proposal including the cost savings estimates. Once the record is complete the Commission will develop an updated cost savings estimate.

2) Is the PRC looking into the Postal Service's possible overpayment into CSRS plan? If so, what approach is the Postal Regulatory Commission pursuing to determine if there is an overpayment and how long will this process take?

Yes, the Commission is looking into it following the March 1, 2010 Postal Service request that the Commission do so per Section 802 (c) of the PAEA. The PAEA requires that upon receipt of such a request that the Commission "shall promptly procure the services of an actuary, who shall hold membership in the American Academy of Actuaries and shall be qualified in the evaluation of healthcare insurance obligations, to conduct a review in accordance with generally accepted actuarial practices and principles and to provide a report to the Commission containing the results of the review." The Commission issued a Request for Proposals from which three bids were received and the Segel Company was selected to perform the work. A contract was signed on May 3, 2010. The Segel report is due by July 1, 2010. The Commission currently anticipates that it will transmit the report along with its comments to Congress, the USPS and OPM before the end of July. This review, comment and distribution process is specified by the PAEA in Section 802(c).

3) ***What is your opinion of the Postal Service's proposal to transfer the $75 billion Civil Service Retirement System overpayment to finance the Postal Service's Retiree Health Benefits Trust Fund?***

The Commission's actuarial contractor is currently studying whether an overpayment exists and, if so, its extent. The contractor is not studying any proposal to transfer the funds to the Postal Service's Retiree Health Benefits Trust Fund and therefore will not offer an opinion on the Postal Service's transfer proposal.

4) ***The GAO report entitled USPS: Strategies and Options to Facilitate Progress toward Financial Viability suggests that that the stream of payments into the Postal Service's retiree health benefit trust fund be altered to provide some relief to the Postal Service's financial situation, but the Postal Service should continue to fund its obligations to the maximum extent its finances allow. The GAO also gives two possible options to revising the current approach: 1) Pay as you go approach to funding retiree health benefits; and 2) actuarial approach to funding retiree health benefits.***
   a. ***How do you believe the stream of payments to the retiree health benefit trust fund should be adjusted, if at all?***
   b. ***How do you view each of the proposed options as an alternative?***

In response to a request by the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives received on June 15, 2009, the Commission conducted a review of methods for calculating the retiree health liability and alternative payment streams into the fund. The Commission found that a lower payment schedule than mandated in the PAEA could achieve essentially the same level of funding implied by the PAEA schedule. The alternative payment schedule identified by the PRC is approximately $2.1 billion per year less than the mandated payment schedule. The full report issued on July 30, 2009 entitled "PRC Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U. S. Postal Service Office of Inspector General" is available at *www.prc.gov* under Library/PRC Reports and Studies.

Based on that study, the Commission does believe that the stream of payments specified in the PAEA can and should be altered and I have affirmed this position in subsequent testimony. The Commission did not study alternatives of pay as you go or starting actuarial based payments before 2016 since they would produce a different liability estimate from what the original stream of payments in the PAEA projected for 2016. The Commission could perform those studies should the Subcommittee request them.

Senator Akaka Question:

As mentioned in my opening statement, I still have questions about the overall savings generated from switching to five-day delivery. The Postal Service estimates around three billion dollars savings. I understand that the Postal Regulatory Commission previously had its own, lower estimate. When did the Commission last update its estimate, and has the Commission analyzed the Postal Service's new estimate?

The Commission's last published update of the estimated cost savings is in the 2009 Annual report submitted to Congress on January 8, 2010. The results from the initial estimate contained in the Commission's Universal Obligation Study submitted to Congress on December 19, 2008 and the update are as follows.

Estimates Based on FY 2007 costs:

- Both use a simple model based only on carrier costs (direct labor and indirect costs)
  - o Eliminate 1/6th fixed delivery costs
  - o Transfer variable delivery costs to remaining 5 delivery days
- Savings estimates
  - o PRC: $1.9 billion
  - o USPS: $3.5 billion
  - o Difference: $1.6 billion
- Sources of difference
  1. $0.5 billion from volume impact assumptions:
     - PRC: 2 percent reduction as result of reduction in service
     - USPS: 0 percent reduction
  2. $0.9 billion from delivery cost of transferred mail (carrier productivity and volume transferred):
     - PRC: no change in carrier's marginal delivery costs; use 1/6 of weekly volume
     - USPS: 50 percent reduction in marginal costs (subsequently changed to approximately 25 percent with a difference of only $0.3 billion); uses Saturday specific volume
  3. $0.2 billion from different indirect carrier cost estimates
     - PRC indirect costs were from published Cost and Revenue Analysis
     - USPS used slightly higher internal cost information on indirect costs

The Commission's 2009 Annual Report updated both estimates with FY 2008 data and assumes:

1. Volume: PRC: 2 percent reduction; USPS: 0 percent
2. Productivity: PRC: constant marginal delivery costs; USPS: 25 percent reduction
3. Indirect carrier cost estimates: Same as USPS
4. Total Estimated Savings:
   - PRC: $2.2 billion
   - USPS: $3.2 billion
   - Difference: $1.0 billion

5. Sources of difference:
   i. $0.6 billion from volume impact assumptions:
      - PRC: 2 percent reduction as result of reduction in service
      - USPS: 0 percent reduction
   ii. $0.4 billion from delivery cost of transferred mail (carrier productivity and volume transferred):
      - PRC: no change in carrier's marginal delivery costs; use 1/6 of weekly volume
      - USPS: approximately 25 percent reduction in marginal costs (originally 50 percent with a difference of about 1.0 billion); uses Saturday specific volume

With the filing of the request for an advisory opinion on 5-day delivery, the Postal Service presents a specific proposal for eliminating Saturday delivery and modifying mail processing operations while maintaining some features of Saturday operations, such as retaining delivery to post office boxes on Saturday. The Postal Service proposal also contains a new operations based analysis to estimate the cost savings from eliminating Saturday delivery. The proposal is contained in PRC Docket No. N2010-1 available at *www.prc.gov*. The Postal Service's estimated savings are $3.1 billion. *See* Docket No. N2010-1, USPS-T-7, Table 6, page 18.

In Docket No. N2010-1, the Commission is developing a record on the Postal Service's proposal including the cost savings estimates. Once the record is complete the Commission will develop an updated cost savings estimate.