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FINDING SOLUTIONS TO THE CHALLENGES FACING 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

DECEMBER 2, 2010

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FINDING SOLUTIONS TO THE CHALLENGES FACING THE U.S. POSTAL SERVICE

THURSDAY, DECEMBER 2, 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 10:02 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Thomas R. Carper, Chairman of the Subcommittee, presiding.

Present: Senators Carper, Collins, and Coburn.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. I am pleased to call our hearing to order and to be here with Senator Collins and, I suspect, a couple of our other colleagues as the morning goes on. We want to thank our witnesses, welcome our witnesses and our other guests, for what I think is an important hearing.

We have held, a number of hearings over the years in this Subcommittee, as well as over in the House, to highlight the numerous challenges facing the Postal Service. It is my hope that with this hearing we will soon get down to the hard work of actually addressing those challenges and clearing the way to enable the Postal Service to emerge from the toughest time that it has faced since it was created four decades ago.

At many of these hearings, members and witnesses talk about how, despite hard times, the Postal Service is achieving its mission and will continue to achieve its mission. The Postal Service has done an admirable job in cutting costs and streamlining operations and reducing its workforce through attrition. They have managed to do all of these things while maintaining and, in some cases, improving service, at least by some measure. And we commend the Postal Service employees, the managers, and soon-to-be former Postmaster General Jack Potter. But the truth is that we are rapidly approaching a time when we may no longer be able to depend on the Postal Service, and that time may come less than a year from now.

The Postal Service, I am told, has lost a record $8.5 billion in fiscal year 2010. Postal management is projecting the loss of a further $6.4 billion in the current fiscal year. As a result, by this time next year the Postal Service will likely have exhausted all of the $15 bil-

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lion line of credit that it has with Treasury and will not have sufficient cash to meet its obligations. In practical terms, this could mean that, during the next year's holiday shopping and mailing season, the Postal Service may not have the resources necessary to keep its doors open.

So much for the bad news. How about the good news? Well, there is some good news, and I take some comfort in the fact that the vast majority of the Postal Service's losses in recent years are attributable to the very aggressive retiree health care pre-funding schedule that was put in place in 2006. In fiscal year 2010, $5.5 billion out of the Postal Service's $8.5 billion loss could be attributed to the retiree health payment it was required to make in September. Only $500 million of the $8.5 billion is actually an operating loss. Only $500 million. That is still a lot of money.

I take some comfort from the fact that there is a level of consensus here in Congress and amongst postal stakeholders that something must be done about the Postal Service's retiree health prepayments, or at least the level of them. But even if we were to completely eliminate the remaining payments, we would only be dealing with a portion of the Postal Service's projected long-term deficit. This is where the bad news comes back in.

This past spring, the Postal Service and a group of highly regarded outside consultants conducted a study showing that if nothing changes, the Postal Service would run up more than $230 billion in cumulative deficits between now and the year 2020. Some of these losses could be stemmed by the Postal Service today without Congress taking any action at all. I am sure that some steps have already been taken since the $230 billion number was first announced. But the enormity of the projected losses tells me that we need to go beyond just addressing the retiree health payments by enabling the Postal Service to make several fundamental changes to the way it does business.

We live in a time when the Postal Service is competing not just with the United Parcel Service (UPS), not just with Federal Express (FedEx), but with the Internet, with email, with electronic bill pay, with cell phones, and other advances in communication and commerce. Simply put, many businesses that in the past had to turn to the Postal Service to reach customers or ship their products have far more choices today. To make the Postal Service a viable choice, we need to give postal employees the tools that they need in order to thrive in the coming years.

Coming together at the last minute a few months down the road and doing just enough to get the Postal Service through Christmas 2011 is not a viable option. I am reminded today, reading the headlines in the papers and watching the news on television, that our Federal Government faces a sea of red ink as far as the eye can see. Adding another $230 billion to our Nation's debt is not a viable option as we seek to replace what I call a culture of spendthrift in Washington with a culture of thrift.

Going forward, the Postal Service cannot remain a part of the problem. It must become part of the solution, and if we work together—and that is something that Senator Collins and I and Senator Coburn are pretty good at doing. But if we work together and

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think outside the box, along with a bunch of you, that can happen, and it needs to.

In September, I introduced legislation, the Postal Operations Sustainment and Transformation Act (POST), P-O-S-T, as we call it, that I believe may be the only proposal out there now that deals comprehensively with the problems facing the Postal Service in both the short term and the long term. It is not a perfect proposal, but we think it is a comprehensive proposal and a bold proposal that has elicited a lot of comments—some positive, some not so positive, but it has elicited a lot of discussion, and I think that is positive.

The key part of our bill aims to permanently fix the postal pension and retiree health issues that have been debated for quite some time now. The legislation does this by requiring the Office of Personnel Management (OPM) to revise the dated methodology used to determine how much the Postal Service pays into the Civil Service Retirement System (CSRS). That change would likely show that the Postal Service has overpaid that system by as much as $50 billion, some would say even more.

The POST Act would allow the Postal Service to use that money over the years, in the next 6 or 7 or 8 years, to satisfy the Postal Service's retiree health prepayment obligation. This would take roughly $5.5 billion or more off the Postal Service's books each year and prevent a catastrophic shutdown in the coming months.

My bill would also empower postal management to take some additional steps to cut costs over time. The Postal Service has been talking for several months now about eliminating $3 billion a year out in costs by reducing a day of delivery. I think that $3 billion is a net number. They have submitted a proposal to the Postal Regulatory Commission, and the Commission is preparing a report on the advisability of this change.

Unfortunately, each year Congress prevents the Postal Service from exercising the authority to change delivery frequency when it believes that doing so is necessary, and we do this despite the fact that the 2006 postal reform legislation explicitly gave the Postal Service the authority to change delivery frequency and other service standards to adjust to customers' changing needs.

Now, let me just make it clear. I am not an advocate of eliminating Saturday delivery. I think there are good arguments both for and against what the Postal Service would like to do. But I am an advocate of giving the Postal Service the freedom to manage, especially when our interfering in management decisions could prevent the achievement of so much in savings at such a critical time. The POST Act would ensure that, on this issue, the Postal Service, working with its regulator and its customers, will make the critical decisions on Saturday delivery without political interference.

The POST Act also seeks to simplify the postal management decisionmaking process when it comes to transforming its retail network. As many in this room know, the Postal Service has tens of thousands of retail locations. Some of these locations are ideally located; some are not. Others operate with significant losses. My bill would remove several legislative restrictions that tie the Postal Service to an outdated retail network and free them to begin to expand to more cost-effective and more convenient retail outlets that

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I believe could and should ultimately enable the Postal Service to better serve its customers.

But the bill I have introduced is not just about cutting. It also recognizes that, while customers may be moving away from hard-copy mail, the Postal Service's retail and delivery network remains extremely valuable. I propose in my legislation that the Postal Service be freed to better capitalize on the value of this network by experimenting with products and experimenting with services not directly related to the mail.

Among the things the Postal Service could do with this authority would be to partner not just with the Federal Government to deliver services to citizens but with State and local governments to provide government services such as license renewals or voter registrations in postal facilities.

And, finally, my bill addresses a flaw in postal labor law by requiring arbitrators to take the Postal Service's financial condition into account when rendering decisions during labor disputes, a proposal embraced by Senator Collins, by Senator Coburn, and other Members of our Subcommittee already.

Let me just close, if I could, by reiterating how critical it is that Congress begin to move on a comprehensive postal bill in the near future. I do not want us to be sitting here 8 months from now, 9 months from now, 10 months from now trying to figure out what we are going to do. The Postal Service operates at the center of a massive mailing industry—Senator Collins probably knows that as well as anybody here in this Senate. The Postal Service operates at the center of a massive mailing industry that employs millions of men and women in every State and congressional district across the country, including ours. These people do not just work at the Postal Service itself. They work at banks. They work at retail operations. They work at newspapers and in countless different sectors of our economy.

With all the challenges we face as a country today, it would be a tragedy to add the loss of these jobs to the list of hardships we need to overcome just because we did not allow ourselves to come together around some additional common-sense reforms of the Postal Service. We are long past the time of fighting the old battles that have hindered work on postal issues for so long, including during 2006 when we finished the most recent postal reform efforts, in no small part because of the good work that my colleague Senator Collins and her staff and my staff—John Kilvington especially—have done. We are also beyond the point at which we should be satisfied with more reports, with more studies, or more reforms that create millions in savings when we really need billions.

I look forward to working with our witnesses, with my colleagues, and with others to enact that meaningful and needed legislation. Senator Collins.

OPENING STATEMENT OF SENATOR COLLINS

Senator COLLINS. Thank you, Mr. Chairman. Let me just start my comments this morning by making three points.

First, I want to welcome our Nation's incoming Postmaster General, Pat Donahoe, who will take over the reins soon.

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Second, I am a strong supporter of the Postal Service. It plays an absolutely vital role in our economy. It is the linchpin of a $1 trillion mailing industry that employs approximately 7.5 million Americans in fields as diverse as direct mail, printing, paper manufacturing, catalogue companies, and financial services. So that is an important premise to keep in mind as we proceed with this hearing.

And, third, the Postal Service is in an abysmal financial crisis. It lost $8.5 billion during the past fiscal year, and significant reductions in mail and revenue over the past several years underscore the urgency of re-engineering the Postal Service business model so that it can adapt to the Information Age. Those who think that we can somehow ignore the problems of the Postal Service are woefully mistaken. It is absolutely essential to our economy and to our American society.

At this defining moment in its history, the Postal Service must embrace change and take aggressive steps towards a structural reinvention. It must enhance its service and value to its customers rather than looking to drastic cuts in service and sharp increases in price that will only further drive away and shrink its customer base. At the same time, it needs to continue to scrutinize its internal operations and redouble its efforts to be leaner and more cost-effective.

The Postal Accountability and Enhancement Act (PAEA) of 2006, which I co-authored with my colleague Senator Carper, provides the foundation for many of those changes. The Postal Service, in my view, has been slow to take advantage of the flexibilities afforded by that law. But to be fair, other problems not of the Service's making, including problems with OPM and the severe recession, have also intruded.

That is why today I am introducing the U.S. Postal Service Improvements Act of 2010. This bill would help the Postal Service achieve financial stability, produce additional cost savings and improve customer services. These are strong fundamentals from which the Postal Service must rebuild. Let me describe my bill.

First, the bill would direct the Office of Personnel Management to use its existing authority to allow the Postal Service to access the more than $50 billion that independent actuaries hired by the Postal Regulatory Commission (PRC) have estimated that the Postal Service has overpaid into the Civil Service Retirement System.

The bill would also provide OPM the authority to allow the Postal Service to access nearly $3 billion that is overpaid into the Federal Employees Retirement System (FERS) pension fund system. It is simply unfair both to the Postal Service and to its customers not to refund these overpayments. I would also note that it is not just the Postal Service's Inspector General (IG) that has these overpayments, but also the independent actuary the Postal Regulatory Commission hired that identified an overpayment, which was a figure lower than the Postal Service IG's estimate.

Second, the bill would improve the Postal Service's contracting practices and help to prevent the kind of waste and ethical violations recently uncovered by the Postal Service Inspector General in a report that I requested. Several months ago, I asked the IG to review the Postal Service's contracting policies, and, frankly, the

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findings of this audit were shocking. The IG found stunning evidence of ethical lapses and costly contract mismanagement. So my bill includes a number of contracting reforms which are in my full statement. They include the establishment of a Competition Advocate, who would improve contract competition, transparency, and accountability. The bill would also require the Postal Service to post justifications of non-competitive contracts above $150,000 on its website. Additionally, the bill would limit procurement officials from contracting with closely associated entities. There is a whole group of contracting reforms.

Third, the legislation would require the Postal Service to create a comprehensive strategic plan to guide the consolidation of its regional and district offices. The IG has estimated that more than $1 billion could be saved through consolidation.

Fourth—and Senator Carper has this provision in his bill as well—it would allow the arbitrator, when rendering decisions about collective bargaining agreements, to consider the financial health of the Postal Service.

Fifth, it would require the Postal Service and the Postal Regulatory Commission to work together to increase the use of Negotiated Service Agreements (NSA), which reduce costs to mailers who agree to help the Postal Service process their mail. There are advantages to both sides if those are properly implemented.

Sixth, it would reduce governmentwide workforce costs by reforming the workers' compensation system. I tried to do this in 2006 but was only able to get one of the reforms through. This reform would require that an individual who is on workers' compensation be shifted to the retirement system upon reaching retirement age. Let me just give you a couple of astonishing facts about what is going on now.

Right now, there are 132 postal employees age 90 or over who are receiving workers' compensation benefits. These individuals are not out on workers' comp for a period of time to recover from their injuries and then returning to work. These individuals should be switched to the retirement system. They are never going to return to work at over age 90. There are, in fact, 8,632 postal employees age 55 or older who are still on the workers' comp system. In most States, that could not happen. They would be switched to the retirement system upon reaching retirement age. This is a reform we should implement governmentwide, as it would bring real savings for the Federal Government and for the Postal Service.

In fact, the Department of Labor (DOL) indicated that it regularly pays worker's compensation benefits to employees in their 70's, 80's, 90's and even 100's. I first tried to get this change through a few years ago. This reform is well overdue.

Seventh, the bill would require the Postal Service to develop a plan to increase its presence in retail facilities, or collocate, to better serve customers. The plan must take into account the impact on the community, particularly in rural areas.

I want the Postal Service to prosper, thrive, and survive. This valuable American institution with roots in our Constitution must be put back on a steady course. I look forward to working with all the stakeholders. I am very pleased that my bill has been endorsed by the National Newspaper Association (NNA), the Affordable Mail

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Alliance (AMA), PostCom, the Alliance of Nonprofit Mailers, the Association of Magazine Media, the Coalition of the 21st Century Postal Service, Conde Nast Publication, the American Catalogue Mailers Association, the Direct Marketing Association (DMA). In addition, we have worked very closely with the National Association of Postmasters and other stakeholders, as well as the National League of Postmasters, the National Postal Policy Council (NPPC), and a host of other groups. So I hope that we can get this done, Mr. Chairman.

Mr. Chairman, you have been generous with the time, and I appreciate that. I have to return to an Armed Services Committee hearing on "Don't Ask, Don't Tell" that Secretary Gates and Admiral Mullen are testifying on, so I am not going to be able to stay, which I very much regret. But I hope it is an indication of how much I care about this issue that I left that hearing to come to this hearing to describe my bill, and I look forward to working with you, Senator Coburn, and all the people who are here today, many familiar faces—the Chairman of the Postal Regulatory Commission and many others—to put the Postal Service back on a sound financial footing.

Thank you, Mr. Chairman.

Senator CARPER. Thanks, and we are delighted that you are here and look forward to continuing working with you on these important issues.

Somebody who has been working on the overall deficit issue facing our country is our Senator from Oklahoma, and I just want to say publicly thank you for the time and energy. And I have talked to others who serve on that Commission with you and have given you good reviews, good reports in terms of the serious nature and the really productive approach that you have taken to addressing the overall challenge, of which this is one. Welcome and thanks for joining us.

Senator COBURN. Thank you, Mr. Chairman.

I have a meeting at 10:45, and I would like, after I finish my short statement, to ask the first questions, if you would permit me.

Senator CARPER. That would be fine.

OPENING STATEMENT OF SENATOR COBURN

Senator COBURN. You will be glad to know I do not have a bill. [Laughter.]

I think it is important—while Senator Collins is here and Senator Carper is here, to point out, there is a difference between cash flow and profit and loss. The things we are addressing in terms of prepayments have nothing to do with profit and loss. They have to do with cash flow. I am supportive of what both of you are wanting to do in that regard, but it is important in the long term, if the post office is to be successful, it has to run a profit. It cannot just run a positive cash flow. While we help the cash flow in the short term, we cannot take our eyes off the objective of the long term.

The Postal Service is in a difficult position because the country has changed in terms of electronic mail. Everybody recognizes that. My hopes would be that we get realistic forecasting rather than desirous forecasting in the future of revenue estimates. You and I had a conversation yesterday. It was a very frank, very open, very

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straightforward. I asked you why in the world you would want this job. [Laughter.]

It is kind of like wanting to go in and get four root canals all at the same time with no anesthesia. You have big problems in front of you, and I know your background, and I know you have vast experience throughout the entire field of the postal organization. I will commit to work with both Senator Collins and Senator Carper in trying to solve this problem. I do not want us however, to have another postal bill. We ought to fix it. The first question I am going to ask our Postmaster General is: How do you fix it now? Because he knows how to fix it now. Actually, he has the authority to do most of it to fix it now.

When you look at what the biggest problem is with the operations side, it is that their labor costs as a component of their total revenues is too high. With revenues shrinking, the tendency, unless the labor costs change, is that will grow. You either have to increase revenues or you have to decrease costs. The largest cost, 80 percent, is labor. So either we have to become more efficient, more effective, or we have to markedly expand revenues.

I have in my home town Economy Pharmacy. Economy Pharmacy has a post office. It costs the post office 5 percent of what it would cost if they had a free-standing post office. It is one-twentieth. That is because the labor is shared. You have a better utilization of labor, better time constraints with the labor, but you also have the overhead shared in terms of creating that post office. It also will fall very good into the idea of creating new products which the post office could potentially market. The Postmaster has that authority now. He can do a lot of that.

Will we politically allow him to do what he knows he has to do and has the authority to do now to put the post office not in terms of the cash flow position but in terms of profit and loss, because we can fix the cash flow over the next 10 years, 5 years. Actually, it will be about 5 if we do it. But if we do not fix the profit and loss, we come right back here in 5 years with the same problem.

So we have to have both positive cash flow and no losses. I am OK if you do not make a profit. I am not OK if you lose money. There is a difference between a balance sheet and a profit and loss statement and a cash flow statement, and we have to keep that in mind as we try to reform the post office; otherwise, we will miss our goal of fixing it and making it viable for the future for all the people in this country that depend on it.

That ends my opening statement, Mr. Chairman.

Senator CARPER. All right. Thank you for that statement. We very much look forward to working with you, Tom.

I am pleased to welcome Mr. Donahoe. Have you testified before——

Mr. DONAHOE. Yes, sir. Mr. Chairman.

Senator CARPER. Before any Committee other than this one?

Mr. DONAHOE. I testified back in the 1990's in front of a couple House committees back when we had less than stellar service in Washington, D.C., and in the early 2000's with a couple committees around what we were doing after the anthrax attacks.

Senator CARPER. OK. Good enough. Well, we are happy that you are here today.

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Mr. DONAHOE. Thank you.

Senator CARPER. And we congratulate you on being named as the successor to Jack Potter.

Mr. DONAHOE. Thank you.

Senator CARPER. Big shoes to fill, but we——

Mr. DONAHOE. He did a great job. Thank you.

Senator CARPER. And we are looking forward to your leadership and to working with you.

I understand that you are currently, at least for another day or so, the Deputy Postmaster General and the Chief Operating Officer (COO) of the Postal Service, and you have been in that position, a dual position, I think for—what?—5 years or so.

Mr. DONAHOE. Yes, sir.

Senator CARPER. And in a few hours—when do you actually assume the leadership mantle? Is it tomorrow?

Mr. DONAHOE. It will be Saturday, but Jack said when he walks out the door, I am in charge, so it might be Friday. We will let him go home early. [Laughter.]

Senator CARPER. All right. As I understand it, I think—I had the pleasure of meeting with him recently, but I understand you spent pretty much your entire career, entire working career, at the Postal Service. You began as a clerk in your home town of Pittsburgh, and I think you also told me that you had gone to school at the University of Pittsburgh and are a big Panther fan but also an Eagles fan.

Mr. DONAHOE. Oh, Steelers fan. [Laughter.]

Senator CARPER. Well, we will have a good time with that.

In your current capacity, you are responsible for the day-to-day operations at the Postal Service, and those operations, as daunting as they are, will be growing significantly, I think, very, very soon. I understand you and your wife, Janet, have been married for quite a while. How many years did you say?

Mr. DONAHOE. It will be 34 years this year.

Senator CARPER. Thirty-four years. And you are blessed with two sons, Bobby and Terry, and they are in their 20's, as are my boys. We look forward to getting a chance to meet them somewhere along the line as well.

Your entire testimony will be made a part of the record, and you are welcome to proceed.

TESTIMONY OF PATRICK R. DONAHOE,[1] DEPUTY POSTMASTER GENERAL AND CHIEF OPERATING OFFICER, U.S. POSTAL SERVICE

Mr. DONAHOE. Thank you. Good morning, Mr. Chairman, and Members of the Subcommittee. It is an honor to testify for the first time as Postmaster General-designate for the U.S. Postal Service (USPS), and I thank you for this opportunity.

I would like to discuss briefly the current state of the Postal Service and our plans for returning to profitability and providing even better service and value for the American people.

I would also like to comment on the legislation under discussion here today, which I support wholeheartedly.

[1] The prepared statement of Mr. Donahoe appears in the appendix on page 57.

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Despite recent headlines, the Postal Service does remain a strong and motivated organization. The past several years have certainly been challenging, but there has also been a great amount of accomplishment. I would like to publicly thank the employees of the Postal Service for their hard work and their accomplishment.

We have achieved spending reductions of $3 billion in fiscal year 2010, bringing our total savings over the last 3 years to over $10 billion. We now have the smallest career complement since the Postal Service was reorganized in 1970. During the past 3 years, I am pleased to say service, customer satisfaction, and trust in the Postal Service has never been higher. However, we have a lot of work to do to get to where we need to be financially and adapt in a very changing marketplace.

Mr. Chairman, we recently issued our fiscal year 2010 financial results. Our total losses for the year were $8.5 billion. This is a stunning number in many aspects, and it is unsustainable. That $8.5 billion figure reflects two payments that we made. One was the $5.5 billion payment for legislatively mandated prepayment for retiree health benefits (RHB). Another was $2.5 billion for a noncash adjustment for workers' compensation future accounting adjustments. If you set aside these two payments, you are left with our operating results, results that we control. Although first-class mail volume had declined last year 6.6 percent, we lost approximately $500 million on our operations, so it was a significant accomplishment to catch that up.

If you look at the aspects of the business within our control, we have done well in responding to the economic conditions. We have an opportunity to turn a corner, though, in the future and to produce regular operating profits.

As Postmaster General, I plan to ensure that we get the most out of what we can control. My personal vision is that of a profitable, nimble Postal Service that competes for customers and has a well-defined, valued role in an ever increasing digital world. Part of that vision is to ensure the Postal Service will always be a resource to every American business and we will be valued and trusted in every American residence.

The way people in businesses are using the mail is changing, and we are adapting to those changes in some fairly significant ways. We will continue to adapt and improve the core business and our core offering to the American public.

Everything we do relates to delivering for our customers. That is a powerful platform which drives commerce and complements the evolving nature of the way that people communicate and conduct business in America today, one that ensures the Postal Service will remain at the heart of an industry which employs millions of people and generates hundreds of billions of dollars in revenue.

Even as technology has changed, the Postal Service will remain a powerful conduit for businesses to reach residential customers. The mail is going to remain the most effective way of reaching customers, and we need to continue to build our business around that concept. New investments in tracking technologies and offerings for small businesses will also help keep us strong.

One of my highest priorities is to improve our customer experience. Every interaction with us, whether it is a carrier, a clerk, at

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a kiosk, on the telephone, online, must be a great experience. We are looking at all aspects of the way that we interact with our customer and will make big improvements. Part of that strategy is expanding points of access and moving away from some traditional post offices in some locations. We think that there are significant opportunities to grow our package business. We have been very successful with our Flat Rate Campaign, and there is major growth in this area which nicely complements the rise in e-commerce. More than anything we do, however, we need to continue to be leaner, faster, and smarter as an organization. We must be very aggressive in realigning the operations of the Postal Service to match the declining mail volumes which are projected in this coming decade.

We need to continue to optimize our network, realign our workforce, reduce energy use and our physical footprint, and drive costs out of every aspect of the Postal Service. We will do all of this with motivated and knowledgeable employees and with the support and collaboration of our customers in the mailing industry.

I very much appreciate the efforts of you, Mr. Chairman, and the introduction of Senate bill 3831, the POST Act. Enactment of this measure would provide the Postal Service the flexibility to implement these business strategies faster and more effectively. The current retiree health benefit provision is especially crucial because we will not have sufficient funds by the end of the year to make that prepayment.

I also see the POST Act as an important improvement——

Senator CARPER. Excuse me. You said by the end of the year.

Mr. DONAHOE. By the end of next year.

Senator CARPER. Next year? End of the current fiscal year?

Mr. DONAHOE. The end of this current fiscal year. I will not be able to make that payment on September 30th.

Senator CARPER. All right. Thank you.

Mr. DONAHOE. With an inflexible business model, our challenges are significant. We do not want to be a burden to the American taxpayers, and the POST Act helps ensure that will not happen. Our goal is to remain viable for the long term, and with your help and a more flexible business model, we will be able to do just that.

Thank you for your continued engagement on postal issues, and I would be more than happy to answer any questions that you might have.

Senator CARPER. Good. Thank you for that testimony.

I am going to yield to Dr. Coburn for the first questions. Tom.

Senator COBURN. Mr. Chairman, thank you for that consideration.

Mr. Donahoe, we had a visit yesterday, and one of the things that you advised me is that you have not come to a contract agreement with the rural letter carriers? Is that correct?

Mr. DONAHOE. Yes, Doctor.

Senator COBURN. Is it not true that you have the ability right now to contract that business out?

Mr. DONAHOE. We can contract routes that are vacant. That is part of our contracting abilities within our contracts with the rural carriers.

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Senator COBURN. If they do not come to an agreement, can you contract other routes?

Mr. DONAHOE. That is something we would have to work through. I would have to double-check as far as how we would be able to work that process. But the contracting provision if there.

Senator COBURN. Can you, without violating your negotiations, tell us what the hang-up is with the rural carriers?

Mr. DONAHOE. Right now, we have reached impasse. We have been talking to the rural carriers about work rules, flexibility, and pay. When I say impasse, we have run to the end of the contracting time frame. We have the door open still. We would like to still work with them. We think there are some opportunities to sit down and come up with some creative aspects going forward. We think that we need the flexibility in the workforce. We need flexibility around how we employ people and the pay associated, and I think that the rural carriers, if they do the responsible thing, step up, come back, and we can sit down and talk.

Senator COBURN. All right. I just have one other question. With your labor costs now at—80 percent?

Mr. DONAHOE. 80 percent.

Senator COBURN. Where do you have to be right now for 2011 to break even at the Postal Service?

Mr. DONAHOE. Well, let us take a look at the finances. As I mentioned before, we had the $8.5 billion loss this year. The way our finances look right now, we are projecting an operating loss of $900 million. That is strictly our revenues less the operating expense. We have to add on to that the $5.5 billion payment. That is more than cash flow. That is part of our bottom line.

Senator COBURN. A portion of that, because—does that truly reflect your level of employment today?

Mr. DONAHOE. The $5.5 billion?

Senator COBURN. The $5.5 billion.

Mr. DONAHOE. No.

Senator COBURN. It actually overstates——

Mr. DONAHOE. The $5.5 billion overstates the number of employees. When the law was written in 2006, it was written with the provision that we were funding for 757,000 employees. We have 580,000 today.

Senator COBURN. Yes, so that is a big difference in the——

Mr. DONAHOE. It is a big difference, and one of the things that we would definitely look for some help on is restating that part of the law.

Senator COBURN. Yes, and I think that is something that needs to be considered in your bill, Mr. Chairman.

So at what level of labor costs would you be at break-even today?

Mr. DONAHOE. Well, if you take a look at it from a percentage standpoint, we would have to reduce the percentage through driving down costs.

Senator COBURN. Well, I mean, would you have to have labor costs at 70 percent, 72 percent, 74 percent, 68 percent, to be at break-even?

Mr. DONAHOE. Well, it is a function of total cost. If you take a look at our business today, in the service business that we are in you are going to have a substantial portion of your costs in labor.

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Senator COBURN. I understand that. All I am saying is——

Mr. DONAHOE. It is the total cost that has to be considered.

Senator COBURN. Let me ask you this, then. Since 80 percent of your cost is labor cost, how much of the savings do you, having somebody that has been experienced in every aspect of the post office, what percentage savings can you get out of that other 20 percent?

Mr. DONAHOE. Not a whole lot.

Senator COBURN. All right.

Mr. DONAHOE. We have transportation costs and real estate costs that we can get some savings from.

Senator COBURN. Yes, so but how much?

Mr. DONAHOE. Probably, a couple percentage points.

Senator COBURN. Nothing to hold you to, but——

Mr. DONAHOE. I can probably get a percent or two out of there.

Senator COBURN. OK. So you can get 2 percent there.

Mr. DONAHOE. Yes.

Senator COBURN. So the one thing we can all know here, unless revenues increase, for you to get to break-even, labor costs have to go down, either through efficiency, attrition, or better contracts.

Mr. DONAHOE. That is exactly correct.

Senator COBURN. There are only three ways.

Mr. DONAHOE. You are still going to have the same percentage of cost to a large extent because of the nature of the service. It is how much that percent actually costs. So what we are looking for is—to put it in context, if you have $60 billion in labor costs, we would be looking for closer to, say, $55 billion in labor costs. You are still going to have the same percent.

Senator COBURN. No, I understand that, but I am——

Mr. DONAHOE. It is a smaller pot.

Senator COBURN [continuing]. Saying if you had the numbers today, what would you have to take off?

Mr. DONAHOE. It is a smaller number.

Senator COBURN. I understand——

Mr. DONAHOE. We are on the same page.

Senator COBURN. But also, as those labor costs go down——

Mr. DONAHOE. Yes.

Senator COBURN [continuing]. Your forward-funded pension costs go down.

Mr. DONAHOE. Yes.

Senator COBURN. Your health care costs go down. They all go down.

Mr. DONAHOE. Yes.

Senator COBURN. So the fact is we know the numbers, we know where we have to get, he knows where he has to get, and we have to have the bargaining units recognize this is where it is going to go. Because I will tell you, as a member sitting on the Deficit Commission, this short-term change in the cash flow will help you do that. After that, it is over.

Mr. DONAHOE. Yes, we realize that.

Senator COBURN. Well, I know you realize it. The bargaining groups have to realize it as well. The very fact that we have a different health care costs for postal workers than the rest of Federal employees is something that has to be changed in the contracts.

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Mr. DONAHOE. We are addressing that with the unions right now. They have taken steps in the last contracts to change that, and that is something we will be working with them going forward.

Senator COBURN. Mr. Chairman, I appreciate it so much. And I welcome you to this toothache.

Mr. DONAHOE. Thank you. [Laughter.]

It is much appreciated.

Senator CARPER. It is too bad Dr. Coburn is not a dentist. He could serve in other ways. [Laughter.]

Senator COBURN. You just pull them out, don't you? That is all you do.

Senator CARPER. All right. Let me just start off, Mr. Donahoe, by asking you just to make it clear for the record what will happen at the Postal Service if Congress does not act on a financial relief proposal in the coming months? The Postal Service, as we have heard, lost $8.5 billion in the fiscal year that has just ended, and I understand that you are projecting more than $6 billion in losses in the current fiscal year. I believe that if these projections do bear out, the Postal Service will be out of cash and out of borrowing authority—I call it "out of running room"—by this time next year, if not sooner. What will happen if this occurs? And will the Postal Service have to cease—or will the Postal Service have to cease operations at some point?

Mr. DONAHOE. Let me answer that in a number of ways. First of all, let us set up what the finances look like. This year, we are predicting a loss of $900 million in our operating funds. That is revenue less expense. In September, we will have to write a check for $5.5 billion for the retiree health benefits. We cannot write that check because we will put ourselves in a negative cash balance of $2.7 billion at that point. The budget we have set up this year is like the budgets we have had the past few years. We are planning on taking 49 million work hours out again this year, and that is on top of over 200 million hours the last 2 years. So people are stretched. We are doing everything we can to get the efficiencies and savings in the organization.

Of course, looking at revenue, we want to try to grow the top line, but with the situation in the economy today, you cannot take that to the bank.

What we would do September 30th is this: We would decide what payment not to make. As the Postmaster General, as a member of our Board of Governors, we know we have a responsibility for service to the American public. We would continue with our service. We would have to make a decision either to not pay the fund or stop paying some of our FERS funds early on because in that situation that does give us the cash and the breathing room at the end of the year.

Senator CARPER. All right. Thank you. Talk to us a little bit about productivity gains and some gains that you have realized by virtue of negotiations with the labor unions which represent your employees. Talk to us about some of those productivity gains, because they have to be rather considerable.

Mr. DONAHOE. They are. We are very, very proud of the fact that over the last 10 years we have doubled productivity in the U.S. Postal Service, and that includes all of the volume loss that we

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have experienced. So people have not only been productive as we grew volume in the middle of this decade, but as volume dropped, our managers and our craft employees came together very well and took substantial costs out of this organization. We have done it through process improvement in our processing plants. We have reduced our network. And we have also worked with the unions. I will give you an example.

The National Association of Letter Carriers (NALC) has worked very closely with us over the last couple years. We have taken 13,000 letter carrier routes out, and it has been a very good process, voluntary, working hand in hand.

What we are most proud of in that time is the fact that we have improved our service, measured service on mailbox to mailbox, measured service with commercial mail, whether it is first class, standard, or the periodicals, and our package business. I would put our package service up against anybody, our scanning performance, and that has all been done by the great work of our people during a pretty trying time.

Senator CARPER. OK. I probably should have asked this question earlier, but you had a number of years to develop your approach to management and your approach to managing people in a large operation. Why don't you just take a minute or two and just talk to us about how you manage, how you see yourself serving in this job. What strengths do you bring to it? And what are some things that you will have to learn on the job?

Mr. DONAHOE. Thank you. I have 35 years in the Postal Service. I have been blessed with a great career, nice opportunities. The Postal Service is a great place to work because almost anything that you want to get involved in you can, and I have had that opportunity. I have been able to move up from a clerk—I was a clerk on the work floor in Pittsburgh, Pennsylvania, in 1975 while attending school during the day, and I have had the opportunity to come up through the ranks in many different positions, and it has really given me a great appreciation for the organization, for our customers, and for the entire industry, which I value.

From a standpoint of my management style, I will tell you I try to be as open and engaging as possible. I am very direct. You are always going to get a straight direct answer from me. I am, I think, a good listener, and that has always helped me to be able to work with people to try to resolve problems. I look for win-win situations, and I think even in these trying times that we have right now there are win-win situations. And between your help with your bill and the work with a lot of people that are in this room today, customers and stakeholders, there are some win-wins here.

Senator CARPER. I like to quote Albert Einstein, who used to say a long time ago, "In adversity lies opportunity."

Mr. DONAHOE. That is true.

Senator CARPER. And he was not talking about the Postal Service, but I think it applies here, too.

This past spring, Postmaster General Potter put forward a plan that includes strategies and legislative recommendations for addressing the challenges that the Postal Service faces. What are some of the goals, your goals? And how are they similar and maybe in some cases different to those laid out by General Potter?

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Mr. DONAHOE. Well, one of the things that I think is critical, and I cannot say this enough: The Postal Service is still a very viable and important part of the American economy and American society. We will deliver 171 billion pieces of mail this year, so it is not something that is going to go away tomorrow or the next day. We still present more bills than anyone, including the Internet, and more people still pay bills through the mail than they pay on the Internet. So even though there have been some changes, the American economy still depends on the Postal Service.

We also do a great job in that same vein from a package perspective. People can come to us, mail packages, and have access to 37,000 locations across the country. So we are still viable, we are still important.

That said, we did put a plan out last March. I think it was a very good plan. It was a balanced plan. And what that plan did, it was two things. It said there are some things that we are going to be responsible for in the Postal Service. It is growing revenue, and at the same time improving the process and taking cost out. And we are committed to those, and we are not only on track, we are ahead of that last year and this year. And we will stay focused on that.

The other side of that plan, of course, is the help that we need—the help that we need from Congress and the stakeholders around some of these issues, like the retiree health benefit, delivery flexibility, and also some retail flexibility. And your bill addresses those, and again I want to say thank you for that.

My own management style ties in very directly with the plan. My focus is going to be on four things.

First, improving the business to customer channel, that is, growing mail. We have to grow revenue. We have to grow the top line in this organization. It is critically important. Like Dr. Coburn said, when you get involved in taking a look ahead, you either can cut costs or grow the revenue. We know we need to grow that revenue. So the focus will be there. We think big business, there are opportunities with NSAs and contracts. We will be working closely with the Commission on that. We think from a small business perspective there are plenty of opportunities out there. When I look at TV, I look at newspaper ads, I will see small businesses advertising there on the Internet, and the Postal Service is still the most direct way to get in front of a customer's eyes. So working with small business, giving them opportunities for products and services to grow their business is one of my focuses.

The second focus is growing the package business. We have some great products out there with the Flat Rate box, and we are introducing some new offers. We have been working with the Commission on that. We are rolling these out.

The other thing that we are focusing on is scanning visibility that will be second to none in the industry. At the end of this calendar year 2011 coming up, we will be there, and that will really enhance our package business. We also think that we should be in the prime position to handle return packages. With e-commerce today, a lot of people buy two things and send one back because they are not sure of the size that they have. So we are in right in that position because we are going to people's houses every day to pick that mail up.

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The third thing you will see a lot more focus on for me is improving the customer experience. I said that in my opening testimony, and I strongly believe that. We do a great job. Our people do a great job every day delivering mail. You asked whether I testified here before. In 1994, I testified with then-Postmaster General Marvin Runyon. Our service in Washington, D.C., was about 50 percent on time. Service in Washington, D.C., today is 97 percent on time. They have done a great job, and we keep our eye on that service.

Now, there are other areas of service than what you see in the post office. Is every experience good? No. But we want to get to the point where every experience is good, and the same with when you pick up the phone or go online with us, every experience has to be great, because we know satisfied customers bring us revenue and also refer us to other people from a revenue standpoint.

Finally, the fourth area, "Leaner, Smarter, Faster." I mentioned that in my testimony. We have done a great job from a productivity standpoint. There are still opportunities looking at what we do in our networks, what we do with our retail. We can continue to take costs out by improving our process.

Smarter, being able to listen to the customers and deliver what they need is critical, and that is critical for us to be able to grow. And faster means being able to deliver on what we promise. I would like to be in a situation, and we are working with our people internally and working with the Commission that if one of our people goes out for a package sale, they have a computer. Right there they negotiate a price, push a button, sign the contract, done. That fast. The process takes way too long now, but moving forward with some of the work we can do with the Commission, we want to shrink that team and be leaner, smarter, and faster.

Senator CARPER. Good. When you say "leaner, smarter, faster," do you know what it reminds me of?

Mr. DONAHOE. What?

Senator CARPER. What our brand in Delaware has been for some years. We are the First State, the first State that ratified the Constitution. In fact, Pennsylvania used to be part of Delaware. [Laughter.]

But our brand is not leaner, smarter, faster, but for years it has been smaller, faster, smarter.

Mr. DONAHOE. Aha. There you go. We are just like Delaware. [Laughter.]

That will be our second line.

Senator CARPER. You could not pick a better State to emulate. It is actually a State that works.

The bill that I have introduced and described earlier removes the legislative restrictions that prevent the Postal Service from exercising its authority to reduce delivery frequency, an authority that we provided you in the 2006 legislation. This would allow the Postal Service to carry out its proposal, when deemed necessary, to eliminate or modify delivery of mail on Saturdays. This proposal has been greeted with some skepticism. What has the Postal Service done to address the concerns that have been raised in recent months by those who want to maintain Saturday delivery just as it is? What would you say to those out there who argue that the

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enactment of my language that would give the Postal Service the authority to go beyond its current proposal and move to 4- or 3- or 2-day delivery?

Mr. DONAHOE. Well, first of all, let me echo your comments from the statement you made at the beginning of the hearing. We do not really want to go to anything less than 6 days. We are, to a large extent, forced into that from what we find economically. We have lost 20 percent of our volume, and as I said, people have done a real nice job picking up the cost. But what you have and what we are faced with is a declining revenue per delivery. Every year we add a million deliveries on, and if our revenue continues to go down, as we have projected, based on a relatively flat mail volume but a much more problematic mix, more standard, less first class, each year that happens it becomes more and more burdensome to deliver 6 days a week to all addresses in America. So we realize it is a financial issue that we have to take a look at.

Now, from a standpoint of the work that we have done around 6-day to 5-day, I think that we have been very, very thorough. We have tried to vet this issue with customers, at all levels, large business, small business, residential. We have done a lot of focus work. We have done a lot of survey work. What has come back to us is this: 6-day to 5-day delivery is more appealing when you compare it to a couple choices. The choices are substantial raises in postage rates, 10, 15 percent, when you give a customer those choices. The other is closing post offices.

So what we did, we went back, took all that survey information, and we have a proposal out there right now, and our proposal is this: We would like to move from 6-day to 5-day in terms of delivering mail, collecting mail, and processing outgoing mail. We would maintain a 7-day-a-week network so that remittance volume and the rest of the mail that comes through our channels maintains service standards. We would also keep post offices open and deliver to post office boxes on Saturday so that if you needed to get mail on Saturday, you could get a post office box. We would continue to deliver Express Mail so if there was something critical, it would get delivered.

Now, as we work through that, there has been a lot of discussion. We have talked to the Government Accountability Office (GAO) about that and asked them to go through and work with us. And we are also open, again, to talking with any other customers going forward with concerns that they have.

We want to make sure that we keep the Postal Service strong and that we keep our networks strong and that we are meeting customers' needs. We do not want to do something that would hinder business nor hurt those customers.

Now, as far as looking ahead, revenue per delivery is an issue. We think that 6-day to 5-day along with other issues or other remedies that you propose in your bill—the retiree health benefit and also giving us some other flexibilities in some cost areas—I think that we would be OK with that for a number of years. Eventually, if we had to cross the line and go to, say, 3-day delivery, I do not think, just looking at our future volumes and what we think we can do financially going forward, I do not think we would have to cross that threshold for a number of years. But the one thing that

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I do appreciate in your bill, I think it is important that you would give the Postal Service, our Board of Governors, the ability to make those decisions.

Senator CARPER. All right.

Mr. DONAHOE. Thank you.

Senator CARPER. You mentioned post offices themselves. The next question I have may be my last one, but the bill that I have introduced would give the Postal Service more freedom to close post offices, including post offices that are operating at a deficit. It is my goal with this language to give you the ability to close outdated facilities that may not be in the best locations and replace them with retail outlets that might be less expensive but more convenient for your customers. I think Senator Coburn referred to one of those back in Oklahoma, I think in his home town.

You talked about win-win situations. I look for a lot of those as well. The ideal outcome, in my view, would be more not less access to postal retail outlets. There is some concern, however, that this language could lead to the Postal Service completely abandoning some communities, especially rural communities. I just want to ask you to take a minute or two to discuss how the Postal Service would use the post office language in the POST Act that I have introduced and dispel, if you can, some or most of those concerns that have been raised about particularly rural access and other potential problems.

Mr. DONAHOE. Thank you. We think access to our customers is paramount, and that is exactly what we would be focused on. The interesting thing about what has happened in the last few years from a Postal Service perspective with the introduction of things like Click-N-Ship and, of course, more access to stamps and postal services in stores like Costco, right now about 35 percent of revenues, retail revenues—stamp sales and postage services—are available and are conducted outside the door of the Postal Service. So America is already changing. What we are trying to do is make sure that we not only catch up but are also ahead of what their needs are.

I understand your concerns and I understand the concerns that we have had from constituents around the country about how do you deal with small post offices in rural areas. One of the things we are looking at is this: You have to look at where your locations are, the viability, and the need. Then also from a standpoint of access you have to come up with some creative solutions going forward, I think, in order to keep us healthy financially.

I am from western Pennsylvania. In western Pennsylvania, there are a lot of small towns and in a lot of these small towns you have a post office, a store, and a gasoline station. And one of the things we are looking at is should we take some of the postal services and contract some of that work out to the local stores that are open in many cases almost double the hours we are, and do that at a fraction of the cost that it takes for us to provide those services today. It does two things: It provides access to customers; it in some cases may keep that store open just because the contract cash flow, as Dr. Coburn mentioned, keeps the doors open, and at the same time it gives us the opportunity to move away from some expensive real estate and some additional costs. We have always worked with our

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employees and I have assured our postmasters as we work through this that we would find landing spots for people. We are pretty proud of the fact that over the years we have eliminated 200,000 people in this organization. We have not laid people off. We always find landing spots, and we will continue to do that as we shrink these networks down.

Senator CARPER. The last question I want to ask, and I am not going to ask you to respond, but I will ask you to respond for the record. This Deficit Commission that Senator Coburn and some of our other colleagues, other people, a Commission led by Erskine Bowles and former Senator Alan Simpson, have submitted a proposal that has caused a fair amount of gnashing of teeth from a lot of different sectors. Some people say it has too much taxes. Some people say it has way too much cuts in spending. And I think the theme that pervades, permeates their proposal is actually a sharing of sacrifice that is being asked. And to the extent they are asking Federal employees to forgo increases in pay, we need to make sure that all of us are being asked to do something, to give up a little bit.

On the issue of benefits, you are going to be looking at the level of benefits that postal employees have and what they pay and what is provided for them. I would just ask that we keep in mind as leaders that we have to lead by example. And that is true for me here and for my colleagues, and it is also true for you and our senior management. I will have a question for the record for you to respond to in that regard. I would just ask you to keep that in mind.

Mr. DONAHOE. I can respond to this point right now, if you would like.

Senator CARPER. Go ahead.

Mr. DONAHOE. We have already frozen executive levels going forward this year. Officer pay for 2011 is frozen at 2010 levels. For executives in the organization, we have frozen what is called the pay band, so you might have somebody that can make a little bit, but they cannot make any higher than the pay bands that existed in 2010. We agree 100 percent. If you take a look at the Postal Service, we are a reflection of what is going on in the U.S. today from a cost standpoint. You have to make some decisions, and choices have to get made. Your bill puts the opportunity out there for the Postal Service and the stakeholders in this organization to sit down and make some tough choices.

The key thing is a healthy Postal Service, a financially healthy Postal Service for this industry. We have all got to sit down, management, our Board of Governors, our leaders, postmasters and managers, our craft employees, all the customers and all the stakeholders, along with Congress, and make this happen.

Again, I appreciate your support. We think the bill is great. We are looking forward to working with you in the future.

Senator CARPER. Thanks, Mr. Donahoe. I will close with this thought: I mentioned earlier the need for us as a country to move away from a culture of spendthrift in the Federal Government to a culture of thrift. And we are endeavoring to try to do that, and I think it is clear that you are as well.

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One of the things we are trying to endeavor to do in the Federal Government is to collect several hundreds of billions of dollars of taxes that are owed but are not being collected. We call it the tax gap, and the last time we counted, it was about $300 billion a year. And so we need to grow our Federal revenues in part by collecting taxes that are owed but in some cases not being paid.

One of the real challenges for the Postal Service—and I think you all have done a very good job in raising productivity—working with your unions and your employees, a real good job in raising productivity and reducing the workforce through attrition, trying to be humane about it. The real challenge is to grow revenues, especially in a down economy, which I think is actually starting to get better.

I do not know who you have at the Postal Service whose job or jobs it is to think outside of the box, to come up with ways for raising revenues. And we have an obligation to give you a reasonable amount of flexibility to do that. But you need to have really, really good people on your payroll, and in some cases not on your payroll, who can help you think through all the advantages that are out there.

I know that somewhere along the line somebody is going to say, "Gosh, why didn't we think of that years ago? That is such a good idea." And I know there are ideas like that, and we just need people out there generating them and, when they are generated, to make sure that you can separate out the good from the bad and then implement the ones that are most promising, and to talk to us if we need to do something to allow you to move forward.

Well, we have enjoyed this visit. We appreciate your being here, and we hope that you will give Jack Potter our best and our thanks.

Mr. DONAHOE. I will.

Senator CARPER. I will use this in closing. I am a baseball fan. I know you are a big fan of the Pittsburgh Panthers. I am a big Ohio State Buckeye fan and a Delaware Fighting Blue Hens fan. But my favorite baseball team is the Tigers. Ever since I was about 8 years old. One of the best players who played for the Tigers for the last 20, 30 years is a guy named Kirk Gibson, some of you will recall. He played for the Tigers for a number of years. He also played for several years with the Los Angeles Dodgers. He was a guy who played hurt, and one particular season he was badly injured. He was playing with the Dodgers at the time. He suited up to play, but he could not play. But he played anyway. And they put him in the game. It was the first game in the series, and he came up with runners on base, and literally he could barely walk up to the plate. And he hit a home run. He could then barely walk around the base paths, but he did. And they took him out of the game after that. The Dodgers went on to win the World Series, I think in four games. And he was the spark that helped them do that.

A couple years later, he went back to the Tigers. Several years after that he retired—not at the beginning of the season and not at the end of the season, but in the middle of the season. In the middle of the season. Kind of unusual. And he held a press conference in the dugout, invited all the press to come in, and he an-

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nounced to them, he said, "I have been traded"—and then he said "traded back to my family." So you can tell Jack Potter that he is being traded back to his family.

Mr. DONAHOE. I will do that.

Senator CARPER. With our thanks. All right. Thank you so much.

Mr. DONAHOE. Thank you.

Senator CARPER. And we will ask our witnesses to come forward for our second panel: Ms. Goldway, Mr. Foley, and Mr. Herr. [Pause.]

Welcome one and all. Our next panel is Ruth Goldway, Chairperson of the Postal Regulatory Commission. Ms. Goldway was elevated to her position in August 2009. She has been a member of the Commission since 1998. Welcome. Nice to see you.

Next we have Jonathan Foley. Mr. Foley is the Director of Policy and Planning at the Office of Personnel Management. He has over 55 years of experience—no, I am just kidding. Twenty-five. Twenty-five years of experience in health policy and management. Mr. Foley, very nice of you to come.

And, finally, we have Phillip Herr, also known as Phil Herr. It is interesting. Your name is spelled P-H-I-L-L. Is that the way you spell it?

Mr. HERR. No, sir. But it is close enough.

Senator CARPER. Well, you can never have too many "L's" in your name, I suppose. But, Mr. Herr, we are delighted you are back, and you serve still as, I think, Director of Physical Infrastructure Issues at the Government Accountability Office. We are trying to get you guys a new permanent Comptroller General over there. We had a hearing, I think in this room.

Mr. HERR. Yes.

Senator CARPER. With Gene Dodaro a couple days ago. He did a nice job. He never uses notes. He has testified any number of times. I have never seen him use a note either for his testimony or for responding to questions. The only other person I have ever seen do that was Chief Justice John Roberts who in his hearings never used a note. You are all welcome to use notes, by the way.

Mr. Herr has been with GAO since 1989 and manages a broad range of issues there, including postal issues. So you have plenty to do.

We are grateful to all of you for being here. Your entire testimonies will be made part of the record, and, Ms. Goldway, why don't you proceed first.

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

Ms. GOLDWAY. Thank you, Senator Carper. Good morning, Chairman Carper, and I want to acknowledge the Subcommittee Members who have attended but had to leave. Thank you for the opportunity to present the Commission's comments on the POST Act. We also want to gratefully acknowledge Postmaster General Potter's long record of service and warmly welcome Postmaster General designee Pat Donahoe.

[1] The prepared statement of Ms. Goldway appears in the appendix on page 66.

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The 2006 PAEA's price cap and service standard provisions successfully forced cost reductions and quality improvements. The Act also wisely included the opportunity for future reform. In fact, a key provision of the POST Act is based on a pension cost study authorized by the PAEA and completed by the Commission. Using the best actuarial practices identified in our study, the POST Act directs OPM to recalculate the allocation of postal pension costs. The actuarial analysis we conducted indicates that this could benefit the Postal Service by as much as $55 billion. Further, the POST Act would allow these funds to be used to defray the Postal Service's liability for future retiree health benefits.

In the Commission's recent exigent rate decision, we identified the $5.5 billion annual payment to this fund as the single biggest cause of the Postal Service's financial difficulty. In an earlier PAEA-directed study, the Commission determination that the Postal Service's Retiree Health Benefit Fund Liability might be reduced by nearly $35 billion is calculated on its current workforce using dynamic, long-term medical inflation rates. The Postal Service's annual payments could then be reduced by $2 billion while meeting the obligations of the original law. Continuing postal workforce reductions seem inevitable. Therefore, it may be prudent to require adjustments of this liability in new legislation.

The POST Act proposes to provide the Postal Service with increased operational and competitive flexibilities. The Commission supports further reform. However, we have questions about how provisions in this bill might negatively affect service, access, and the competitive marketplace. We believe that appropriate safeguards and oversight are needed where new flexibilities are authorized.

The bill would allow the Postal Service to furnish property and services for compensation to state and local governments, as it now does successfully with Federal agencies. Appropriately applied, this promises to be beneficial to both the State and local level and for the Postal Service. The Commission is less sure of language in the bill to allow unregulated use of Postal Service mail networks and technologies to provide new non-postal services. The authority is very broadly defined, and it is difficult to assess how it will be used.

In reviewing non-postal services under the PAEA, the Commission is directed to consider "the public need for the service and the ability of the private sector to meet the public need for that service." Would this kind of public interest standard apply to non-postal services authorized by the POST Act?

Current law also authorizes the Commission to oversee and regulate Postal Service market tests, both to protect the public interest and to promote positive outcomes for the Postal Service. Would this be affected as well? The Commission strongly believes that prior regulatory review has been effective under the PAEA and should be required if the Postal Service's competitive flexibility is expanded.

The POST Act would also allow the Postal Service to reduce the frequency of mail delivery service and to more easily close post offices. The Commission expects to issue its advisory opinion later this month on the Postal Service's 5-day delivery plan. We have

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held a dozen public hearings on this issue and developed a substantive evidentiary record that we are now reviewing. I will reserve comment until the opinion is issued later this month. However, I would ask whether the POST Act would allow the Postal Service to reduce delivery service to 4 days or 3 days without prior review. This possibility was not a focus of our hearings.

Earlier this year, the Commission issued an advisory opinion on a Postal Service proposal for station and branch closings. We acknowledged the Postal Service's discretion in adjusting its retail access as long as universal service is maintained. However, in the decision we recommended that a standardized review process be developed and consistently applied to all post offices, stations and branches if closures are to occur. The 10-day notice now given to stations and branches is inadequate.

Since 1976, the Postal Service has been required to give post office customers at least a 60-day notice of its intention to close a post office, and affected customers have 30 days to appeal to the Commission. We found that such notice and due process should be available to all customers. To customers, a post office by any name is a post office. The Commission's longstanding practice does not recognize the difference either. A legislative clarification on this issue would assist the Commission and, more importantly, assist citizens in addressing their concerns.

In closing, I would like to thank Senator Carper and Senator Collins for putting forward possible reforms to the PAEA and thank all the Subcommittee Members for their thoughtful oversight and support of the Postal Service. I must emphasize that a resolution of the pension and retiree health benefit issues is the key to real reform. The Postal Service must have manageable financial obligations if it is going to effectively manage its operations, serve its customers, and improve for the future.

Thank you.

Senator CARPER. Thank you, Madam Chairman.

Mr. Foley, please proceed.

TESTIMONY OF JONATHAN FOLEY,[1] DIRECTOR OF PLANNING AND POLICY ANALYSIS, U.S. OFFICE OF PERSONNEL MANAGEMENT

Mr. FOLEY. Chairman Carper, I am pleased to be here today on behalf of Office of Personnel Management Director John Berry. OPM commends you in your efforts to help the Postal Service stay financially viable, and we share in your commitment to do so while maintaining our fiduciary responsibility to the Civil Service Retirement and Disability Trust Fund.

Senate bill 3831 readdresses the issue of how responsibility for the retirement costs of pre-1971 postal employment should be apportioned. The underlying question is whether the Treasury or the Postal Service should be responsible for the effects of postal pay increases on the value of that service in computing CSRS annuities. Given prior discussions, I will only provide a brief outline of relevant history.

[1] The prepared statement of Mr. Foley appears in the appendix on page 71.

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In 1973, Congress enacted Public Law 93–349 which established the policy, then supported by the Postal Service, that it would accept responsibility for the effects of pay increases on annuities. In 2003, the Postal Service first suggested that OPM transfer responsibility for the effects of postal pay increases to the Treasury. After careful consideration by OPM and it's Board of Actuaries, OPM determined that the original apportionment method complied with the law. This past January, the Postal Inspector General issued a report again raising the apportionment issue and asserting a $75 billion overpayment.

In June, the Postal Regulatory Commission issued the results of a Segal Company study on the apportionment methodology. The Segal report only addressed one aspect of the complicated funding arrangement and did not discuss the historical context of the issue. Segal acknowledges this by stating that its "recommendation is, in essence, a 2010 fresh look, and does not attempt to deal with the history accumulated over [40] years since the [Postal Reform Act] was enacted."

The Segal-proposed methodology was a slight variation on the Postal IG's proposal and suggested a $50 to $55 billion overfunding. The PRC also suggested that the PAEA gave OPM authority to reapportion responsibility for pre-1971 service as part of the redetermination process. Enacted in 2006, the PAEA's primary purpose was for the Treasury to take responsibility for the cost of military service credit in the computation of Postal Service annuities, leading to a savings of $28 billion to the Postal Service.

The law further provided for a review process initiated at the request of the PRC for OPM to reconsider any determination or redetermination made by the Office of Personnel Management under this section. The PRC asserted that this reconsideration authority permitted OPM to make the reallocation. We believe the assertion that OPM has the discretion to make basic changes in the allocation method between the Postal Service and the Treasury goes beyond the intent of and the authority provided to OPM in PAEA.

The reconsideration process provided for in section 802(c) of the PAEA allows for the appeal and review of OPM's specific calculations of the annual supplemental liability determination according to the established fund allocation methodology. For example, 802(c) allows reconsideration of the population or accounting data underlying the annual liability determination but not of the allocation methodology. Thus, the question of whether there should be a change in the apportionment of responsibility is one that is appropriate for consideration by Congress.

Our comments on Senate bill 3831 are limited to section 2, which would transfer responsibility to the Treasury for the effects of postal pay increases on the value of pre-1971 Postal employment in computing CSRS annuities, a change estimated to be $50 to $55 billion. It would also permit the resulting Postal Service surplus to be used at the discretion of the Postal Board of Governors to satisfy the $5.5 to $5.8 billion annual payments to the Postal Retiree Health Benefits Fund (RHBF) for fiscal years 2010 through 2016.

OPM's principal roles in this matter are those of program administrator and trust fund fiduciary. As such, our primary concerns are with the efficient operation and reliable funding of the retirement

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and insurance programs. As a fiduciary, our main concern is with the adequate funding of the program and not with the source of that funding. Since Senate bill 3831 will not change funding levels for CSRS but only the source of those funds, OPM takes no position at this time as to the substance of section 2. However, we do have concerns regarding certain technical aspects of that section. We previously provided technical assistance on the draft bill and would be pleased to work further with the Subcommittee on this matter.

I appreciate the opportunity to appear before you today and would be pleased to answer any questions you may have.

Senator CARPER. Thank you. Thank you very much for that testimony, sir. We look forward to continuing to work with you.

Mr. Herr, you are on. Thanks.

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

Mr. HERR. Chairman Carper, I am pleased to be here today to participate in this hearing on proposed legislation to address the Postal Service's challenges.

Just 4 years after postal reform legislation was passed, Congress is again faced with an array of pressing issues that must be addressed to put the Postal Service on sound financial footing. Today I will first discuss the Postal Service's financial condition and outlook; second, why the Postal Service needs to continue to modernize and restructure; and, third, key issues that need to be addressed by postal legislation.

In fiscal year 2010, mail volume decreased about 6 billion pieces from the previous fiscal year to 171 billion pieces, about 20 percent below the peak in 2006. Most of the volume declines were in profitable first-class mail. Revenue declined $1 billion to $67 billion. Total expenses, as has been discussed, increased to nearly $76 billion, resulting in a loss of $8.5 billion. Outstanding debt also increased to $12 billion. Projections for the current fiscal year call for outstanding debt to reach $15 billion, the statutory limit, with a $2.7 billion cash shortfall.

Given this financial picture, the Postal Service must continue to modernize and restructure to become more efficient and control costs. Key challenges include declining mail volume, stagnating revenues, realigning processing and retail facilities, and addressing compensation and benefit costs of about $60 billion, close to 80 percent of total costs.

Proposed postal legislation provides a starting point for decisions that will involve difficult trade-offs. S. 3831 would require OPM to recalculate the Postal Service's pension obligation and authorize its transfers to the Retiree Health Benefits Fund. These changes could increase the government's pension obligations by the amount transferred and raise the deficit.

With regard to postal retiree health care, we agree that Congress should consider modifying the cost structure of this program in a fiscally responsible manner, with the Postal Service funding its obligations to the maximum extent possible. In addition, we also con-

[1] The prepared statement of Mr. Herr appears in the appendix on page 74.

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tinue to favor a requirement that arbitrators consider the Postal Service's financial condition if the Service and its unions go to binding arbitration. Action is also needed to right-size postal networks and its workforce, as S. 3831 recognizes. In this area, we agree that Congress needs to address the constraints and legal requirements that have limited progress in this area. The Postal Service continues to move its retail services to more convenient locations which facilitates both improving service and right-sizing its retail network.

S. 3831 would also loosen current law to permit the Postal Service to introduce new non-postal products. This raises several questions. In what areas should the Postal Service be allowed to compete with the private sector and how would fair competition be assured? Would the Postal Service be subject to the same regulatory entities as its competitors? And would losses, if any, be borne by postal ratepayers or taxpayers?

Just this past March, the Postal Service reported that if it entered banking or sold consumer goods, its opportunities would be limited by its high cost structure and relatively light customer traffic. Only about 600 customers obtained window service at a post office in an average week. The Postal Service also said that entering a number of non-postal areas would not be viable because of its net losses and limited access to cash to support investment.

In closing, the need for additional postal reform has arrived as the use of mail continues to change. Congress and the Postal Service need to reach agreement on a comprehensive package of actions to enable such changes, and GAO is happy to work with your Committee going forward on this.

This concludes my statement, and I would be happy to answer any questions.

Senator CARPER. Good. Again, thanks for working with us and for all the good that you do. We appreciate very much your willingness to help us as we move forward from this day.

Let me ask a question of—this is not a question I anticipated asking, but it has, I think, become an important question to ask in light of some comments that Pat Donahoe made and maybe one or two of you have in your testimony.

Earlier in the hearing, you may recall Mr. Donahoe suggested that the retiree health payment or prepayment schedule in law today may be even more aggressive than we thought if you take into account the significant reductions in the postal service's employees head count over the last 7, 8 years. And I think he indicated that some further reductions are likely give improvements in productivity and just doing things smarter, but some further reductions are planned in that regard.

Let me just ask, what are your thoughts—I think at least one of you mentioned this in your testimony, but what are your thoughts on the size of the payments or prepayments for health benefits for retirees in light of these developments? "These developments" being specifically reductions of several hundred thousand people in head count in anticipation of some further reductions going forward.

I do not care who goes first. Mr. Herr, do you want to go first?

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Mr. HERR. Senator Carper, last spring we completed a report looking at the Postal Service's business model, and as part of that, we worked with OPM's actuaries and the Postal Service to get updated staffing projections. We did two things in that report: One, we talked about what the pay-as-you-go cost might be, and then also looked at an actuarial estimate of reamortizing those costs. So in a sense, we did try to provide some updated figures in that report, and we lay out some of the context for that.

Ms. GOLDWAY. And I would add that the work that we did on this in 2009, which included both a reduction in employees, and an adjustment in the actuarial process, estimated that at the end of the payment period you would have paid 80 percent of the liability by paying $2 billion less per year. If you then, after 2016 factor in further employee reductions, you might be able to justify an even lower annual payment that would get to the goal of assuring that the Postal Service has paid at least 80 percent of its health care retiree benefit liability.

Senator CARPER. OK. Thank you.

Mr. Foley, your thoughts, please? You have probably thought more about this than anybody.

Mr. FOLEY. Well, we would be happy to continue to provide technical assistance, as Mr. Herr referenced, on this matter. We do not have a specific level or recommendation for you, but we would be pleased to continue to provide assistance to the Postal Service and GAO and the Congress on the exact level.

Senator CARPER. OK. Thanks.

A question, if I could, for Mr. Herr and Ms. Goldway. Another provision in the bill that I introduced would loosen the restrictions and allow the Postal Service to engage in certain non-postal activities that might take advantage of the Postal Service's retail, processing and transportation network. There is some fear, however, that this might lead to the kinds of failure that were seen in years past when the Postal Service dabbled in e-commerce activities, and there is also some concern about the impact this might have on private businesses.

How might we modify the language in the POST Act on non-postal products to address the concerns that you and others might have? Ms. Goldway, do you want to go first on that? And then Mr. Herr.

Ms. GOLDWAY. Well, I think in my testimony I suggested that some of the language that is in the PAEA now that gives standards or benchmarks for what a non-postal product should be might be included in new legislation so that it is better defined. And then I do think that some sort of prior review, at least on broad categories of non-postal services, would be necessary.

We have seen examples of where non-postal activities have lost ratepayers money, and we had some issues in which it appeared that the Postal Service was engaged in a contract for a non-postal product in direct competition with the private sector, and the private sector was very concerned about that. The Postal Service's vast network, its monopoly status, gives it, in some ways, a preferred status to work with non-postal products. So I think some form of regulation in your bill is necessary.

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But I would agree that diversification is essential if the Postal Service is going to survive into the future. In principle, I certainly support that effort.

Senator CARPER. OK. Thanks. Mr. Herr.

Mr. HERR. As Chairman Goldway referenced, there is a provision in PAEA that would permit a review at the PRC. I think given the uncertainty about what some of these changes are, continuing to have that oversight mechanism in place to ensure that there is not cross-subsidization occurring is important. I also think it would be an important venue for the public and for Congress to understand the kinds of things the Postal Service is interested in entering into. It is hard now to get a firm idea on what that is, what niche of the market is underserved now, where might they be able to move in and add value, what is the potential for profitability and really adding to the bottom line, which has been discussed here today, but to help people understand and work through what some of those issues are. I think that venue would be a potential place to do that.

Senator CARPER. I will close this part of the hearing with this comment. I am reminded—there are no silver bullets when it comes to helping meet the fiscal challenges of the Postal Service. But there are a lot of BBs, big BBs, that can be helpful. I am reminded, as we heard first from Mr. Donahoe and now from each of you, that collocation can work both ways. It can be locating a post office in an existing retail outlet which would actually provide better service, could provide better service if we are smart about it, and collocation where other services that might reasonably be provided in a post office could be provided and, again, serve as a benefit to the folks in that community. So hopefully we can, if we are looking for ways to think outside the box, we can do that.

Ms. GOLDWAY. That is a great idea.

Senator CARPER. All right. At 11:30, another meeting has begun, and it is a meeting, a briefing on the report, the recommendations of this Deficit Reduction Commission that Erskine Bowles and Alan Simpson have led. I want to go to that meeting, but I am going to excuse this panel, and I want to invite our next panel to come forward to present their testimony. I have other questions for this panel that I would like to submit for the record, and I would just appreciate it if you would respond to those.

Ms. GOLDWAY. Thank you.

Senator CARPER. Yes, thank you all.

All right. As our second panel takes their leave, I will ask our guests to lower their voices please, and I will now have the pleasure of introducing our third and final panel.

The first witness on panel three is no stranger. We are happy to see you again and thank you for your leadership and thank you for your thoughtful leadership. Thank you for being here with us today. It is Fred Rolando, who is the President of the National Association of Letter Carriers. Being president today is a tough job, whether it happens to be President of the United States or President of the National Association of Letter Carriers. But we are happy that you are and that you are here today. We look forward to your testimony.

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Another president, Bob Rapoza, President of the National Association of Postmasters of the United States. Bob, welcome. We are delighted you could be with us today.

Finally, Jerry—I will probably butcher your name. Is it Cerasale?

Mr. CERASALE. Close.

Senator CARPER. Cerasale. I am sorry. Jerry Cerasale is the Senior Vice President for government affairs at the Direct Marketing Association and is testifying today on behalf of the Affordable Mail Alliance. It is nice to see you. Thank you so much for coming.

Again, as I said with previous witnesses, your entire testimony will be made part of the record, and you are welcome to summarize that. I would ask you to try to keep it to about 5 minutes so I will have time to ask you some questions. Again, thank you.

Mr. Rolando, please proceed.

TESTIMONY OF FREDRIC ROLANDO,[1] PRESIDENT, NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL–CIO

Mr. ROLANDO. Thank you. Good morning, Chairman Carper. On behalf of the nearly 290,000 members of the National Association of Letter Carriers, I thank you for allowing me the opportunity to summarize my written testimony on the Chairman's proposed POST Act of 2010.

The past 4 years of recession have been the most difficult in postal history with the Postal Service reporting losses of more than $20 billion. But these figures are misleading, and I will explain why.

The three main causes for the Postal Service's losses are, by importance, the $20.9 billion cost since 2007 of pre-funding future retiree health benefits, declining mail volume caused by the recession, and the Internet diversion. Conventional wisdom often flips the order of these factors, but absent the pre-funding congressional mandate of 2006, which no other institution in America faces, the Postal Service would have had a net surplus of $611 million in the past 4 years despite the worst recession in 80 years and despite the Internet.

Pre-funding is optional in the private sector. No other company comes close to allocating 8 percent of its operating revenues to prefund future retiree health as the post did in the year 2010. For example, AT&T allocated just 2 percent of its revenues to pre-funding.

I want to thank Senator Carper for taking the lead by introducing S. 3831. Though we cannot support all of its provisions as drafted, we believe it gets the two most important policy issues exactly right.

First, to help stabilize the Postal Service's finances, the POST Act would relieve the burden of pre-funding future retiree health benefits by letting the Postal Service use the $50 to $75 billion surplus in its civil service pension account to cover the pre-funding payments. This is a responsible approach supported by the entire postal industry—management, labor, and the mailers. I would also like to thank Senator Collins for her tireless work on OPM's authority to transfer our surplus pension funds.

[1] The prepared statement of Mr. Rolando appears in the appendix on page 89.

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Second, we think section 3(b) of S. 3831 will spur innovation that is needed to preserve universal mail service by permitting the Postal Service to partner with companies, nonprofits, and State and local governments to use its retail, its processing, and its delivery networks to offer new services. NALC believes that such innovation can help spur economic growth and it can create jobs inside and outside the Postal Service. In May, we will sponsor an international conference on postal innovation in Washington, D.C., in an era of rapid change where communications are a key for economic and national security purposes. We should strengthen, not weaken, our universal communications networks.

However, we strongly oppose both section 3(e) regarding the arbitration of labor disputes and section 3(g) on the frequency of mail delivery, and I will address each in turn.

Under the current interest arbitration process, an arbitration board must give labor and management a full and fair hearing, and arbitrators are bound to consider all the evidence presented by the parties when rendering their decisions. This is in section 1207(c)(2) of Title 39. The proposed changes to this section of the law would prioritize three managerial objectives. That would needlessly disrupt the balance and fairness of the existing process for resolving collective bargaining impasses in the Postal Service, a process which has assured peace for four decades and served the parties and the public very well.

The Postal Service's so-called fact sheet on arbitration says that arbitrators are not required to take the fiscal health of the Postal Service into account. This is flatly untrue. Arbitrators must consider all evidence that is given to them by the parties, and in reality, evidence and testimony on the financial condition of the Postal Service has been provided to every arbitration board that has been established. Therefore, giving this issue special status along with the other managerial objectives such as the comparability standard in compliance with rate-setting rules is unwarranted. Sadly, we believe that this misleading information has been accepted as fact by this Subcommittee.

At the markup of S. 1507 in July 2009, Senator Coburn introduced the language requiring arbitration boards to consider the Postal Service's financial condition when rendering a decision. He argued that current law prohibits arbitrators from considering the financial impact of the competing contract proposals. This is, as noted, completely inaccurate. Let us not fix what is not broken.

The other major provision we oppose would give the Postal Service, free of congressional oversight, the power to reduce the frequency of delivery from the current mandated 6 days per week. Doing away with Saturday delivery would save little money while risking the loss of much more revenue over time by driving customers away, and it would eliminate 80,000 decent jobs during a recession. Congress would essentially be outsourcing a key public policy decision to whoever occupies the position of Postmaster General at any given time. There would be no way to prevent the Postal Service from dropping 2 or even 3 days of delivery per week to meet short-term cost-cutting targets. This would destroy the Postal Service.

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Both the Obama administration and a bipartisan majority of the House of Representatives that has cosponsored House Resolution 173 oppose eliminating Saturday delivery, and we urge you to reject this proposal as well.

Let me conclude by thanking Senator Carper and Senator Collins for your years of diligent work on postal issues. Fortunately, the challenges that are facing the Postal Service are not partisan in nature, and we are convinced that, working together, we can resolve them. NALC has demonstrated repeatedly in recent years it is willing to do its part to help preserve the long-term viability of the Postal Service. We are prepared to work with this Subcommittee to craft legislation that will maintain the integrity of the Postal Service while serving the American people and helping businesses that rely on universal service prosper.

Thanks again for inviting me to testify, and I am ready for any questions. Thank you.

Senator CARPER. Thank you, President Rolando, and thank you not just for your testimony but for the spirit in which it was prepared and delivered. Mr. Donahoe already spoke to the terrific cooperation and sense of team that has existed for years, and I think he specifically mentioned the NALC. So we appreciate the fact that is there and it is going to continue. We need that. Thank you.

Mr. ROLANDO. Thank you.

Senator CARPER. Mr. Rapoza, please proceed. Your whole testimony will be made part of the record.

TESTIMONY OF ROBERT J. RAPOZA,[1] NATIONAL PRESIDENT, NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES

Mr. RAPOZA. Thank you, Chairman Carper and Members of the Subcommittee. I am Robert Rapoza, President of the 38,000-member National Association of Postmasters of the United States (NAPUS). NAPUS represents the managers in charge of post offices. Postmasters guarantee your constituents accessibility to essential postal services.

The Constitution established post offices as a Government responsibility. Aggressive congressional oversight acknowledges this congressional obligation, and postmasters thank you for the attention that this Committee provides.

NAPUS strongly supports legislative efforts to revitalize the Postal Service through accurately recalculating the agency's CSRS pension obligations. The present formula is inequitable and unfairly saddles the Postal Service with at least $50 billion more than is justified.

NAPUS commends the Chairman and Senator Collins for their bills which seek to legislatively shoehorn the PRC-recommended methodology into law. These provisions would determine the Postal Service's true pension obligation. Moreover, NAPUS supports the provisions that enable the Postal Service to use its pension surplus to reduce its retiree health care liability.

In addition, NAPUS supports efforts to provide the Postal Service with access to surplus pension payments to FERS. We believe

[1] The prepared statement of Mr. Rapoza appears in the appendix on page 102.

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that Congress should enact these provisions as soon as possible. Furthermore, NAPUS urges Congress to enact a pension liability recalculation provision independently of any other postal legislation. We believe inclusion of controversial provisions may delay essential postal relief.

NAPUS acknowledges and has actively participated in the past, and are currently participating in the development of strategies to streamline operations and reduce costs. However, we are deeply concerned about the elimination of the prohibition against the closing of post offices solely for being unprofitable.

We are also concerned about striking the requirement that the Postal Service provide a "maximum degree of service" to rural areas. We consider these two provisions essential to universal service.

Just yesterday, the so-called Deficit Reduction Commission performed a terrible disservice by incorrectly suggesting that closing post offices or reducing delivery frequency has an impact on the Federal deficit, and that the 1-year deferral of the USPS transferring a sum of its own postage revenue from one account to another as a bailout. Quite to the contrary. In fact, the Postal Service has unfairly subsidizing the Federal budget for years. However, having said that, NAPUS strongly believes that the Postal Service should cut expenses that do not impact postal services.

For example, the postal IG identified postal area and district offices as ripe for aggressive pruning, and NAPUS agrees. According to the IG, the cost of maintaining area and district infrastructure totals $1.5 billion. That is about three times greater than the cost of providing convenient postal access to small-town and rural communities through the post offices.

My 44 years of postal experience convinces me that trimming the postal bureaucracy would advance postal efficiency. NAPUS recognizes that the proper deployment of convenient access points may generate new revenue. However, we are concerned that the Postal Service may exploit this effort as a pretext to close post offices.

Postal contractors are not accountable to the community. They do not offer the full menu of postal products and services, and can be closed for no reason whatsoever, thereby denying the communities access to essential postal products and a postal facility. Consequently, NAPUS supports the preservation of current law relating to post office closings, which do not place unreasonable obstacles before the Postal Service.

It is crucial to note that the post office is the community's "touchpoint" to the Federal Government and to universal service. Rural and small-town post offices provide the essential access point for citizen mailers who are the customers most reliant on a universal service. NAPUS feels that the Postal Service is not fully maximizing its retail network. Consequently, NAPUS supports the provision in S. 3831 to provide expanded opportunities for the agency to raise revenue.

As I testified in June, NAPUS believes that the wide distribution of post offices is an asset, not a liability. It offers tremendous opportunities to partner with State and local governments as well as commercial interests to provide identity verification and licensing and permitting services.

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Mr. Chairman, the Postal Service has entered a new phase in its evolution. The only way that it will remain viable is to be treated equitably and to offer the American public and business community accessibility and the products they desire. We must be careful of using Band-aid fixes as we search for lifelong changes that will enhance our postal assets. NAPUS looks forward to working with you, and we continue this journey together. Thank you.

Senator CARPER. Yes, we do. Thank you, Mr. President. Mr. Cerasale. Cerasale, is that correct?

Mr. CERASALE. That is correct.

Senator CARPER. Has your name ever been mispronounced?

Mr. CERASALE. No. [Laughter.]

Senator CARPER. I bet it has.

Mr. CERASALE. You are the first.

Senator CARPER. I bet it has.

Mr. CERASALE. I answer to anything close usually.

Senator CARPER. Mr. Cerasale, please proceed. Thank you.

TESTIMONY OF JERRY CERASALE,[1] SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS, DIRECT MARKETING ASSOCIATION, INC., ON BEHALF OF AFFORDABLE MAIL ALLIANCE

Mr. CERASALE. Thank you very much, Senator Carper. I am testifying today on behalf of the Affordable Mail Alliance, and I am happy to report that I am also authorized to say that the Coalition for a 21st Century Postal Service also endorses this testimony as we mailers work together to present one voice to Congress for you.

We want to particularly thank this Subcommittee for all it has done on behalf of the Postal Service and, therefore, on behalf of our postal customers. But we want to particularly thank you and Senator Collins for all your efforts in the past, in the present, and we know in the future to help create a strong, viable postal system and postal community.

It is interesting and it is great that both the POST Act and the Postal Service Improvement Act of 2010 of Senator Collins begin with postal pensions and retiree health benefits. As mailers, through postage we have been paying for retiree benefits of postal employees since July 1971, and the IG and the PRC have come up with a $50 to $75 billion overpayment from the postage that we have been paying to the Postal Service. Those payments increased postage; they reduced mail volume; they reduced the number of jobs that we had within our community, within our membership.

We also have to contribute to the unfunded retiree health benefits, and there is an aggressive payment schedule in the 2006 act.

We approve of your legislation and that of Senator Collins to use the customer overpayment for postal pensions to fund retiree health benefits. We do ask, however, that you should require the Board of Governors to so use and transfer those funds to get rid of the legacy costs of the Postal Service and not give them the opportunity to use those funds elsewhere. If we can get rid of these legacy costs and put us on a better footing, that is just so much better.

[1] The prepared statement of Mr. Cerasale appears in the appendix on page 116.

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Senator Collins has also included in her act a review of FERS payments. We understand that it is a potential $6.8 billion overpayment as well to the FERS account. Now, I am not sure—I am not the actuary on that and how it works, but we would ask that you take a look and add that in any legislation or review of that so that we do not create a new overpayment for postal pensions.

As we look to collective bargaining, we are not at the table. We do not want to be at the table. But we want to just point out that on July 1, 1971, 80 percent of postal costs were employee compensation. Today it remains 80 percent of postal costs. After great improvement in productivity, billions of dollars in capital investments, work sharing, a significant drop in worker complement, all of that compensation still remains at 80 percent. We urge Congress to look at every single idea to try and improve the collective bargaining process which does not allow for strikes, to try and create—help the Postal Service survive in the 21st Century.

Looking at facilities, the Postal Service could probably deliver 300 billion pieces of mail a year. They are looking to deliver in 2020 150 billion pieces of mail a year. It has to downsize, and we have to downsize relatively quickly. And so we cannot afford that excess capacity.

Looking at co-location, however, we think that is phenomenal idea, both from working with local and State governments within postal facilities and having retail facilities within communities provide postal services. That would even potentially expand hours, so that is a good—we support that.

Looking at delivery days, the Postal Service has to provide services that customers need. A Saturday delivery drop would cause all mailers to adjust. Some can adjust more readily than others. But the Postal Service has to ensure that they meet the needs of customers; otherwise, a 17-percent drop in service could dramatically hurt mail volume.

Looking at new products, I think the onus is on us, the mailers, as well as the Postal Service to come in and look at what do we need, what new products can we offer. But with an $8.5 billion loss this past year, you cannot revenue your way out of this problem. It is not the silver bullet, as you say.

The one thing that we really want to be careful of, however, is we do not want to have expertise of the Postal Service pulled out to offer new products and ignore the core functions of transporting and delivering the mail. So that is important for us.

The Postal Service should also re-evaluate its requirements that it has placed on mailers, increasing costs to enter the mail stream which is driving mail away. I think that is something that should be totally re-examined. And Senator Collins also has in her bill that she mentioned looking at NSAs, and we think that the Postal Service should more aggressively use Negotiated Service Agreements in market-dominant products, but also should look at doing it in combination of market-dominant and competitive products.

Thank you very much for this opportunity.

Senator CARPER. Thank you, Mr. Cerasale.

I have a couple of questions, and let me direct the first one to President Rapoza. In talking about collocation, my preference—and I suspect your preference, too—would be as we want to maintain

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a postal presence in communities across the country that we think outside the box and we are really smart and diligent about identifying other kinds of activities that could be collocated in a post office. And today in a number of post offices across the country, folks can get help with passports. We allow the Federal Government to collocate services in the Postal Service, not State and local governments. And we suggest in our legislation we ought to change that.

But I would ask you, if you want to say for the record here, what are some ideas that the postmasters have of the kinds of services that could be offered in post offices so that they would not have to close.

Mr. RAPOZA. Thank you, Chairman. First of all, we should look at what the needs of the community should be considered and what types of services we render to them. But it could be potential services. It could be hunting and fishing licenses, motor vehicle transactions, public utility transactions, State and local applications for service that require identity verification, other things that would assist Government agencies. And certainly we would like to get a return on our investment.

Just for the record, NAPUS does not object to the Postal Service expanding retail services, and we heard here today from you, Senator Carper, was that the Postal Service should better serve our customers. In addition, the incoming Postmaster General says it should improve customer experience. But he also said our customer satisfaction is already at 97 percent, so we are looking to improve that other 3 percent, it makes more sense to bring the businesses to the facilities we have than to take it somewhere else.

Senator CARPER. And I think this is pretty self-evident, but to the extent that we can better identify services that logically could be provided at post offices in order to add to the bottom line at the Postal Service, that would be our preference. And so I would just ask you to work with us to help—not just you but postmasters across the country and others, help us to identify those opportunities, and to not just identify them but to seize them. As we say in Delaware, carpe diem. Seize the day.

If I could, for President Rolando, you and I have had this conversation before, but I want to revisit it because I think it may be even more timely today. In previous labor negotiations, as I recall, there has been significant discussion between labor and management, particularly with the letter carriers, to try to come up with a way to continue to have 6-day service, to continue to have Saturday service, but in a way that actually saves money, and not just millions of dollars but a lot more. If the Postal Service would go to 5-day service, they expect after a loss of revenue they would save about $3 billion a year, which is not small. And in your negotiations with the Postal Service on behalf of your members, to the extent that you can identify ways to achieve not $3 billion in savings but a considerable amount of that, I would urge you to do that. I would urge you to do that. I know you have tried to do that before, you and your predecessors have tried to do that before. And I would just urge you to take another run at it. I have certainly had that discussion before with Postmaster General Potter, and I will have that conversation with his successor.

But any reaction to that comment?

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Mr. ROLANDO. Well, the $3 billion projected savings is no small amount, but I doubt if it is accurate either. But we are certainly looking forward to the negotiations and resuming those talks. We have informally had those discussions, but we are totally open to what we tried to do before.

Senator CARPER. Good. OK. I think I am going to close it up today. If I leave now, I might be able to get to the tail end of this other meeting that I am missing.

We very much appreciate your being here. We appreciate the chance to have worked with you in the past, and we just need to continue to do that, use our best thinking or best thoughts, and I think we can figure this out. Actually, I come out of this hearing encouraged rather than discouraged. And every now and then when I am trying to address or help address a big problem, I reach a point in time where the path ahead becomes a little more clear. And for me, some of the fog has gone away, and I am able to start seeing the pieces come together and give us a path forward that comes pretty close to doing the job for all of us. So I am encouraged by that, and I appreciate each of you for being here to help provide some of that additional clarity.

With that, this hearing is over, and those who were not here have an opportunity, my colleagues have an opportunity to submit questions for, I think, another 2 weeks, and if you could respond promptly to them, we would be most grateful.

Thank you so much. With that, this hearing is adjourned.

[Whereupon, at 12:05 p.m., the Subcommittee was adjourned.]

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APPENDIX

FOR IMMEDIATE RELEASE

TOM CARPER

UNITED STATES SENATOR · DELAWARE

FOR RELEASE: Dec. 2, 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: "Finding Solutions to the Challenges Facing the U.S. Postal Service"

Opening Statement of Senator Thomas R. Carper, Chairman

We've held a number of hearings over the years in this subcommittee and in the House that highlighted the numerous challenges facing the Postal Service. It is my hope that, with this hearing, we will soon get down to the hard work of actually addressing those challenges and clearing a way to enable the Postal Service to emerge from the toughest time it has faced since it was created four decades ago.

At many of these hearings, members and witnesses talk about how, despite hard times, the Postal Service is achieving its mission and will continue to achieve its mission. The Postal Service has done an admirable job in cutting costs, streamlining operations, and reducing through attrition the size of its workforce. They've managed to do all this while maintaining or even improving service, at least by some measures.

But the truth is that we're rapidly approaching a time when we may no longer be able to depend on the Postal Service. That time may come less than a year from now.

The Postal Service lost a record $8.5 billion in fiscal year 2010. Postal management is projecting the loss of a further $6.4 billion in the current fiscal year. As a result, by this time next year the Postal Service will likely have exhausted all of the $15 billion line of credit it has with the Treasury and won't have sufficient cash to meet its obligations. In practical terms, this could mean that, during next year's holiday shopping and mailing season, the Postal Service may not have the resources necessary to open its doors.

There is some good news here. I take some comfort in the fact that the vast majority of the Postal Service's losses in recent years are attributable to the very aggressive retiree health care pre-funding schedule put in place in 2006. In fiscal year 2010, $5.5 billion out of the Postal Service's $8.5 billion loss could be attributed to the retiree payment it was required to make in September. Only $500 million of the $8.5 billion is an actual operating loss.

I take some comfort from the fact that there is a level of consensus here in Congress and amongst postal stakeholders that something must be done about the Postal Service's retiree

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health pre-payments. But even if we were to completely eliminate the remaining payments, we would only be dealing with a portion of the Postal Service's projected long-term debt.

This is where the bad news comes in. This past spring, the Postal Service and a group of highly-regarded outside consultants conducted a study showing that – if nothing changed – the Postal Service would run up more than $230 billion in cumulative debts between now and 2020.

Some of these losses could be stemmed by the Postal Service today without Congress taking any action at all. I'm sure that some steps have already been taken since the $230 billion number was first discussed. But the enormity of the projected losses tells me that we need to go beyond just addressing retiree health payments by enabling the Postal Service to make several fundamental changes in the way it does business.

We live in a time when the Postal Service is competing not just with UPS or FedEx but with the Internet, e-mail, electronic bill pay, cell phones, and other advances in communication and commerce. Simply put, many businesses that in the past had to turn to the Postal Service to reach customers or ship their products have far more choices today. To make the Postal Service a viable choice, we need to give postal employees the tools they need to thrive in the coming years.

Coming together at the last minute a few months down the road and doing just enough to get the Postal Service through Christmas 2011 is not a viable option. Our federal government faces a sea of red ink as far as the eye can see. Adding another $230 billion to our nation's debt is not a viable option as we seek to replace what I call a culture of spendthrift in Washington with a culture of thrift.

Going forward, the Postal Service cannot remain a part of the problem. It must become part of the solution. If we work together and think outside the box, that can happen.

In September, I introduced legislation – the Postal Operations Sustainment and Transformation Act, or POST Act – that I believe may be the only proposal out there now that deals comprehensively with the problems facing the Postal Service in both the short-term and the long-term.

The key part of my bill aims to permanently fix the postal pension and retiree health issues that have been debated for so long. The legislation does this by requiring OPM to revise the dated methodology used to determine how much the Postal Service pays into the Civil Service Retirement System. That change would likely show that the Postal Service has overpaid into that system by as much as $50 billion. The POST Act would allow the Postal Service to use that money over the years to satisfy its retiree health payments. This would take $5.5 billion or more off the Postal Service's books each year and prevent a catastrophic shutdown in the coming months.

My bill would also empower postal management to take additional steps to cut costs over time.

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The Postal Service has been talking for several months now about saving as much as $3 billion a year by eliminating Saturday delivery. They've submitted a proposal to the Postal Regulatory Commission and the Commission is preparing to report on the advisability of this change.

Unfortunately, Congress each year prevents the Postal Service from exercising its authority to change delivery frequency when it believes that doing so is necessary. And we do this despite the fact that the 2006 postal reform legislation explicitly gave the Postal Service the authority to change delivery frequency and other service standards to adjust to customers' changing needs.

I'm not an advocate of eliminating Saturday delivery. There are good arguments both for and against what the Postal Service would like to do. But I am an advocate of giving the Postal Service the freedom to manage, especially when our interfering in management decisions could prevent the achievement of so much in savings at such a critical time. The POST Act will ensure that, on this issue, the Postal Service, working with its regulator and its customers, will make the critical decision on Saturday delivery without political interference.

The POST Act also seeks to simplify postal management's decision-making process when it comes to transforming its retail network. As many in this room know, the Postal Service has tens of thousands of retail locations. Some of these locations are not ideal. Others operate with significant losses. My bill would remove several legislative restrictions that tie the Postal Service to an outdated retail network and free them to begin to expand to more cost-effective and more convenient retail outlets that I believe will ultimately enable the Postal Service to better serve its customers.

But the bill I've introduced isn't just about cutting. It also recognizes that, while customers may be moving away from hard-copy mail, the Postal Service's retail and delivery network remains extremely valuable. I propose in my legislation that the Postal Service be freed to better capitalize on the value of this network by experimenting with products and services not directly related to the mail. Among the things the Postal Service could do with this new authority would be to partner with state and local governments to provide government services such as license renewal or voter registration in postal facilities.

Finally, my bill addresses a flaw in postal labor law by requiring arbitrators to take the Postal Service's financial condition into account when rendering decisions during labor disputes, a proposal embraced by Senator Collins and other members of our committee.

I'd like to close by again reiterating how critical it is that Congress begin to move on a comprehensive postal bill in the near future. The Postal Service operates at the center of a massive mailing industry that employs millions of men and women in every state and congressional district across our country. These people don't just work at the Postal Service itself. They work at banks, at retailers, at newspapers, and in countless different sectors of our economy.

With all of the challenges we face as a country today, it would be a tragedy to add the loss of these jobs to the list of hardships we need to overcome just because we didn't allow

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ourselves to come together around some additional commonsense reforms of the Postal Service.

We're long past the time of fighting the old battles that have hindered work on postal issues for so long, including during 2006 when we finished the most recent postal reform efforts. We're also beyond the point at which we should be satisfied with more reports and studies or with reforms that create pennies in savings when we really need billions. I look forward to working with our witnesses and with my colleagues to enact meaningful legislation.

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Statement of Ranking Member
Susan M. Collins

"Finding Solutions to the Challenges Facing the U.S. Postal Service"

December 2, 2010

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The Postal Service's announcement that it lost $8.5 billion during fiscal year 2010 was only the latest in a series of disappointments. Significant reductions in mail volume and revenue over the past several years have underscored the urgency of re-engineering the Postal Service business model to adapt to the information age.

The Postal Service is the linchpin of a $1 trillion mailing industry that employs approximately 7.5 million Americans in fields as diverse as direct mail, printing, catalog companies, paper manufacturing, and financial services.

Postal Service employees deliver mail six days a week to hundreds of millions of households and businesses. From our largest cities to our smallest towns, the Postal Service is a vital part of our national communications network.

But facing an unprecedented shift to electronic communication and rapidly evolving technology, the Postal Service has been unable to keep pace. It is no wonder, then, that the Postal Service's current fiscal condition is abysmal.

At this defining moment in its history, the Postal Service must embrace change and take aggressive steps toward a structural reinvention. It must enhance its service and value to customers, rather than looking to drastic cuts in service and sharp increases in price. At the same time, it also needs to scrutinize its internal

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operations and redouble its efforts to be leaner and more cost-effective.

The Postal Accountability and Enhancement Act of 2006, which I co-authored with Senator Carper, provides the foundation for many of these changes. The Postal Service has been slow to use the flexibilities afforded by the law. But, to be fair, other problems not of the Service's making, such as the severe recession, have also intruded.

Today, I am introducing the "U.S. Postal Service Improvements Act of 2010." This legislation would help the Postal Service achieve financial stability, produce additional cost savings, and improve customer services. These are the strong fundamentals from which the Postal Service must rebuild.

First, the bill would direct the Office of Personnel Management to use its existing authority to allow the Postal Service to access the more than $50 billion that the Postal Regulatory Commission estimates the Postal Service has overpaid into the Civil Service Retirement System. The bill would also provide OPM the authority to allow the Postal Service to access the nearly $3 billion it has overpaid into the Federal Employees Retirement System pension fund. It is simply unfair – both to the Postal Service and its customers – not to refund these overpayments.

Second, the legislation would improve the Postal Service's contracting practices and help prevent the kind of waste and ethical violations recently uncovered by the Postal Service Inspector General.

Several months ago, I asked the Inspector General to review the Postal Service's contracting policies. The findings of this audit were shocking. The IG found stunning evidence of costly contract mismanagement and ethical lapses.

My legislation would help remedy many of the contracting issues the IG identified. The bill would:

- direct the Postmaster General to establish a Competition Advocate, responsible for reviewing and approving justifications for noncompetitive purchases and for tracking the level of agency competition;
- improve competition, transparency, and accountability by requiring the Postal Service to publish justifications for noncompetitive contracts above $150,000 on its website;

- limit procurement officials from contracting with closely associated entities; and
- require the Postal Service's ethics official to review any ethics concerns that the contracting office identifies *prior* to awarding the contract.

Third, the legislation also would require the Postal Service to create a comprehensive strategic plan to guide consolidation of its regional and district offices. In a separate review that I requested, the IG found that the Postal Service's eight area offices and 74 district offices leave significant room for consolidation. These offices cost approximately $1.5 billion in fiscal year 2009. The strategic plan required by my bill would provide a road map for future savings.

The bill also would:

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- allow information on the financial health of the Postal Service to be considered by the arbitrator when rendering decisions about collective bargaining agreements;
- require the Postal Service and Postal Regulatory Commission to work together to increase the use of negotiated service agreements, which reduce costs to mailers who agree to help the Postal Service process their mail;
- reduce government-wide workforce costs by converting retirement eligible postal and federal employees on long-term workers' compensation to retirement annuities when they reach retirement age. There are 132 employees age 90 and over who are on workers' compensation; and

- require the Postal Service to develop a plan to increase its presence in retail facilities, or co-locate, to better serve customers.

I want to point out that *before* co-location decisions could be made, the bill would direct the Postal Service to weigh the impact of any decisions on small communities and rural areas and solicit community input. The bill also would require that co-location does not diminish the quality of service.

I want the Postal Service to survive and thrive. This valuable American institution with roots in our Constitution must be put back on steady course. I look forward to working with the incoming Postmaster General Patrick Donahoe and all postal stakeholders to achieve these vital reforms.

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STATEMENT OF SENATOR JOHN MCCAIN, RANKING MEMBER

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

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

"Finding Solutions to the Challenges Facing the U.S. Postal Service"

December 2, 2010

Senator Carper, thank you for holding this hearing today to examine the fiscal challenges the Postal Service continues to face. I share your concerns over the Postal Service's failing financial health and believe that we all must begin to make hard choices in order to rectify the current unsustainable situation.

The Postal Service recently released its fiscal year 2010 financial statements showing a loss of over $8.5 billion. That is unacceptable. Unfortunately, fiscal year 2011 looks equally as bleak with projected losses totaling another $6.4 billion. Just as it did for fiscal years 2009 and 2010, the Postal Service predicts it will be so strapped for cash by the end of 2011that it will be forced to choose between making payroll or default on its retiree health trust fund payment.

Until now, the Postal Service has relied on short-term fixes to address its long-term problems. Over the years, the Postal Service has cumulatively borrowed $12 billion from the Treasury, and will likely exhaust its $15 billion borrowing limit this fiscal year. Last year, Congress provided temporary financial relief by granting the Postal Service a waiver from making a majority of its retiree health trust fund payment. More recently, the Postal Service sought to increase mailing rates. The Postal Regulatory Commission, however, denied its exigency request, ruling that that it would not solve the Postal Service's enduring cash flow problem.

The Postal Service cannot continue to push for short-term fixes such as increasing its debt cap or its service rates. It must do more to reduce the workforce and streamline operations, since labor costs continue to account for a staggering 80percent of operating expenses. As one example, the Postal Service and its employees might follow the

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President's recent embrace of a two-year pay freeze for federal employees. This should, of course, cover senior executives. Taxpayers were justifiably outraged by recent reports of incentive bonuses and multi-million dollar "golden parachutes" for the outgoing postmaster general, when the Postal Service has not turned a profit since 2006.

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 lay-off employees during business downturns, and it is restricted in its outsourcing capabilities. The Postal Service also cannot assign idle workers to perform tasks outside their designated craft. And, finally, it must pay for health and life insurance benefits greater than those offered by other federal agencies.

The Postal Service faces huge obstacles in reducing excess capacity and labor costs, some of which result from restrictive collective bargaining agreements. The failure of recent contract renegotiations with one of the major postal unions is cause for concern. In current and future negotiations and related arbitrations, the economic health of the Postal Service must figure prominently into compensation and benefit determinations. It makes absolutely no fiscal sense to maintain or increase current compensation and benefit levels while the Postal Service continues to hemorrhage money.

Congress must also do its part by removing regulatory and statutory roadblocks, provided universal service can be guaranteed and communities are not adversely affected. The Postal Service must be given the flexibility to manage its operations effectively and close unneeded facilities. Now that the Postal Regulatory Commission has published its opinion on the Postal Service's pension overpayment, the Postal Service, the Office of Personnel Management, and Congress must also address the most responsible way to resolve this issue.

It is up to everyone -- postal management, the employees, their unions, and Congress -- to make some tough, but necessary, choices. The lingering recession and declining mail volumes will require the Postal Service to exercise even greater fiscal discipline into the future. We cannot allow the taxpayers to pick up the tab any longer.

Thank you again Mr. Chairman. I thank the witnesses and look forward to the discussion.

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Senate Homeland Security and Governmental Affairs Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

"Finding Solutions to the Challenges Facing the U.S. Postal Service"

Statement of Senator Daniel K. Akaka

Thank you, Mr. Chairman, for holding this important hearing to discuss options for getting the Postal Service back on sound financial footing.

Last year, I supported S. 1507, which would have reduced the burdensome requirement that the Postal Service pre-pay retiree health benefits. However, I strongly disagreed with a provision impacting collective bargaining rights that was added during markup of the bill.

I want to commend Chairman Carper for continuing to seek alternatives to help the Postal Service. Many of these alternatives are reflected in his bill, the Postal Operations Sustainment and Transformation Act (POST Act).

First and foremost, the POST Act would address billions of dollars that the Postal Service may have overpaid into the civil service pension fund. By most accounts, this solution would alleviate the financial burden of the retiree health pre-payment requirement and give the Postal Service much needed operating funds. As Chairman of the Federal Workforce Subcommittee, I look forward to additional analysis of the potential overpayment to make sure that this fix would not impact the continued viability of the Civil Service Retirement and Disability Fund for other federal workers.

I am pleased that the POST Act would allow the Postal Service to offer additional products and services in order to raise revenue. Increasing business through innovation is just as important as cost-cutting measures.

However, the bill does contain some controversial provisions. It would tip the scales in favor of the Postal Service in collective bargaining, even further than in S. 1507, by adding new factors that favor the Postal Service over workers. Postal workers have worked extensively to help address the Postal Service's financial crisis. Any changes to the collective bargaining process should have buy-in from all sides.

I also worry that the provision on closing rural post offices could leave small communities with more limited access to postal facilities. I understand that the current process for closing postal facilities may be burdensome. However, we must make sure that any changes still allow Americans reasonable access to post offices.

Finally, the POST Act would expand the authority of the Postal Service to reduce delivery service to five days or less. In September, I submitted testimony to the Postal Regulatory Commission asking them to carefully consider the unique impacts of reducing delivery service on the people of Hawaii, such as delivery of medicine and access to alternative shipping services. I ask consent to enter that testimony into the record.

I do want to acknowledge the outstanding savings and efficiencies created by the Postal Service over the last few years using its existing authorities. I hope that Congress can take action on issues of broad agreement to address Postal Service's immediate needs.

I look forward to continuing to work with my colleagues, and I thank the Chairman for holding this important hearing.

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Senator Daniel K. Akaka
Prepared Remarks
The Impact of Eliminating Saturday Delivery Service on the People of Hawai'i.
October 1, 2010

Chairman Goldway, thank you for inviting me to submit written remarks on the Postal Service's proposal to eliminate Saturday delivery on the people of the State of Hawai'i. Thank you for inviting me to provide my views on behalf of my constituents. I understand the logistical difficulties posed by holding field hearings throughout the country. Although it is unfortunate that you were not able to visit Hawai'i and Alaska, I do appreciate the thoroughness the Commission has already shown in visiting a diverse selection of regions that, while not exactly the same, shed some light on the concerns that I will express as well.

One of the unfortunate truths already facing the people of Hawai'i is that the mail simply moves slower because of a combination of logistical, physical, and financial barriers. The service standards enacted by the Postal Service reflect this, causing providing a delivery standard of nine to ten days for standard mail from the contiguous United States to Hawai'i. The need to distribute mail to 6 islands further slows mail delivery. Hawai'i has only one mail processing facility on Oahu that serves all of the islands. All of Hawai'i's mail is supposed to be processed at the Honolulu Processing and Distribution Center, including inter-island mail, causing delays in all classes of mail.

Another unique feature of Hawai'i mail transport is the shipment of non-first class mail, which is normally shipped by ground, either on rail or by truck, on the mainland. In Hawai'i, this mail is shipped over water on cargo vessels. Unlike USPS trucks or rail contracts, inter-island and island-mainland shipping is not always a daily service, and the Postal Service has fewer options to achieve efficient delivery. These inherent inefficiencies in postal services in Hawai'i already impact our mail versus the mail of those in the lower 48. Adjusting delivery frequency could further degrade service, and I urge to Commission to take this into account as you develop your advisory opinion.

For the people of Hawai'i, the Postal Service is a government service that is perhaps more uniquely important and integral to daily life than most anywhere else. With ocean waters separating Hawaiians from friends, family, and business partners on neighbor islands and the mainland, the Postal Service provides important links within Hawai'i and to other places. Residents do not have the luxury of getting in a car and delivering items to anyone farther than their island's shores. The same goes for courier services for important personal business items. Residents must rely on the services of the Postal Service, or one of its competitors.

Prescription drug delivery is a particularly important service in Hawai'i. Many residents in Hawai'i rely on mail-order pharmaceuticals provided through employer plans, including the Employer-Union Trust Fund Health Plan. These prescriptions often come from the mainland, and increased time at processing facilities or waiting to get into the hands of those who need it could prove dangerous to consumers. As Vice President of Operations Keith McFalls of PrimeMail and Triessant Prime Therapeutics testified in at a Homeland Security and Governmental Affairs Subcommittee hearing in June, mail order pharmaceuticals are especially sensitive to delivery timeliness.

Earlier this year, Hawai'i, like some other states, performed a vote-by-mail election, where all residents would cast their ballots through the Postal Service. This is possible around the country

because of the protections afforded by sending mail securely through the Postal Service. Cutting a day of delivery could further complicate this process, lessening the certainty that a ballot will be counted.

Small, local businesses in Hawai'i, such as community newspapers who distribute the paper through the mail, would be greatly impacted as well. Hawai'i is unique in that we rely on our neighbors for services and goods to a higher degree than our mainland counterparts. Cancelling a day of service would force many businesses to cut services, and they could struggle in this already dire economic environment.

Perhaps the most important issue facing Hawai'i is the lack of alternative access for important Saturday deliveries. The Postal Service offers a predictable, low price priority mail service throughout the State of Hawai'i. Sending a one pound Priority Mail package from Hilo to Honolulu costs less than $5.00, and it can be delivered on a Saturday. FedEx and UPS do not offer Saturday delivery service in Hawai'i, so customers would have be left with essentially one option, USPS Express Mail, for around $15.00. Express Mail is already in many cases more expensive than FedEx and UPS during weekly delivery. Moreover, Express Mail is a competitive product, meaning USPS could halt Saturday Express Mail delivery in Hawai'i if the service is losing money.

The alternative touted by the Postal Service for Saturday mail is renting a Post Office Box at a local retail facility. Unfortunately, in many areas in Hawai'i, P.O. Boxes are already scarce. Requiring those who want Saturday mail to rent a P.O. Box that they only need one day a week will further exasperate existing shortages and force residents to pay extra just to get the services they have grown to expect. Postal facilities in Hawai'i are already understaffed, stretching Postmasters, Supervisors, and other employees. The Postal Service has now said that in order to make Saturday Express mail delivery, postal staff may be required to leave the facilities to make special deliveries, calling in to question how much service will be available on Saturdays at retail facilities.

Finally, cutting a day of delivery service could cost up to 40,000 postal jobs, according to the Postal Service. As Chairman of the Federal Workforce Subcommittee in the United States Senate, I worry about the impact on federal workers in these challenging economic times, as well as the dedicated postal workforce in the State of Hawai'i.

I have broader concerns about moving to five-day delivery that impact the entire United States. The Postal Service has told us that reducing service could save $3 billion per year. However, there are differing estimates, and not enough sound, independent analysis has yet been done. I encourage the Commission to take the real savings into account in forming your decision.

It is important to also note that cutting one day of delivery would eliminate 17 percent of delivery service, for a projected five percent savings. This is a heavy trade-off, and one that could further reduce customer demand for postal services. This would also begin to beg the question, at what point would cutting delivery frequency start to violate the Postal Service's universal service obligation?

One of the important reasons that we created an independent regulator for the Postal Service was to provide an independent voice to ensure sound policy decisions. I very much value the input that we expect from the Postal Regulatory Commission in the coming months, and I think that your advisory opinion will be invaluable to Congress as we weigh the future direction and role of the United States Postal Service.

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While I have not taken a position yet on reducing delivery service, because of the reasons above, I remain concerned about some of the consequences to the people of Hawai'i, as well as to the Postal Service and its employees. I urge the Commission to take these considerations into account, along with concerns raised by others in the Hawai'i and Alaska delegations.

UNITED STATES POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL/CEO-DESIGNATE PATRICK R. DONAHOE
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT,
GOVERNMENT INFORMATION, FEDERAL SERVICES,
AND INTERNATIONAL SECURITY
UNITED STATES SENATE

DEC. 2, 2010

Good morning, Mr. Chairman and members of the subcommittee. It is an honor for me to be testifying for the first time as Postmaster General-designate of the United States Postal Service. I would like to take a moment to first recognize my predecessor, Jack Potter. All of you worked with him for quite a long time and you know firsthand of his dedication, leadership, hard work and commitment to keeping the Postal Service viable and growing. Mr. Potter saw the Postal Service through extremely challenging times, including the 2001 anthrax attacks, which took place only months after he assumed office. He provided exceptional leadership through some tough years; years which saw the Postal Service have its highest mail volume and years that brought some of its toughest losses, both in mail volume and revenue. I appreciate everything he did for this organization and I thank him for his years of service.

I look forward to fostering my own positive, strong relationships with each of you. I value the trust that the Postal Governors have placed in me and I plan to work with all stakeholders – with members of Congress, the mailing industry, unions and management organizations, our employees and anyone who shares my goal of continuing to make the Postal Service better, more efficient, and the epitome of excellent service. The Postal Service has considerable challenges in front of it, but I am not dismayed by these challenges; rather, I am energized by them and I look forward to working with each of you on a variety of crucial matters.

As I begin my term leading the Postal Service at this most critical time, it is important that I give you a brief snapshot of both what we have done up to this point and what actions are still needed to improve the Postal Service. Let me stress that strategies you have heard about previously from Postmaster General Potter will not change. Rather, we will enhance these initiatives with renewed energy, with a sharper focus on customers and their experience in using the Postal Service. Our ultimate goal is to make sure customers of every type have a positive interaction with all Postal employees. Our commitment is to be the very best delivery organization, connecting senders and receivers throughout the world. Postal employees are fully engaged and they want to be as helpful to our customers as possible. Ensuring customer satisfaction is the ultimate goal within all the plans and strategies I will discuss today.

My personal philosophy can be summed up in a single word: service. Nothing is more important to me than providing the absolute best service to our customers. My commitment is to make sure that no matter when or where customers interact with us, they have a positive experience. My aim is to not simply meet, but surpass the expectations of the customer – individuals and businesses - when they utilize the Postal Service at any level. Providing top-notch service for our partners in the mailing industry is the key to their success - and to ours. With our vast network and unsurpassed reach into American homes, we provide direct customer access to businesses. Our industry partners run the gamut from printers and consolidators to Approved Shippers, non-profit organizations, mail service providers, and small and large mailers. The mailing industry is a multi-billion dollar a year business, employing millions of people. It is our job to position the mail as a tool to help companies – large and small – enhance their business, create jobs and fuel economic growth. It is our job to make the mail

as simple and efficient to use as possible. The core activity and focus of the Postal Service is simple - delivering. That is at the heart of what we do. And the tools available to our customers should be just as simple; an easy-to-navigate website, pricing structures that are easier to understand, and products and services with a more intuitive feel. Whether a customer interacts with us through our 1-800 help line or drops off a shipment at a Business Mail Entry unit, we will make that experience simple, secure and personal. We want customers to think of the Postal Service first to fulfill their mailing and shipping needs. We will do that by ensuring every customer's experience is of consistently high quality.

The ideal of a relentless focus on customer service has been honed over years of working on programs and processes that directly affect what we do every single day – collect, process, transport and deliver the mail to approximately 150 million addresses. Over the last several years, the Postal Service has taken steps to make sure we keep our organization strong. Many of these initiatives take place behind the scenes, so the public is not always aware of them, but they do affect our bottom line in many ways.

Since I am new to many of you on the committee, I would like to take a moment and introduce myself to you. As Chief Operating Officer for the past nine years and as Deputy Postmaster General for the last five years, I have had the privilege of working with teams across the entire spectrum of Postal operations to introduce a variety of new management practices. These changes have led to vastly improved operations and have changed mail processing exponentially. Using the latest technology, we have improved the flow of mail through our system with advancements such as delivery point sequencing for letters, flats and parcels. We have introduced tools that allow customers to track mail through the system. Teams of highly motivated employees throughout the Postal Service are using Lean Six Sigma methodologies to reduce waste, improve processes, and find long-term solutions to existing practices. As with everything we do, the role our employees play in these initiatives ultimately drives their success. For example, letter carriers have participated fully in realignment efforts to make delivery routes more efficient. Through joint agreements with letter carrier unions, we have been able to consolidate carrier routes and, over the last two years, eliminate more than 12,000 routes. The net result of these actions helped drive a 20.1 million work hour reduction in City and Rural Delivery operations.

Even during extremely challenging times, the Postal Service has made both productivity and efficiency gains. Our employees have risen to the occasion time and time again. We are essentially doing the same job today as we did ten years ago, but with 200,000 fewer employees. That is a testament to the dedication of the entire Postal Service team. By working smarter, using cutting-edge technological advancements, and carefully managing our workforce, we have become more productive and efficient while delivering service that is second to none. But we will not stop there. We will continue to seek ways to become leaner, smarter and faster, offering simplified but extremely effective tools for business customers and individuals, never taking our eyes off the ultimate goal, which is exceptional customer service.

A healthy Postal Service equals a healthy mailing industry, which, as I noted, contributes hundreds of billions of dollars a year to our economy. I will discuss in more detail ways we have already begun to ensure the future viability of both the Postal Service and the mailing industry; but there is still more to be done. We have a responsibility to help customers to grow their businesses, to provide simple, affordable and convenient products and services to consumers, and we have a responsibility to our employees to keep the Postal Service a vigorous and robust organization.

Our commitment is to listen carefully and gather input from our partners in the mailing industry, such as suppliers, printers, consolidators, mail service providers, and transportation companies. We rely equally on feedback from other stakeholders, including our employees, unions, management associations, Congress, the Postal Regulatory Commission (PRC), Government Accountability Office (GAO), Postal Service Office of the Inspector General (OIG), Office of Management and Budget (OMB) and the Office of Personnel Management (OPM). We welcome suggestions and appreciate the concern for the future of the Postal Service shared by all the groups I just named.

In recent years, you have heard testimony numerous times about the serious financial circumstances in which the United States Postal Service finds itself. While our service remains strong, our financial situation continues to be dire. The reasons are the same ones that have plagued us for quite some time. Volume for First-Class Mail, our most profitable product, continues to shrink. Another concern is the continued change in the mix of mail. While projections show future increases in Advertising Mail volume, this mail brings in less revenue and contribution per piece. It takes three pieces of Advertising Mail to equal the profit contribution generated by one piece of First-Class Mail. Specifically, the contribution per piece from First-Class Mail to the Postal Service is 22 cents, while the contribution per piece from Advertising Mail is only 7 cents. You can clearly see the reason for our concern regarding First-Class Mail volume declines. Customer habits continue to evolve and our business model, in place and successful for decades, is threatened. Because this business model is based on hard copy communications, the focus now must be on finding ways customers can avail themselves of our network, which is one of our strongest assets. Customers who use the mail to tap into this vast network – which reaches every home and business in America – can reap huge dividends. Let me share with you the story of one business owner in Bethlehem, PA, who used the Postal Service to great success in growing his business.

George Lioudis, owner of Lehigh Pizza, used various methods to let customers know about his pizza restaurant. These included coupon books, phone directory ads, even door flyers. But the return on his investment was not what he hoped for. George decided to use the mail to send menus to customers in the area. Using available saturation mail incentives, Lehigh Pizza was able to save a significant amount of money over other advertising methods. His menus went directly into the mailboxes and into the hands of customers. The results were amazing and business increased substantially. This is just one example of the incredible reach and value of the mail. It shows how using newer products, such as saturation mail incentives, can benefit both businesses and the Postal Service. It was a simple but highly effective strategy to grow business using the mail.

As this story illustrates, despite the significant value of hard copy mail, the Postal Service continues to be affected by a combination of the digital communications revolution, shifting customer habits, and the lingering effects of the severe recession. We are obligated to deliver to every home in the country, which we do proudly and with a level of service unsurpassed by any other Postal system in the world. At the same time, our address and delivery networks continue to grow, on average, by 1 million each year. We are burdened by law with a pre-funding obligation which is borne by no other entity, public or private. With our business model threatened and with our continued troublesome finances, we need immediate and substantial changes to help ensure our financial solvency. These challenges are affecting not only the Postal Service. The entire mailing industry is at stake, including the millions of people who work in this field.

Let me share just a snapshot of our overall performance for FY 2010. Mail volume declined 3.5 percent. Our total net loss for the fiscal year was $8.5 billion. This loss consisted of a $500 million loss from our controllable operations, plus $5.5 billion of pre-funding for Retiree Health Benefits (RHB), plus a $2.5 billion non-cash adjustment to our workers' compensation liabilities driven mostly by changes in interest rates. By managing the things under our operating control, and with the extraordinary efforts of our employees, we were able to hold the line on costs and reduce our controllable operating loss from $1.1 billion in 2009 to just $500 million in 2010. Based on our operational performance, including a 6 percent work hour savings, we reduced costs by $3 billion and were only $500 million short of breaking even on controllable operations. Although we sought a deferral on the pre-payment obligation for RHB of $5.5 billion, similar to one we received in 2009, that action was not approved by Congress this year and we made the full payment on September 30. Unfortunately we will see some of the consequences of making this full payment at the end of FY 2011. While the Postal Service will continue its aggressive cost-cutting efforts and we will carefully manage our finances, our current forecasts show we will not have sufficient cash to make the next $5.5 billion pre-funding payment, due on September 30, 2011. Any major disruption, such as mail volume declines, weather-related challenges or emergency circumstances, could cause us to experience an earlier cash shortfall resulting in defaults on financial obligations earlier in FY 2011. Simply put, the risk remains quite high.

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To help mitigate this risk, the Postal Service has, over the last two years, conducted extensive outreach with a variety of stakeholders. We exchanged ideas, sought input, and are currently pursuing an array of solutions, based on these conversations. These meetings included discussions with you, Mr. Chairman, your colleagues and staff both here and in the House. We appreciate the deep interest and the genuine concern about the future of the Postal Service. Our efforts involved meetings with Postal customers, including medium and small-businesses, to determine their needs and gather their ideas. We sought feedback from CEOs and individual consumers alike. Virtually everyone agrees on one main concept – there must be substantial, meaningful and significant across-the-board changes in our operational, regulatory and legal framework.

Four years ago this month, the Postal Accountability and Enhancement Act (PAEA) was signed into law. While the RHB pre-funding component of the Act presents tremendous challenges, we have seen positive results from the law as well. We are now able to bring products and services to market more quickly. We can propose and resolve pricing matters within a faster schedule, without the cumbersome 18-month timeline, which was used for years. One component of the PAEA focused on transparency within Postal Service operations. Our dedicated employees once again have proven to be the difference, as the Postal Service recently became fully compliant with Sarbanes-Oxley (SOX) requirements. We take great pride in being the first and only government entity to achieve this. We have met the objectives and requirements for SOX compliance and our financial and operational conditions are fully documented and supported.

Even with the positive changes brought about by the PAEA, further improvement is urgently needed. The Postal Service has been through reform before, beginning in 1971 with passage of the Postal Reorganization Act (PRA). We continued to evolve with implementation of the PAEA. However, additional measures are needed to continue these efforts at shaping the Postal Service of the future. In 2006, the year the PAEA was passed, the Postal Service saw mail volume hit its peak of 213 billion pieces. At the time, it was thought the changes in the law would support the Postal Service's ability to finance universal service for many years. Soon after, however, the recession hit and our entire financial picture changed. We now are in need of further updates to existing law that will preserve our ability to move forward. We created an action plan and issued that plan on March 2, 2010, to identify the needed changes in law and the steps we can take to close the significant financial gap we are now facing.

Today, I will update you on our progress since we issued our plan. The action plan noted that without changes, the Postal Service could face a $238 billion projected gap in 2020. Without regulatory and statutory changes, the Postal Service could close that gap by $123 billion by focusing on those things within our control. In FY 2010, we cut spending by $3 billion, bringing our total cost savings over the last three years to $10 billion. We now have the smallest career complement since Postal reorganization in 1970. We have reduced our total number of employees by 200,000 over the last ten years; 100,000 of those in the last three years. And we did all this while continuously improving service across all product levels, including on-time delivery and enhanced customer experience. Our Total Factor Productivity, which is a measure of efficiency using the relationship between mail volume, workload and resources, doubled in the last ten years. None of these achievements would be possible without our employees, who have worked hard to bring about cost savings and efficiencies unheard of even in the private sector. Yet despite these efforts, as well as others you will hear more about, there remains a gap that needs immediate attention.

One of the most important changes and one that has been discussed in detail since enactment of the PAEA is the pre-funding requirement for retiree health benefits (RHB). As you know, the PAEA requires the pre-funding of future Postal Service retiree health benefits on an extremely aggressive ten-year schedule. As we continually point out, no other federal agency or private sector companies have a similar burden. This unique statutory requirement was put in place under very different circumstances, as I mentioned, and at the time of enactment, the Postal Service believed the provisions within the PAEA were achievable.

Payments for RHB pre-funding average approximately $5.6 billion per year. In 2007 and 2008, the Postal Service made the required pre-funding payments and consequently sustained losses of

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$5.1 billion and $2.8 billion, respectively. Had it not been for these payments, in 2007 the Postal Service would have seen profits of $3.3 billion and in 2008 profits would have been $2.8 billion. In 2009, Congress passed legislation that deferred $4 billion of the payment, reducing our $5.4 billion pre-payment to $1.4 billion. While the Postal Service appreciated that effort, it was a short-term fix. Further, even with the deferral, Postal Services losses for 2009 totaled $3.8 billion. The 2010 net loss was $8.5 billion, driven most significantly by $5.5 billion of RHB pre-funding and the $2.5 billion non-cash workers compensation adjustment. The degree to which Postal operations cannot generate sufficient contributions to cover the accelerated pre-funding of RHB highlights the need for a long-term resolution to the issue of pre-funding health benefits for retirees.

In March, the Postal Service proposed that Congress restructure the current pre-funding model in such a way as to uphold our obligation to current and former employees while not constraining cash flow. As I have indicated, cash flow and liquidity are very real concerns we have going forward in FY 2011. A comprehensive solution would help ensure the Postal Service could make payroll, payments to vendors and suppliers, and required payments covering workers' compensation funds. In FY 2010, the Postal Service made the required $5.5 billion payment to the Retiree Health Benefits Fund (RHBF). However, this brought Postal Service cash reserves to a level well below that recommended by external bankers. With a net loss of $6.4 billion forecast for FY 2011 and a statutory limit on borrowing of $3 billion for the year, we project we will have a cash shortfall of $2.7 billion by the end of FY 2011. Additionally, as we will have borrowed up to our overall statutory limit of $15 billion, we will have no liquidity heading into FY 2012.

In January 2010, almost one year ago, the Postal Service's OIG issued a study regarding possible overpayments made by the Postal Service to the Civil Service Retirement System (CSRS) pension fund. I would like to thank the OIG for undertaking the work that went into producing this and other reports and for their continuing efforts in bringing attention to this crucial policy matter. 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.

I would also like to offer my thanks and appreciation for the assistance of the PRC on this matter. Earlier this year, at our request, the PRC hired an outside actuary, the Segal Company, to perform an independent audit of the existing methodology and the division of the CSRS liability between the former Post Office Department and the Postal Service. The findings of the Segal Company determined that the methodology used subsequent to the Postal Reorganization Act (PRA) was not fair, equitable or appropriate and did impact the Postal Service unfairly. Segal agreed that a surplus does exist in the amount of approximately $50-$55 billion. In subsequent discussions with OPM, they agreed with Segal's estimate of the surplus value given their calculation method. However, OPM continues to advise that their calculations have been performed in accordance with their reading of the statutes. If there were clarifying modifications to the statues, then OPM would perform the new calculations to determine any surplus.

In recognition of the serious state of Postal Service finances, Senator Carper introduced S. 3831, the *Postal Operations Sustainment and Transformation (POST) Act of 2010*. I would like to take this opportunity to thank Senator Carper for his acknowledgement and understanding of the significant financial risk facing the Postal Service. This is a wide-ranging bill which seeks to make improvements in a number of areas and provides the Postal Service with the legislative flexibility it needs. One of the most crucial aspects is a permanent fix for the pre-funding issue for RHB. The solution for RHB is tied to our other significant legacy cost issue - the CSRS overpayment I mentioned before. In an effort to address the CSRS issue, H.R. 5746, the *United States Postal Service's CSRS Obligation Modification Act of 2020*, was introduced by Rep. Stephen Lynch (D-MA). This bill changes the methodology used by OPM for calculating the amount of any postal surplus or supplemental liability under the CSRS. The bill provides direction and a timetable for OPM to review the Postal Service's obligation and make corrections if a surplus is found.

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Enactment of S. 3831 would solve both the RHB and the CSRS situations. S. 3831 would require OPM to use the Segal-suggested methodology to calculate whether a surplus exists and, if so, the amount of the overpayment. It would allow the Postal Service Board of Governors to vote to transfer an amount up to the annual required pre-funding amount from the CSRS Trust Fund to the RHBF to satisfy the annual pre-payment amount. Any remaining surplus would be transferred to the RHBF in 2017. In short, it satisfies the often-stated need to fairly charge the Postal Service for CSRS pension benefits, and it satisfies the requirement to pre-fund retiree health benefits as prescribed under PAEA. Swift action on this pending legislation would permit the Postal Service to have some breathing room and operate in an environment of improved stability, supporting growth and expansion of our core business.

The Postal Service is taking a multi-pronged approach to righting our ship and laying out plans for our future viability. RHB and CSRS are two very large pieces of the puzzle, but they are by no means our only strategy for success. Another important part of our March 2 action plan was a proposal to allow the Postal Service to manage delivery frequency; a provision which is also contained in S. 3831. We do not want to be in a position of diminishing service, but we have to face our new reality; especially since we lost 20 percent of our mail volume. The flexibility to manage delivery frequency would give the Postal Service one of the most effective tools available to reduce operating costs. This transition could save the Postal Service more than $3 billion annually, according to our calculations. I mentioned earlier in this testimony that our delivery network has grown by an average, over the last ten years, of 1 million addresses each year. Even in this down market, our delivery points increased by some 739,000 addresses in 2010. Contrast that growth with another startling figure, the number of pieces of mail per delivery has declined from an average of five pieces in 2000 to four pieces in 2009. That is a 20 percent reduction. Absent any changes in our business model, the Postal Service can expect to see an average of three pieces per delivery by 2020. Another way to look at it is in terms of revenue contribution per delivery. In 2000, the Postal Service brought in $1.80 in revenue for each delivery. By 2009, that number had shrunk to $1.40 and, by 2020, it is estimated the figure could be around $1.00 in revenue contribution for each delivery point.

On March 30, we pursued another part of our March 2 plan when we formally filed a request for an advisory opinion, related to adjusting delivery frequency, with the PRC. We incorporated customer feedback in our proposal and modified our plan to reflect that feedback. We will continue to deliver mail to P.O. Box customers and deliver Express Mail on Saturday. Customer feedback, via a number of public polls, shows the majority of the mailing public would rather see a reduction to five-day delivery than have a substantial stamp price increase or see their local Post Office close.

Mr. Chairman, our organization is one of the largest in the nation. We help drive the American economy. We are the second largest civilian employer in the nation. Our survival is vital to the American economy. Many of the mailing industry businesses I mentioned as part of that multi-billion dollar partnership are small or medium-sized businesses, which we all know are the lifeblood of the economy. In order to preserve the Postal Service, in order to keep the economy as a whole – not just the Postal Service – thriving, we must make changes in how we operate. Adjusting the current delivery frequency schedule is just one step, but it is a vital step; one that can help guarantee the survival of a huge part of the American economy.

In our March 2 plan we also noted that, as our customer needs and behaviors change, the Postal Service requires the ability to adapt quickly by expanding access to postal products and services. Over and over, we have heard that the Postal Service must use creative thinking when planning its future course. Our primary goal when it comes to expanding access is to better align where the customers are, where they shop, where they make those purchases, how they pay for purchases and how they mail. Offering more options for customers is an integral part of our future action plan.

On March 2, the Postal Service proposed that we be permitted to fully explore improvements that will enhance alternate access channels, which currently number around 70,000. We committed to expand existing partnerships and seek out new opportunities to reach customers where they shop, spend and mail. One example of the importance of alternate access channels is the success of the Automated Postal Center (APC), launched in 2005. We have had extraordinary success with these self-serve

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kiosks where customers can do virtually everything they do at a Post Office. The average APC currently generates $240,000 in revenue per year - more than the revenue brought in at 19,000 of our smaller Post Offices. We partner with a number of small and medium-size businesses to create neighborhood mailing centers under our Approved Shippers program. In August, we began a new partnership with over 1,000 Office Depot stores. Office Depot stores offer customers the opportunity to purchase stamps as well as other postal products, such as Express Mail, Priority Mail, our popular Flat Rate boxes, Parcel Post and special services like Delivery Confirmation and Signature Confirmation. The Postal Service worked closely with Office Depot to ensure their staffs would be able to respond to customer questions and allow for quick, easy and convenient mailing and shipping. Office Depot is the first national retailer the Postal Service has worked with in this way and we anticipate extending our reach even further in the future. By providing convenient alternatives to customers, the Postal Service can move toward making improvements in the structure of our network.

Increased flexibility and the ability to fully pursue partnerships are crucial to our success, but as we do that, we must also be able to adjust our retail network. In our March 2 plan, we requested more flexibility in determining exactly where our retail facilities should be located. As the Postal Service seeks to remain relevant in the lives of our customers, one key strategy is to go where the customers are. Our existing network of retail outlets does not always allow us to do that. In many cases, Postal facilities were put in place decades earlier. As populations expand and move outward, our Post Offices, stations and branches are located in areas where people no longer live, work or shop. We often have a redundancy in our network, with one, two or even three locations within a five mile radius. Allowing the Postal Service the ability to close offices that fail to cover their costs is a huge step toward our future viability.

We must find the right balance between our physical locations, alternate access channels placed where the public shops, and a full suite of online options. In many communities, small businesses struggle to survive, especially in the current tough economy. The Postal Service can serve as a lifeline for these business owners, with partnerships such as Contract Postal Units (CPU). A CPU not only provides Postal services for the community, they increase traffic in existing businesses, allowing for growth and survival of these vital components of the local economy. Current law prohibits the Postal Service from closing Post Offices solely for economic reasons. This law must be modernized in recognition of changing customer habits. Customer service research indicates that the American public is open to change, if it enhances their ability to do business quickly and conveniently. Having postal services available where customers shop is key. Allowing the Postal Service to take a careful and measured approach in determining how best to align our infrastructure will free us to reach our goals of expanding access points to all customers. Allowing the Postal Service the ability to close offices that fail to cover their costs is a huge step toward our future viability.

It is my responsibility to guide the Postal Service as we continue to become leaner and more efficient. It is a responsibility I take seriously. Effectively managing those things under our direct control extends to our workforce. As I have noted today more than once, the key to our success lies with our employees and consideration of issues affecting them is at the forefront of our plans. This year, we entered into negotiations with two of our unions - the American Postal Workers Union, AFL-CIO (APWU) and the National Rural Letter Carriers Association (NRLCA). While negotiations with the NRLCA resulted in an impasse, at the time of submission of this testimony, we were still in negotiations with the APWU. Failure to reach agreements sets in motion a process which could result in a third party determining contract terms and work rules for more than 324,000 employees whose wages and benefits exceeded $20 billion last year. On March 2, we reiterated our support for legislation that requires arbitrators to take into account the financial health of the Postal Service before making a final decision. Senator Carper's bill, S. 3831, includes this important provision. Requiring an arbitrator to take into account the financial health of the organization would provide an additional level of assurance that agreements reached with our labor organizations are fair and equitable to employees and to the mailing public.

The Postal Service has continued to make operational changes to increase efficiency. A new effort that we are exploring is to realign employees in our delivery units. Through our Delivery Unit Optimization (DUO), each district decides how best to combine carrier operations at facilities in close

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proximity. We reached out to Postmasters in this effort, gathering their feedback on guidelines. They have done an excellent job helping us move forward with realizing even greater efficiencies in our delivery units. These changes are transparent to customers and allow the Postal Service to make better use of existing larger facilities, to save energy and maintenance costs, and to put our carriers in centralized locations that make logistical sense.

The March 2nd plan also called for pricing flexibility. In 2010, the Postal Service filed an exigent price proposal with the PRC, which was subsequently denied by the Commission. Our appeal to the U.S. Court of Appeals for the D.C. Circuit is pending at this time. The court has granted the request to expedite our appeal and the current schedule calls for a possible decision sometime next spring, although that timeline is at the Court's discretion. It is important that the Postal Service obtain added flexibility in price setting. Presently, our hands are tied, to some extent, when it comes to setting prices. We want to continue working with the PRC to enhance our ability to quickly bring to market new products and services, and to swiftly implement price changes that will keep us competitive.

We plan to take full advantage of the law and move as much as possible to the Competitive category. We continue to strengthen the business to customer channel, creating an array of attractive products and services. We have proposed incentive programs, such as Reply Rides Free and Saturation Mail/High Density options, which give mailers flexibility and allow them to save when mailing higher volumes. We are seeking the ability to handle more lightweight parcels through Standard Mail, leveraging our last mile capability to generate mail volume and increase revenue. We want to provide simpler access to the mail and we welcome the opportunity to work with customers to increase both their profits and mail volumes

On November 2, the Postal Service filed with the PRC a proposal for price increases for Competitive products. As with any price change proposal, we sought to minimize increases while still allowing the Postal Service to price our products in line with customer use and demand. The Postal Service, with this filing, introduced innovative new product offerings, such as a Legal Flat Rate Envelope, a new Regional Rate Box; and a new Critical Mail product. We continue to find creative ways to generate revenue by offering Commercial Base Prices and Commercial Plus Prices for Express Mail and Priority Mail, giving customers the ability to save money when mailing high volumes. It is expected the PRC will complete its review and issue an opinion sometime today, December 2. New prices for Competitive products will be implemented on January 2, 2011, which is in keeping with our goal of providing mailers a predictable and manageable timeline for Competitive price increases.

In the last few years, the Postal Service has entered into new customer agreements, launched new ideas and formed partnerships with private companies and government entities to grow the mail. To help gauge the future of the mail, understand customer needs and find ways to enhance their mail experience, we held three innovations symposiums this year. The first was with the Mailers Technical Advisory Committee (MTAC) which is a group of mailing industry and Postal representatives. This group meets regularly and discusses the "nuts and bolts" of the mail. On National Postal Customer Council (PCC) Day this year, we took the opportunity to solicit input and feedback from thousands of mailers and business owners. We asked them to send us their ideas for innovation in the mail. Finally, in October we held a third symposium which included CEOs, executives from large, medium and small businesses, marketing experts, members of academia and Congressional staff. During these meetings, we held focused breakout sessions to garner the "best of the best" in ideas that will lead the way to a profitable future for the Postal Service, our partners in the mail, and the economy as a whole.

We are currently evaluating this tremendous feedback. Discussions at these symposiums revealed that the process of translating ideas into products was something on which we needed to focus. We are committed to doing that. Once the evaluation is complete, we will report back to all stakeholders who gave so freely of their valuable time to help us generate thoughtful debate and discussion on Postal innovation. From these meetings will spring new products, services, and offerings that will allow the Postal Service to help our customers build their businesses.

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Creative and new uses of the mail are out there. I will give you just one example. This is one of my favorite stories about how to use the mail in ways no one ever imagined. In Hawaii, one of the biggest and best-known attractions is Hilo Hattie. Hilo Hattie, in business since 1963, is Hawaii's most visited retail outlet, with over 60 million customers logged in its 47-year history. It is a landmark; a place where tourists can buy fashions, jewelry, food, and anything and everything to help them remember their time in Hawaii. One of the gentlemen here today, Mr. Bob Rapoza, is from Hilo and can probably tell you even more about it. This unique retailer gives their customers a novel way to shop. At Hilo Hattie, customers can walk in and get a Priority Flat Rate Box at the door. They put the box together and can then simply browse the store, putting the items they want into the box. When they are ready to check out, the folks at Hilo Hattie add in the cost of postage to send the boxes to wherever the customer wants. Most of the time, customers send the packages back home, and they do not have to risk having no room in their luggage for gifts and souvenirs. Hilo Hattie clerks even package the boxes, providing cushioning where needed and securely taping them. All you have to do is pick up the box with the rest of your mail once you get back home. I cannot think of an easier, more convenient and fun way to shop. Again, this is just one of the incredibly innovative uses of the mail to increase Hilo Hattie's revenue and the Postal Service's, too.

Our March 2 plan was a roadmap for our future; one that would ensure we continue to grow, to fulfill our universal service obligation and remain a part of the fabric of this nation. It is important to note that, although we requested a great deal within our action plan, the Postal Service has not been idle, simply waiting for enactment of our suggestions. I noted some of the efforts we have undertaken, operating as well as we can under current constraints. Not only have we continued to innovate and work hard to find new sources of revenue, we have accomplished savings and fiscal restraint most other businesses only dream of.

Our history is long, Mr. Chairman, and the Postal Service has a rich heritage of service in binding the nation together. We have been there through the growth, the development and the prosperity of our country. Behind all the numbers I mentioned today are hundreds of thousands of people. People who live and work in the communities you and your colleagues represent. People whose daily efforts begin and end with what is found in millions of mailboxes every day.

The mail has meaning. The mail is important. The mail is relevant. We do need change, however, and the proposals I have detailed today will allow us to become leaner, more efficient, more business-like and ultimately more successful. We value our place in the landscape of America and our goal is to remain viable for a long time to come. With your help, we can achieve that goal.

I appreciate your ongoing support in ensuring a sound Postal Service. I will be happy to answer any questions you may have.

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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
December 2, 2010

Good morning. Chairman Carper, Ranking Member McCain, Members of the Subcommittee, I thank you for the invitation to testify and the opportunity to present the views of the Postal Regulatory Commission.

In the last year, the Commission has received over 20,000 public comments and inquiries on Postal issues, an 11 fold increase. This is indicative of how important the Postal Service is to our citizens, and how all of us share your concern regarding the future of the postal service. We appreciate your leadership in shaping the debate on what must be done to assist the Postal Service and to ensure its sustainable future.

PAEA Successes

In fewer than three weeks, we will observe the fourth anniversary of the signing of the Postal Accountability and Enhancement Act (PAEA). The signing of the PAEA capped more than a decade of hard work by Congress and the postal community.

The PAEA delivered greater transparency and accountability. This has been of vital importance to the Postal Service as it has worked to improve service and explain its precarious situation during recent years as mailing patterns have changed.

The Commission believes that the price cap, which is at the heart of the law, has proven to be a powerful incentive for the Postal Service to improve efficiency and reduce costs, including $11 billion in cost reductions in the past three years.

The streamlined rate-setting processes required by the PAEA performed well, providing postal customers with small, predictable price increases at the rate of inflation, although the law did not contemplate an extended period of very low inflation and even deflation.

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Greatly enhanced service measurement has helped to improve service quality in some areas and maintain it overall despite the rapid downsizing of the postal workforce and the mail processing adjustments the Postal Service has undertaken to cut costs.

Although innovation has been a challenge for the Postal Service, the Commission has approved seasonal sales of Standard and First-Class Mail, and two experimental product market tests, with a third product currently under review. The use of Negotiated Service Agreements (NSAs) has flourished, with 21 NSAs approved by the Commission in 2008, 64 in 2009 and 127 this past year. Just last week, the Commission approved a new streamlined process for review of international NSAs that gives the Service wide discretion and promises to rapidly increase the number of such contracts in the next year.

And while the Postal Service has experienced large deficits in the last three years, the Retiree Health Benefit Fund (RHBF) established by the PAEA now totals more than $42 billion, and represents payments of nearly $21 billion over the past four years. This is a substantial new asset and a major accomplishment of the PAEA.

As a result of the PAEA, the Commission's workload expanded significantly. The Commission faces constant pressure to process more and more cases. Yet we all agree that the PAEA was an important step forward. It provides a solid foundation for the future and for developing further refinements to the postal model. In fact, it is a PAEA authorized study that provides the basis for the opening section of the Postal Operations Sustainment and Transformation Act (POST Act).

POST ACT

Let me begin my discussion of the POST Act by stating the Commission's support for the general principle embodied in the bill that the Postal Service cannot sustain its mandated scheduled payments for the RHBF. As the Commission noted in its decision on the Postal Service's request for an exigent rate increase, these substantial annual payments are the single biggest cause of the Postal Service's current dire financial position.

The Commission also appreciates the specific approach of the bill in directing the Office of Personnel Management (OPM) to recalculate the allocation of the costs of Civil Service Retirement System (CSRS) benefits paid to former Post Office Department (POD) employees. The recalculation methodology in the POST Act represents current best practices as identified by the Commission and documented in the actuarial report of the Segal Company, which was provided to this Subcommittee, Members of Congress, the Postal Service and OPM.

Applying best practices to a current calculation could benefit the Postal Service by as much as $50 to $55 billion according to Segal. These funds could then be applied to defray its RHBF liabilities as outlined in the POST Act. The bill provides that the Postal Service Board of Governors would have discretion in transferring any funds accruing from a recalculation to the RHBF fund.

I should also note that in May of 2009, 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 RHBF. 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 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. In consideration of the likely further declines in the postal workforce, it may be prudent to require in the bill possible adjustments of this liability.

Other Postal Service Provisions

The POST Act proposes a number of changes that come within the Commission's purview and can be grouped together under their effect on postal services and Universal Service.

POSTAL SERVICES

The POST Act lists proposals for the introduction of new postal services. One would allow the Postal Service to furnish property and services for compensation to all units of state and local governments. This is an extension of similar authority given to the Postal Service relative to the Federal government. The Commission does not regulate these types of agreements; however, we do provide transparency though our oversight. In general, Postal Service "federal" agreements have increased the availability of government services for citizens, added operational flexibility for government agencies and provided incremental revenue to the Postal Service. Appropriately applied, such arrangements promise to be similarly beneficial at the state and local level.

The Commission is concerned, however, by language in the bill that would allow unregulated use of Postal Service processing, transportation, delivery, retail network or technology to provide new nonpostal services, albeit consistent with the public interest. It is difficult to assess the effects of such an open-ended authority. For example, the Congress previously took issue with the Postal Service's use of its retail facilities to sell mugs, tee-shirts and other items. Would this be in the public interest now? And who would decide that issue? Posts around the world are trying to diversify their services but with uneven success. Diversification could be beneficial to the Postal Service; however, the Commission strongly believes that prior regulatory review of such proposals is needed to safeguard existing markets and to ensure a level playing field for participants in those markets.

The application of postal technology raises additional issues. The Postal Service has a substantial information technology infrastructure and data bases. Could these be used to provide postal customers with Internet access or marketing services? In reviewing nonpostal services for continuation under the PAEA, the Commission was directed to consider "(A) the public need for the service; and "(B) the ability of the private sector to meet the public need for the service." Would this standard be retained?

It is worthwhile to note that current law authorizes the Commission to approve and regulate Postal Service market tests, both to protect the public interest and to promote a

successful business outcome for the Postal Service. Currently, the Postal Service is operating a growing, less-than-truckload pallet service approved through these procedures. The Commission has approved a test marketing program to distribute product samples, and we are currently reviewing a request involving the use of prepaid postage on greeting cards sold at retail. Will these provisions in the Post Act affect this process?

UNIVERSAL SERVICE

Second, the POST Act would lift and limit restrictions to allow the Postal Service to reduce the frequency of mail delivery service and to more easily close post offices.

Earlier this year, the Postal Service requested an Advisory Opinion from the Commission on a proposal to end Saturday street delivery service nationwide. The Commission has now completed its review – including seven field hearings – and is now finalizing its opinion and findings. I will reserve further comment until the Commission issues its Advisory Opinion. But I will take this opportunity to ask whether the language in the proposed legislation would allow the Postal Service to reduce service to four days or three days without prior review. We expect to issue our opinion by the end of this month and we will provide copies to the Postal Service and to Congress.

The Commission appreciates the historic and continuing role that post offices play in the lives of American citizens and the communities where they live and do business. We also understand that American society is mobile and its needs ever changing. At the start of the 20th century, a rural American nation was served by more than 70,000 post offices. Today, an urbanized society four times larger is served by just over 36,000 offices.

Earlier this year, the Commission issued its Advisory Opinion on a Postal Service proposal to consider 3,200 station and branch retail facilities for possible closure. The list of potential outlet closings was reduced during our review, to just 162 offices at the time we issued the Opinion.

In the Opinion, the Commission affirmed the Postal Service's authority to adjust its retail network but recommended several improvements. For example, we found that ten-day advance customer notice was insufficient and limited opportunities for community consultation. Further, inconsistent financial and operational analyses impaired evaluations of facility closures and consolidations. The Commission also recommended that standardized review procedures should be developed and consistently applied nationwide to all post offices, stations and branches in order to ensure adequate and efficient service levels and comply with statutory guidelines.

The Postal Service's nomenclature differentiates among stations, branches and post offices. But customers do not recognize any difference, and the Commission's long-standing practice does not recognize the difference either. Citizens expect and deserve the same public notice, opportunity for comment and rights of appeal if and when postal facilities they depend on may be closed. During the station and branch review, the Postal Service made it clear that it did not believe that those same customer rights applied to stations and branches, and that it came before the Commission only because of the potential impact of its proposal on service

nationwide. A legislative clarification would assist the Commission and, more importantly, citizens in addressing their concerns.

Since 1976, the Commission has had jurisdiction to hear customer appeals of post office closings. The Postal Service is required to give post office customers at least a 60-day notice of its intention to close a post office so that customers have adequate opportunity to provide their views. Additionally, affected customers have 30 days in which to file an appeal with the Commission following a written determination by the Postal Service to close or consolidate the office.

The Commission believes these protections, which require the Postal Service to adhere to a closing and consolidation policy, provide due process and the minimum periods necessary to give meaningful notice to the public. They also protect the public's right to participate in the process and to raise concerns that may have been neglected.

STRONGER FUTURE

The Commission commends the Postal Service for its sustained effort over many years to increase productivity, improve processes and lower its costs. We also are heartened to see mail volume reviving and the expectations by the Postal Service of modest overall growth this year. Legislation that effectively supports these trends is important.

Nevertheless, we believe Congressional action to address the pension and retiree health benefit issues remains the key element of any reform effort. Before a broader strategy for effectively managing its business and serving its customers can be realistically implemented, the Postal Service must be able to manage its mandated payments.

That concludes my testimony. Thank you.

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UNITED STATES OFFICE OF PERSONNEL MANAGEMENT

STATEMENT

of

JONATHAN FOLEY

DIRECTOR OF PLANNING AND POLICY ANALYSIS

U.S. OFFICE OF PERSONNEL MANAGEMENT

before the

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

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

on

FINDING SOLUTIONS TO THE CHALLENGES FACING THE U.S. POSTAL SERVICE

December 2, 2010

Chairman Carper, Ranking Member McCain, and Members of the Subcommittee.

I am pleased to be here today on behalf of Director John Berry of the Office of Personnel Management (OPM) to discuss "Finding Solutions to the Challenges Facing the U.S. Postal Service," and provide comments on S. 3831, the POST Act of 2010, as introduced by Chairman Carper. OPM commends the Subcommittee for its efforts to provide for the financial viability of the United States Postal Service, and we share the Subcommittee's commitment to help the Postal Service stay viable, while maintaining our fiduciary responsibility to the Civil Service Retirement and Disability Trust Fund.

As you know, S. 3831 would readdress the issue of how responsibility for the retirement costs of pre-1971 Postal employment should be apportioned. In particular, the underlying question

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is whether the Treasury or the Postal Service should be responsible for the effects of Postal pay increases on the value of that service in computing annuities under the Civil Service Retirement System (CSRS). Given the extensive prior coverage of this issue, I will limit myself today to a brief outline of relevant history.

In 1973, the Congress enacted P.L. 93-349 which established the policy, then supported by the Postal Service, that it would accept responsibility for the effects of pay increases on annuities. No further consideration was given to the issue until 2003, when the Postal Service first suggested that OPM transfer responsibility for the effects of Postal pay increases to the Treasury. After careful consideration by OPM and its Board of Actuaries, OPM determined that the original apportionment method complied with the law. The issue was not raised again until January of this year when the Postal Inspector General issued a report raising the apportionment issue and asserting a $75 billion overpayment.

In June of this year, the Postal Regulatory Commission (PRC) transmitted to OPM a Segal Company (Segal) study commissioned by the PRC on the apportionment methodology. The Segal report only addressed one aspect of the complicated funding arrangement and did not discuss the historical context of the issue. Segal acknowledges this by stating that its "recommendation is, in essence, a 2010 fresh look, and does not attempt to deal with the history accumulated over forty years since the PRA [Postal Reform Act] was enacted." The Segal proposed methodology was a slight variation on the Postal IG's proposal, and suggested a $50-55 billion overfunding.

At that time, the PRC also suggested that P.L. 109-435, the Postal Accountability and Enhancement Act (PAEA), gave OPM authority to reapportion responsibility for pre-1971 service as part of the redetermination process. Enacted in 2006, the primary purpose of the PAEA was for the Treasury to take responsibility for the cost of military service credit in the computation of Postal CSRS annuities, leading to a savings of $28 billion for the Postal Service. The law further provided for a review process, initiated at the request of the PRC, for OPM to reconsider "any determination or redetermination made by the Office of Personnel Management under this section." The PRC asserted that this reconsideration authority gave OPM authority to make the reallocation.

We believe the assertion that OPM has the discretion to make basic changes in the allocation method between the Postal Service and the Treasury goes beyond the intent of and the authority provided to OPM in PAEA. The reconsideration process provided for in section 802(c) of the PAEA allows for appeal and review of OPM's specific calculations of the annual supplemental liability determination, according to the established Fund allocation methodology. For example, section 802(c) allows for reconsideration of the population or accounting data underlying the annual liability determination, but not of the allocation methodology. Thus, we believe that the question of whether there should be a change in the

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apportionment responsibility is one that is appropriate for consideration by the Congress.

Our comments on S. 3831 are limited to section 2, which would transfer responsibility to the Treasury for the effects of Postal pay increases on the value of pre-1971 Postal employment in computing annuities under CSRS, a change estimated to be $50-55 billion. In addition, it would permit the resulting Postal CSRS surplus to be used at the discretion of the Postal Board of Governors to satisfy the $5.5 to 5.8 billion annual payments to the Postal Service Retiree Health Benefits Fund (PSRHBP) required under 5 U.S.C. 8909a(d)(3)(A) for fiscal years 2010-2016.

OPM's principal roles in this matter are those of a program administrator and trust fund fiduciary. As such, our principal concerns must be for the efficient operation and reliable funding of the retirement and insurance programs. As a trust fund fiduciary, our principal relevant concern is with the adequate funding of the program and not with the source of that funding. Since S. 3831 will not change funding levels for CSRS, but only the source of those funds, OPM takes no position at this time as to the substance of section 2.

However, we do have concerns regarding certain technical aspects of that section. The amendment to 5 U.S.C. 8348(h)(2)(B) would require that the annual computation of the Postal surplus or liability be completed by March 31 following the end of each fiscal year. Because not all necessary data is available by that date, we suggest that it be changed to June 30, which will still give the Postal Board of Governors three months for consideration prior to the funds transfer date. There are also internal inconsistencies between the dates specified for calculations and the dates for payments to the PSRHBP. Finally, there are technical problems with the wording of the new 5 U.S.C. 8348(h)(2)(C)(4) in that the required methodology is not supported by available data. We would be pleased to provide the Subcommittee with more detailed explanations and suggested technical revisions that would retain the substantive intent of these provisions.

I appreciate the opportunity to appear before you today and I would be pleased to answer any questions you may have. We look forward to assisting the Subcommittee in its efforts to assist the Postal Service in continuing its third century of contributions to the nation.

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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 10:00 a.m. EST
Thursday, December 2, 2010

U.S. POSTAL SERVICE

Legislation Needed to Address Key Challenges

Statement of Phillip Herr, Director
Physical Infrastructure Issues

GAO-11-244T

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Highlights

Highlights of GAO-11-244T, a 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

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook deteriorated sharply during fiscal years 2007 through 2009. USPS actions to cut costs and increase revenues were insufficient to offset declines in mail volume and revenues. Mail volume declined from 213 billion pieces in fiscal year 2006, to 171 billion pieces in fiscal year 2010—or about 20 percent. Volume declines resulted from the recession and changes in the use of mail as transactions and messages continued to shift to electronic alternatives. In this environment, USPS initiatives to increase revenues had limited results.

USPS expects mail volume to decline further to about 150 billion pieces by 2020. This trend exposes weaknesses in USPS's business model, which has relied on growth in mail volume to help cover costs. GAO and others have reported on options for improving USPS's financial condition, including GAO's April 2010 report on USPS's business model (GAO-10-455). Recently, legislation has been introduced that addresses USPS's finances and the need for flexibility to help modernize operations.

This testimony discusses (1) updated information on USPS's financial condition and outlook, (2) the need to modernize and restructure USPS, and (3) key issues that need to be addressed by postal legislation. It is based primarily on GAO's past and ongoing work. In comments on our statement, USPS generally agreed with its accuracy and provided technical comments that were incorporated as appropriate.

View GAO-11-244T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

December 2, 2010

U.S. POSTAL SERVICE

Legislation Needed to Address Key Challenges

What GAO Found

USPS's financial condition continued to decline in fiscal year 2010 and its financial outlook is poor for fiscal year 2011 and the foreseeable future. Key results for fiscal year 2010 included total revenue of $67.1 billion and total expenses of $75.6 billion, resulting in

- a record loss of $8.5 billion—up $4.7 billion from fiscal year 2009,
- a $1.8 billion increase in outstanding debt to the Treasury, thus making the total outstanding debt $12 billion, and
- a $1.2 billion cash balance at the end of the fiscal year.

USPS's budget for fiscal year 2011 projects

- a $6.4 billion loss,
- a $3 billion increase in debt to the $15 billion statutory limit, and
- an end-of-year cash shortfall of $2.7 billion.

USPS has reported achieving close to $13 billion in cost savings in the past 5 fiscal years. However, as its most profitable core product, First-Class Mail, continues to decline, USPS must modernize and restructure to become more efficient, control costs, keep rates affordable, and meet changing customer needs. To do so, USPS needs to become much leaner and more flexible. Key challenges include: changing use of the mail; compensation and benefit costs that are close to 80 percent of total costs; difficulties realigning networks to remove costly excess capacity and improve efficiency; constrained capital investment, which has declined to one of the lowest levels in two decades and led to delays in buying new vehicles; lack of borrowing capacity when USPS reaches its statutory debt limit; and large unfunded financial obligations and liabilities of roughly $100 billion at the end of fiscal year 2010.

Proposed postal legislation, including S. 3831, provides a starting point for addressing key issues facing USPS and facilitating changes, such as rightsizing networks, that will take time to implement and produce results. Also, decisions on postal issues may involve trade-offs related to USPS's role as a federal entity expected to provide universal postal service while being self-financing through businesslike operations. Three key areas addressed by the bill include compensation and benefits; rightsizing USPS networks and workforce; and whether to allow USPS to expand its nonpostal activities. For example, resolving large USPS funding requirements for retiree health benefits is important, while continuing to prefund retiree health benefits to the extent USPS's finances permit. It is equally important to address constraints and legal restrictions, such as those related to closing facilities, so that USPS can take more aggressive action to reduce costs. Allowing USPS to expand into nonpostal activities raises issues of how to mitigate risks associated with new lines of business, assure fair competition with the private sector, and how to finance such efforts. Congress and USPS urgently need to take action to restore USPS's financial viability as business and consumer use of the mail continues to evolve.

United States Government Accountability Office

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to participate in this hearing on proposed legislation[1] to address the U.S. Postal Service's (USPS) challenges to remain self-supporting while providing effective and efficient universal postal service to the nation. My statement will discuss (1) updated information on USPS's financial condition and outlook, (2) the need to modernize and restructure USPS, and (3) key issues that need to be addressed by postal legislation.

This statement is based on our past and ongoing work, including our reviews of USPS's business model,[2] financial condition, networks, service, and postal reform issues. We interviewed USPS officials and reviewed the POST Act of 2010; USPS's audited financial statements for the fiscal year ended September 30, 2010; and other reports, testimonies, and communications on USPS's financial condition, operations, and outlook.[3] We conducted this performance audit in November 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]Postal Operations Sustainment and Transformation Act of 2010 (POST Act of 2010), S. 3831, 111th Cong. (2010).

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

[3]Our review included considering information from: USPS audited financial statements and other information in the annual reports for the fiscal year ended September 30, 2010, including the report filed with the Postal Regulatory Commission (PRC) on Form 10-K dated November 15, 2010; USPS quarterly reports filed with the PRC on Form 10-Q for the periods ended June 30, 2010; March 31, 2010; and December 31, 2009; and the USPS Fiscal Year 2011 Integrated Financial Plan.

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USPS's Financial Condition Continues to Decline and Its Financial Outlook Is Poor

USPS's financial condition continued to decline over the past fiscal year and its financial outlook is poor for fiscal year 2011 and the foreseeable future. Key USPS results for fiscal year 2010 included a $1.0 billion decline in total revenue to $67.1 billion, and a $3.7 billion increase in total expenses to $75.6 billion, resulting in

- a record loss of about $8.5 billion,
- a $1.8 billion increase in outstanding debt (which left $1.2 billion of available borrowing authority),[4]
- a total of $12 billion in outstanding debt due to the Treasury,[5] and
- a $1.2 billion cash balance at the end of the fiscal year.

USPS has recently released its budget for fiscal year 2011, projecting

- a $6.4 billion loss (see fig. 1)—one of the largest in USPS history—including the impact of a $5.5 billion payment due in 2011 to prefund retiree health benefits;
- a $3 billion increase in outstanding debt due to the Department of the Treasury (Treasury), thereby reaching its $15 billion statutory limit; and
- a $2.7 billion cash shortfall at the end of the fiscal year.

[4]The statutory limit on annual increases in USPS outstanding debt is $3 billion. 39 U.S.C. § 2005(a).

[5]The statutory limit on total USPS outstanding debt is $15 billion. 39 U.S.C. § 2005(a).

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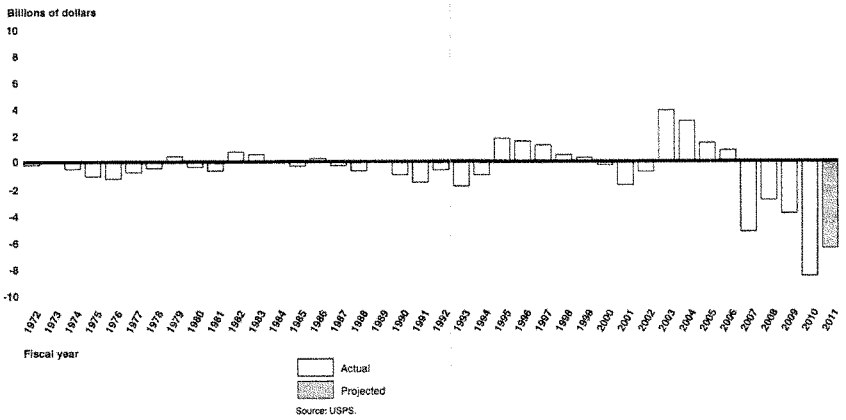
Figure 1: USPS Net Income, Fiscal Years 1972 through 2011



Source: USPS.

USPS's revenue drop in fiscal year 2010 was driven by continuing declines in total mail volume. In fiscal year 2010, mail volume decreased about 6 billion pieces from the previous fiscal year to 171 billion pieces. This volume was about 20 percent below the peak of 213 billion pieces delivered during fiscal year 2006. Most of the volume declines were in profitable First-Class Mail—which were particularly significant because the average piece of First-Class Mail generated about three times the profitability of the average piece of Standard Mail.[6]

USPS currently projects mail volume to increase by about 2 billion pieces in fiscal year 2011. In this fiscal year, First-Class Mail is expected to decrease by 3 billion pieces, but Standard Mail is expected to increase by 5 billion pieces. With these volume changes and expected small rate

[6]First-Class Mail consists of single-piece mail (e.g., bill payments and letters) and bulk mail (e.g., bills, statements, and advertising). Standard Mail is mainly bulk advertising and direct mail solicitations.

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increases,[7] USPS projects revenues to increase $0.6 billion in fiscal year 2011.

Meanwhile, USPS's expenses increased by $3.7 billion in fiscal year 2010 compared to fiscal year 2009 for several reasons. First, in fiscal year 2010, USPS made its statutorily required payment of $5.5 billion to prefund health benefits for its retirees, in contrast to fiscal year 2009 when Congress deferred all but $1.4 billion of USPS's scheduled payment of $5.4 billion.[8] Second, USPS's workers' compensation costs in fiscal year 2010 were $3.6 billion, up $1.3 billion from the previous fiscal year, primarily from the non-cash effect of changes in the discount rates used to estimate the liability. Third, results of USPS cost savings efforts in fiscal year 2010 were insufficient to offset rising costs in other areas.

According to USPS, it achieved a total of close to $13 billion in cost savings from fiscal years 2006 through 2010 (see fig. 2), primarily by reducing 280 million work hours and its workforce by 131,000 employees. Most savings resulted from attrition, reductions in overtime, and changes in postal operations. USPS reported saving $3 billion in fiscal year 2010, primarily because of a reduction of 75 million work hours—half the savings achieved in fiscal year 2009. Looking forward, USPS projects cost savings of $2 billion in fiscal year 2011, primarily from continued attrition and associated savings.

[7]USPS projects a small average rate increase for market-dominant products by the limit it expects under the inflation-based price cap. These products primarily include First-Class Mail, Standard Mail, Periodicals (mainly magazines and local newspapers), and some types of Package Services (primarily single-piece Parcel Post, Media Mail, library mail, and bound printed matter).

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

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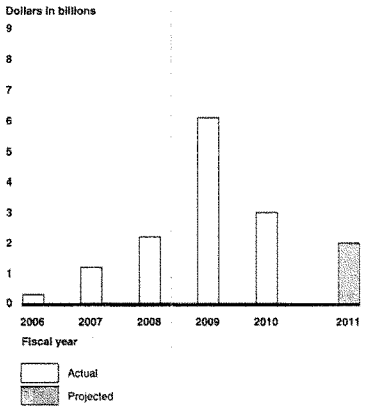
Figure 2: Cost Savings Reported by USPS, Fiscal Years 2006 through 2011



Source: USPS data.

Further Actions Are Needed to Modernize and Restructure USPS

As its core product—First-Class Mail—continues to decline, USPS must modernize and restructure to become more efficient, control costs, keep rates affordable, and meet changing customer needs. To do so, USPS will need to become much leaner and more flexible. Key challenges include the following:

- *Mail volume and changing use of the mail*: USPS projects mail volume to continue declining to about 150 billion pieces by fiscal year 2020—about 30 percent below its 2006 peak. Most of the declines are projected to be in profitable First-Class Mail. Use of the mail is changing as communications and payments continue to shift to electronic alternatives—a shift that is being facilitated by rapid adoption of broadband. These trends expose weaknesses in USPS's business model, which has relied on volume growth to help cover costs.

- *Postal revenues*: USPS expects revenue to stagnate in the next decade as continued declines in mail volume are offset by rate increases. Rate

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increases are generally limited by the inflationary price cap on market-dominant products that generate close to 90 percent of USPS revenue.

- *Compensation and benefit costs*: Compensation and benefits, including retiree health benefits and workers' compensation, totaled about $60 billion in fiscal year 2010, or close to 80 percent of USPS costs. USPS pays a higher share of employee health and life insurance premiums than other federal agencies.

- *Difficulties achieving network realignment*: Realigning USPS's mail processing and retail facilities will be crucial for it to achieve sustainable cost reductions and productivity improvements, but limited progress has been made in rightsizing these networks to eliminate costly excess capacity. Although USPS is working to consolidate some mail processing operations, it has closed few large mail processing facilities since 2005. Similarly, its network of post offices and postal retail facilities has remained largely static despite expanded use of retail alternatives and population shifts.

- *Capital investment*: Continuing losses from operations have constrained funds for USPS capital investment. USPS's purchases of capital property and equipment and building improvements have declined in recent years, from $1.8 billion in fiscal year 2009 to $1.4 billion in fiscal year 2010. The deferral of maintenance could impede modernization and efficiency gains from optimizing mail processing, retail, and delivery networks. Further, USPS has delayed buying new delivery vehicles for lack of capital resources. We have an ongoing review of USPS's delivery fleet of about 185,000 vehicles, including about 140,000 long-life vehicles purchased in the late 1980s and early 1990s that are nearing the end of their 24-year expected operating time frame. USPS has estimated replacing its delivery fleet will cost about $5 billion.

- *Lack of borrowing capacity:* USPS expects to increase its outstanding debt to Treasury during fiscal year 2011 by $3 billion, thereby reaching its total statutory debt limit of $15 billion. Even with this debt increase, USPS projects a cash shortfall at the end of this fiscal year. Its cash outlook is uncertain, as indicated by recent experience. USPS reported in August 2010 that it "would likely experience a cash shortfall if legislation similar

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to that passed in September 2009 is not passed."[8] USPS ended fiscal year 2010 with cash of about $1.2 billion and remaining annual borrowing authority of an additional $1.2 billion, or slightly more than the funds needed for one biweekly payroll. USPS projects it will have insufficient cash at the end of fiscal year 2011 to meet all of its obligations.

- *Large unfunded financial obligations and liabilities*: USPS's unfunded obligations and liabilities were roughly $100 billion at the end of fiscal year 2010. Looking forward, USPS will continue to be challenged by these financial obligations and liabilities, together with expected large financial losses and long-term declines in First-Class Mail volume.

Key Issues Need to Be Addressed by Postal Legislation

Proposed postal legislation, including S. 3831, provides a starting point for considering key issues where congressional decisions are needed to help USPS undertake needed reforms. This bill is based on legislative proposals USPS made this past spring. Resolving large USPS funding requirements for pension and retiree health benefits is important. It is equally important to USPS's future to address constraints and legal restrictions, such as those related to closing facilities, so that USPS can take more aggressive action to reduce costs. Urgent action is needed as some changes, such as rightsizing networks, will take time to implement and produce results. In addition, including incentives and oversight mechanisms would make an important contribution to assuring an appropriate balance between providing USPS with more flexibility and assuring sufficient transparency, oversight, and accountability.

Congressional decisions may involve difficult trade-offs related to USPS's role as a federal entity expected to provide universal mail delivery and ready access to postal retail service while being self-financing through businesslike operations. Future USPS actions and other stakeholder actions are expected to be informed and guided based on congressional decisions related to public policy questions, such as:

- *Benefits*: What changes, if any, should be made to USPS pension and retiree health benefit obligations and payment schedules? What would be the impact on the federal budget?

[8]The September 2009 legislation deferred $4 billion from USPS's statutorily required payment to prefund retiree health benefits, reducing it from $5.4 billion to $1.4 billion. Pub. L. No. 111-68, § 164(a), 123 Stat. 2023 (Oct. 1, 2009).

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- *Delivery*: Should the long-standing requirement for Saturday delivery be dropped so USPS can implement its proposal to reduce delivery frequency to 5 days a week? What would be the specific effects on operations, costs, workforce mix, employees, service, competition, the value of mail, mail volume, and revenue? How would shifting to 5-day delivery affect customers including business mailers and the public?

- *Post office closings*: Should USPS have greater flexibility to rightsize its retail networks and workforce, which may involve closing post offices and moving retail services to alternative commercial locations that are often open more days and longer hours than postal facilities? Or should USPS retain its retail facilities and provide new nonpostal products and services?

- *Nonpostal products*: Should USPS be allowed to offer new nonpostal products and services that compete with private-sector firms? If so, how should fair competition be assured? Would it need additional capital for such initiatives? If so, how would they be financed?

- *Processes for change*: What role should Congress, the PRC, USPS, employees, and customers, including business mailers and the public, have in decisions on postal policy issues? What incentives and oversight mechanisms are needed as part of congressional actions to assure an appropriate balance between providing USPS with more flexibility and assuring sufficient transparency, oversight, and accountability?

We have discussed several options that Congress and USPS could consider in a report we issued last April,[10] and are currently conducting a congressionally requested review of USPS's 5-day delivery proposal. In this testimony, we will highlight some options related to three areas that are also addressed by S. 3831—compensation and benefits, rightsizing networks and workforce, and expanding nonpostal activities.

Postal Compensation and Benefits

S. 3831 addresses key retiree health and pension benefit issues. Specifically, it requires OPM to recalculate USPS's CSRS pension obligation in a way expected to make the federal government responsible for a greater share of USPS's CSRS pension obligation. The bill also authorizes the USPS Board of Governors to transfer any part of a resulting

[10]GAO-10-455.

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pension surplus to the Postal Service Retiree Health Benefits Fund. The sponsor of S. 3831 has estimated that these legislative changes could result in an increase in the government's pension obligations of approximately $50 billion. Such an increase could impact the federal budget deficit and require funding over time.

USPS has said it cannot afford its required prefunding payments to the retiree health benefit fund on the basis of its significant volume and revenue declines, large losses, debt nearing its limit, and limited cost-cutting opportunities under its current authority. We have reported that Congress should consider providing financial relief to USPS, including modifying its retiree health benefit cost structure in a fiscally responsible manner.[11] Several legislative proposals have been made to defer costs by revising statutory requirements, including extending and revising prefunding payments to the Retiree Health Benefits Fund, with smaller payment amounts in the short term followed by larger amounts later. Deferring some prefunding of these benefits would serve as short-term fiscal relief. However, deferrals also increase the risk that USPS will not be able to make future benefit payments as its core business declines. Therefore, it is important that USPS fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. In addition to considering what is affordable and a fair balance of payments between current and future ratepayers, Congress would also have to address the impact of these proposals on the federal budget. Further, the Congressional Budget Office has raised concerns about how aggressive USPS's cost-cutting measures would be if prefunding payments for retiree health care were reduced.[12]

Congress could revisit other aspects of the postal compensation and benefits framework. USPS is required to maintain compensation and benefits comparable to the private sector, a requirement that has been a source of disagreement between USPS and its unions in collective bargaining and binding arbitration. If USPS and its unions go to arbitration, there is no statutory requirement for arbitrators to consider USPS's financial condition. We continue to favor such an arbitration requirement. The law also requires USPS's fringe benefits to be at least as

[11]GAO-10-455.

[12]Congressional Budget Office, *H.R. 22: United States Postal Service Financial Relief Act of 2009* (Washington, D.C.: July 20, 2009); *S. 1507: Postal Service Retiree Health Benefits Funding Reform Act of 2009* (Washington, D.C., Sept. 14, 2009).

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favorable as those in effect when the Postal Reorganization Act of 1970[13] was enacted. Career employees participate in federal pension and benefit programs, and USPS covers a higher proportion of its employees' health care and life insurance premiums than most other federal agencies. USPS is also required by law to participate in the federal workers' compensation program, and some benefits paid exceed those provided in the private sector. Furthermore, USPS employees in this program can choose not to retire when they become eligible to retire, and they often decide to remain on the more generous workers' compensation rolls.

Rightsizing USPS's Networks and Workforce

Congressional action is needed to speed USPS's progress in rightsizing its networks and workforce, and S. 3831 seeks to address these issues. Such progress is limited by both stakeholder resistance and statutory requirements. USPS has costly excess capacity and inadequate flexibility to quickly reduce costs in its processing and retail networks. USPS has faced formidable resistance to facility closures and consolidations because of concerns about possible effects on service, employees, and communities, particularly in small towns or rural areas. We have suggested that Congress consider establishing a panel similar to the military Base Realignment and Closure Commissions to facilitate action and progress. Such panels have successfully informed prior difficult restructuring decisions. The panel could consider options for USPS's networks including the following:

- *Mail processing*: Decisions to maintain or close facilities are best made in the context of a comprehensive, integrated approach for optimizing the processing network. Issues include how to inform Congress and the public, address resistance, and ensure employees will be treated fairly. Related issues include whether to relax current delivery standards to enable additional facility closures and associated savings.

- *Retail*: USPS has retained most of its retail facilities in recent years despite the growing use of less costly alternatives to traditional post offices, such as self-service kiosks and stamp sales in grocery stores, drug stores, and over the Internet. USPS has called for statutory changes to facilitate modernizing its retail services.

[13]The Postal Reorganization Act eliminated the Post Office Department and created the United States Postal Service. Pub. L. No. 91-375, 84 Stat. 719 (Aug. 12, 1970).

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Expanding USPS Nonpostal Activities

USPS has asked Congress to change the law so it can diversify into nonpostal areas to find new opportunities for revenue growth, and S. 3831 would authorize such action. This could involve USPS entering into new business areas or earning revenues from partners selling nonpostal products at USPS facilities. About 10 years ago, we reported that USPS incurred losses on early electronic commerce and other nonpostal initiatives, and its management of its electronic commerce initiatives was fragmented, with inconsistent implementation and incomplete financial information.[14] Congress then restricted USPS from engaging in new nonpostal activities in the Postal Accountability and Enhancement Act of 2006.[15] Allowing USPS to expand into new nonpostal activities would raise issues about the areas in which it should be allowed to compete with the private sector, how to assure fair competition, how to mitigate risks associated with entering new lines of business, and how to finance such efforts. Related issues could include whether USPS's mission and role as a government entity with a monopoly[16] should be changed, what transparency and accountability would apply, whether USPS would be subject to the same regulatory entities and regulations as its competitors, and whether losses would be borne by postal ratepayers or taxpayers.

A senior USPS official told us that USPS is studying various possibilities for introducing new products and services. A continued issue is whether USPS would make money if it was allowed to compete in new nonpostal areas. USPS has reported that if it could enter such areas, such as banking or sales of consumer goods, its opportunities would be limited by its high cost structure and the relatively light customer traffic of post offices compared with commercial retailers. (There are 600 weekly counter customers at the average post office, compared to 20,000 at the average major supermarket, according to USPS.) USPS has said that the possibility of building a sizable presence in logistics, banking, integrated marketing, and document management was currently not viable because of its net losses, high wage and benefit costs, and limited access to cash to support

[14]GAO, *U.S. Postal Service: Development and Inventory of New Products*, GAO/GGD-99-15 (Washington, D.C.: Nov. 24, 1998); *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections*, GAO-02-79 (Washington, D.C.: Dec. 21, 2001); *U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce*, GAO/GGD-00-188 (Washington, D.C.: Sept. 7, 2000).

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

[16]USPS has a monopoly over delivery of certain types of letter mail and access to mail boxes.

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necessary investment. USPS concluded that building a sizable business in any of these areas would require "time, resources, new capabilities (often with the support of acquisitions or partnerships) and profound alterations to the postal business model."[17]

In summary, the need for postal reform continues as business and consumer use of the mail continues to evolve. Congress and USPS urgently need to reach agreement on a package of actions to restore USPS's financial viability and enable it to begin making necessary changes.

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

Contact and Staff Acknowledgments

For further information about this statement, please contact Phillip Herr at (202) 512-2834 or herrp@gao.gov. Individuals who made key contributions to this statement include Joseph Applebaum, Chief Actuary; Susan Ragland, Director, Financial Management and Assurance; Amy Abramowitz; Teresa Anderson; Joshua Bartzen; Kenneth John; Hannah Laufe; SaraAnn Moessbauer; Robert Owens; Crystal Wesco; and Jarrod West.

[17]United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C., March 2010). This plan is available at the following Web address: http://www.usps.com/strategicplanning/_pdf/ActionPlanfortheFuture_March2010.pdf (accessed on Nov. 23, 2010).

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Testimony of

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to a hearing on "Finding Solutions to the Challenges Facing

the U.S. Postal Service" held by the

Senate Sub-Committee on Federal Financial Management, Government

Information and International Security

December 2, 2010

Good morning Chairman Carper and other members of the sub-committee. On behalf of the nearly 290,000 members of the National Association of Letter Carriers, I am pleased to be here today. Thank you for inviting me to testify concerning the Chairman's proposed POST Act of 2010.

The legislation you have proposed is vitally important to the American economy and to the millions of workers employed by the mailing industry, not just to the Postal Service and the hundreds of thousands of workers who serve the nation as postal employees. The Postal Service is a vital infrastructure service that not only remains an essential element of the country's financial payments system, but also a key facilitator of business and communications for the 150 million homes and businesses it serves six days a week.

The past four years of recession have been the most difficult in the history of the USPS and the mailing industry in general – and with more than 15% of the nation's labor force unemployed or underemployed, the recession is far from over. Over the past four years, the Postal Service has reported what appear to be eye-popping losses amounting to more than $20 billion. But these results are misleading and cannot be accurately compared to those reported by other companies. Let me explain.

There are three main causes for the Postal Service's losses. In order of importance they are: the $20.9 billion cost since 2007 of pre-funding future retiree health benefits, the large drop in mail volume and revenue caused by the Great Recession and the ongoing

impact of mail volume lost to Internet diversion. By far, the congressional mandate to pre-fund future retiree health benefits is the most important of these factors, though the conventional wisdom often flips the order of these factors. Indeed, in the absence of the pre-funding mandate, which no other agency or private company in America faces, the USPS would have recorded a net surplus of $611 million over the past four years, despite the worst recession since the Great Depression of the 1930s and the continued impact of electronic diversion. (See the table below).

USPS Finances ($billions): 2007-2010

	2007	2008	2009	2010	2007-2010
Reported Net Income	-5.142	-2.806	-3.794	-8.505	-20.247
Pre-funding payments to of the PSRHBF*	8.358	5.600	1.400	5.500	20.858
Income w/o PSRHBF pre-funding payments	3.216	2.794	-2.394	-3.005	0.611

***Note: PSRHBF = Postal Retiree Health Benefits Fund created by the PAEA. The 2007 figure includes the mandated transfer of $2.958 billion from the escrow account established by P.L. 108-18 and the $5.4 billion pre-funding payment mandated by P.L. 109-435 (PAEA).**

Source: Annual Reports of the Postmaster General, 2009-2010.

In other words, the financial crisis facing the Postal Service was not primarily caused by the recession or the Internet – it was an unintended consequence of decisions made by Congress and President Bush in 2006 to require the Postal Service to massively pre-fund the health benefit costs it expects to incur over the next 75 years for current and future retirees. I know the highly accelerated schedule of prefunding payments (some $55 billion over 10 years) provided for in the 2006 Postal Accountability and Enhancement Act was driven by short-term CBO scoring concerns, but it is clear in

hindsight that it was a terrible mistake – particularly with the onset of the deep recession just around the corner.

Pre-funding is optional in the private sector. Most companies pay retiree health benefits on a pay-as-you-go basis. Nearly two-thirds of Fortune 1000 companies do not pre-fund retiree health benefits at all and those few that do pre-fund have set aside far less of their future retiree health liability than the Postal Service (33% vs. 47% for the Postal Service). The overall pre-funding level of America's largest companies stands around 12% of future costs, about a quarter of the level of the USPS. (See Attachment #1, the 2010 report on post-retirement benefit funding produced by Towers Watson, p. 20 Figures 27 and 28.) The Postal Service's heavy pre-funding of retiree health care costs makes it impossible to compare the Postal Service's financial results with those of any other company. Indeed, no other company has come close to allocating 8% of its operating revenues to pre-funding future retiree health the way the USPS did in 2010. The comparable figures of other large U.S. corporations in 2009 (the latest year for which data are available) are revealing – AT&T allocated just 2% of its revenues to prefunding, while the figures for Boeing and General Electric were 0.04% and 0.1% respectively.

While fixing the pre-funding problem will dramatically improve the immediate financial picture, NALC fully understands that more must be done. The internet is changing the mailing needs of the American people and the American business community; there will be less demand for letter mail and more demand for small package delivery. So, as I

testified to this sub-committee earlier this year, we know that in order to help the Postal Service survive and adapt to an uncertain post-crash economy, two things are essential. First, postal employees and their unions will have to embrace innovation and seek win-win solutions with the Postal Service at the bargaining table. And second, beyond developing and passing legislation that permanently addresses the crisis caused by the pre-funding mandate, Congress should give the USPS enough freedom to explore new ways of using its existing networks to serve the public and the U.S. economy.

NALC intends to meet its obligation to do its part next year in collective bargaining. I hope the Congress will do the same. Clearly, that is the intent of Chairman's Carper's legislation before us today.

I want to thank Senator Carper for taking the lead with the introduction of S. 3831. Although we cannot support all of its provisions as drafted, we believe it gets the two most important policy issues exactly right.

First, to help stabilize the Postal Service's finances in the short run, the POST Act would provide immediate relief to the excessive burden of pre-funding future retiree health benefits by allowing the Postal Service to use the $50-$75 billion surplus in its civil service pension account to cover the cost of the pre-funding payments required by the PAEA. This pension surplus was revealed by two independent private sector actuarial firms over the past year, the Hay Group (hired by the USPS Office of Inspector General) and the Segal Company (hired by the Postal Regulatory Commission). Both concluded that the Office of Personnel Management should adopt actuarial methods that more

fairly allocate the cost of pensions for pre-1971 service between the Post Office Department and the U.S. Postal Service -- that is between taxpayers and postage ratepayers. This conclusion has the full backing of the entire postal industry – management, labor and mailers of all stripes.

The methods advocated by the Hay Group and the Segal Company should have been used when the Postal Service Retiree Health Benefit Fund was established with an initial transfer of surplus pension funds from the CSRS as provided by the postal reform law. If they had been used, the balance in the Fund today would exceed $92 billion, more than enough to fully fund all future retiree health benefits – which would obviate the crushing burden of annual pre-funding payments that now exceed $5 billion. It would have also allowed the USPS to use the Retiree Health Fund to cover the $2-$3 billion annual cost of insuring its current retirees and preserved its borrowing authority for more productive uses. Unfortunately, the Office of Personnel Management has maintained that any change in actuarial methods requires new legislation. We do not agree. Indeed, as Senator Collins has pointed out repeatedly in recent months, the PAEA gives the OPM the authority to revise its methods on its own and transfer the funds if a larger postal surplus is found. Section 2 of S. 3831 would resolve this issue along the lines Senator Collins has urged. I want to publicly thank Senator Collins for her tireless work on this matter.

Second, the POST Act would clear the way for the Postal Service to develop new uses of its existing networks to serve the needs of businesses and the public. We believe

Section 3(b) of S. 3831 will spur the kind of innovation needed to preserve universal mail service for decades to come by permitting the Postal Service to partner with companies, non-profits and state and local governments to better use its retail, processing and delivery networks to offer new services. NALC believes that such innovation can help spur economic growth and create jobs inside and outside the Postal Service. In fact, in May 2011 we are sponsoring an international conference on postal innovation in Washington, D.C. Our colleagues from postal unions all over the world will be here to share examples of how innovative postal companies around the world are adapting to meet the needs of 21st Century economies. The examples of innovative postal services can help us in the United States re-imagine the possibilities of our own national networks. In an era of rapid change, where communications are more important than ever for economic and national security purposes among others, we should strengthen -- not compromise – our universal communications networks.

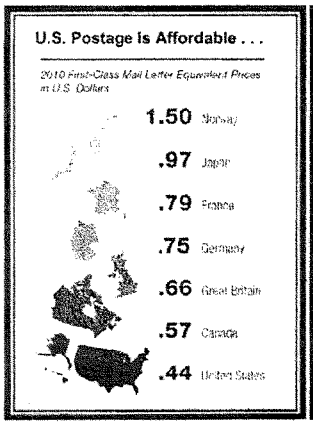
In light of the possibilities for developing new uses of our retail and delivery networks, we urge the sub-committee to reconsider Section 3(a) of the bill, which would allow the USPS to close post offices for solely economic reasons. Rather than reducing the level of service the USPS should seek to find new ways to use post offices to serve local needs as permitted by Section 3(b).

NALC supports the remaining provisions of S. 3138 with two notable exceptions. With all due respect, we strongly oppose both Section 3(e) regarding the Arbitration of Labor Disputes and Section 3(g) on the Frequency of Mail Delivery. I will address each in turn.

Under the current interest arbitration process, an arbitration board must give labor and management a full and fair hearing and arbitrators are bound to consider all the evidence presented by the parties when rendering their decisions -- see Section 1207 (c)(2) of Title 39. The proposed changes to this section of the law would highlight three managerial objectives among the factors to be considered by arbitration boards while neglecting to mention any employee objectives that are typically presented to arbitrators. In so doing, the POST Act would needlessly disrupt the balance and fairness of the existing process for resolving collective bargaining impasses in the Postal Service that has served the parties very well for more than 40 years. Over that period, NALC and the Postal Service negotiated seven national agreements (often in conjunction with other unions) without resort to arbitration, including the last two agreements which covered 2001-2006 and 2006-2011. During that same 40-year period, we arbitrated four agreements and partially negotiated and partially arbitrated one contract (the 1978-1981 national agreement). The experience of our sister unions has been very similar. The process has not only worked well for the USPS and its employees, it has also served the public interest as well.

For the nation's 200,000 letter carriers, the existing process has enabled us to preserve the purchasing power of our hourly wages, which in real terms increased only 3.4% between 1972 and 2009 – even as postal labor productivity has increased by more than 43 percent. Of course, the real cost of our benefits has increased significantly as the rising cost of employer provided health care has spiked, but not more than the rise in productivity and not enough to drive postages rates up in real terms.

For the country in general, the current process has ensured labor peace -- there has not been a single destructive work stoppage or lock-out or disruption of essential postal services in more than four decades – while permitting the Congress to completely eliminate taxpayer subsidies that once covered nearly a quarter of the Postal Service's costs. And it has ensured stable and affordable postage rates for the nation's mailers. Indeed, our postage rates are among the lowest in the industrialized world and adjusted **for inflation, overall U.S. postage costs (as measured by the Producer Price Index for** Postage calculated by the Bureau of Labor Statistics) have increased less than the



. . . And Overall Postage Has Tracked Inflation: 1972-2010

Year	PPI-USPS (1989=100)	CPI-All Items (1982-84 =100)
1972	36.6	41.8
2010	187.7	217.9
Pct Inc	413%	421%

Note: PPI = Producer Prices; CPI = Consumer Prices

Source: Bureau of Labor Statistics

overall Consumer Price Index since the Postal Service was created in 1971. Moreover, since 1997 when the BLS began measuring a Consumer Price Index for private Delivery Services, postage rates have increased much less than private delivery rates – up just 43% for postage compared to an increase of 127% for private delivery.

In view of this background, it is difficult to see what problem the proposed change in the labor arbitration process is designed to address. Sadly, we believe this proposed change is based on misinformation provided to this sub-committee by the Postal Service. For example, at the mark-up of S. 1507 on July 30, 2009 Senator Coburn introduced the language requiring arbitration boards to consider the financial condition of the Postal Service when rendering a decision. At that time he argued that the current law "prohibits" the arbitrators from considering the financial impact of the competing contract proposals. This is absolutely, unequivocally untrue.

Unfortunately, the Postal Service has played fast and loose with the facts on this issue. Its so-called fact sheet on arbitration says that arbitrators are "not required to take the fiscal health of the USPS into account." This is flatly untrue and the Postal Service knows it. Arbitrators are required to consider all the evidence presented to them by the parties. Postal interest arbitration is a tripartite process and the Postal Service has at least one appointed arbitrator on every arbitration board. There is no way for an arbitration board to avoid considering the finances of the Postal Service in their decisions – unless the Postal Service wants Congress to believe that its advocate arbitrators and lawyers sometimes fail to present evidence on postal finances. If any past arbitration board failed to consider the financial condition of the Postal Service – which I can tell you has never happened – then the only party to blame would be the Postal Service for appointing incompetent advocates and arbitrators. But in reality at least one of the parties (union or management) has presented evidence and testimony on the financial condition of the Postal Service to every arbitration board that has been

established. And even if the law did not require arbitrators to consider all evidence, they would do so as a matter of well established professional practice. Therefore, giving this issue special status along with the other managerial objectives such as the comparability standard and compliance with rate setting rules is unwarranted. We don't think Congress should put its thumb on the scale in favor of management. The existing law is fair and remains preferable to the proposed legislation before this sub-committee. In layman's terms, let's not fix what is not broken – there are plenty of other things to fix in the Postal Service.

The NALC and the other postal unions are in complete agreement on this issue: we respectfully call on the sub-Committee to eliminate Section 3(e) from the bill.

The other major provision we oppose is to give the Postal Service, free of congressional oversight, the power to reduce the frequency of delivery from the currently mandated six days per week. We shared our strongly held views on this issue with this sub-committee earlier this year and presented extensive evidence to the Postal Regulatory Commission during its review of the Postal Service's proposal to eliminate Saturday delivery. (See Attachment #2, the NALC's brief submitted to the PRC.) I will not repeat that testimony in this submission. But, in short, eliminating Saturday delivery would be a mistake of the first order. It would save very little money and risk the loss of much more revenue over time. Cutting service (and inconveniencing customers) is not a way to strengthen the Postal Service. In America, business is conducted 24 hours a day, seven days a week. Many businesses, especially small businesses such as Amazon.com re-sellers, rely on Saturday delivery and reducing the speed and quality of

service will simply drive customers away. We have already seen some significant customers begin to quit using the Postal Service, on the false assumption that 5-day delivery is a done deal. Weekly newspapers and direct advertisers who value Saturday delivery will follow suit.

At a time when the nation is suffering an acute jobs crisis, throwing another 80,000 decent jobs away in a moment of panic does not make sense – especially when there are better alternatives without negative side-effects. Both the Obama administration and a bipartisan majority of the House of Representatives who have co-sponsored H. Res 173 oppose the elimination of Saturday delivery. We urge all of you to reject this proposal as well.

We should note that the proposal included in the POST Act is especially dangerous because Congress would essentially be outsourcing an important public policy decision on the scope of universal service to whoever occupies the position of Postmaster General at any given time. There would be no way to prevent the Postal Service from dropping two or even three days of delivery per week to meet short-term cost cutting targets if this provision is adopted. This would destroy the Postal Service. Again, we respectfully urge this sub-committee to remove this provision from the proposed legislation.

Let me conclude by again thanking Senator Carper and Senator Collins again. We very much appreciate your years of diligent work on postal issues and are convinced that a

bipartisan solution to the challenges facing the Postal Service can be found. NALC has demonstrated repeatedly in recent years that it is prepared to do its part to help preserve the long-term viability of the USPS. Just as we have worked with the Postal Service at the bargaining table in recent years to adjust routes and effectively deal with the steep decline in mail volume as a result of the recession, we are prepared to work with the members of this sub-committee to craft legislation that will serve the best interests of the country as well as our members. Our goals are to preserve decent middle class jobs for our members and to maintain the integrity of the Postal Service while serving the American people and helping the businesses that rely on universal service to grow and prosper.

Thanks again for inviting me to testify. I am ready for any questions.

NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES

TESTIMONY OF

ROBERT RAPOZA

NATIONAL PRESIDENT

HEARING

SENATE SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
DISTRICT OF COLUMBIA
WASHINGTON, DC

DECEMBER 2, 2010

Chairman Carper and Committee Members, thank you for the opportunity to once again share the views of our Nation's Postmasters regarding the state of the Postal Service, and specifically S. 3831, the "POST Act". As the frontline managers of the nation's Post Offices, Postmasters have a strong commitment to the Postal Service, its continued viability, and to ensure the maximum degree of service to our customers.

As the Chairman and the Committee can certainly appreciate, there are parts of S. 3831 that NAPUS whole-heartedly support, while there are other parts with which we have reservations. The testimony I offer on behalf of my members will touch upon these issues.

At the outset, I need to state that Postmasters bear a very heavy burden as they attempt to maintain high-quality service, as the financial and operational conditions of the U.S. Postal Service continues to teeter. Although the agency and Congress confronts a colossal task to ensure the universal postal system, I do not believe the declaration by the Postal Service that it is facing a $230 billion deficit within the next decade to be particularly helpful or accurate. In fact, at a House hearing, earlier this year, outgoing Postmaster General Potter conceded that the number is "theoretical"; it is predicated on the Postal Service and the Congress doing absolutely nothing. You know that this is not true. In addition, Senators recognize that postal employees, frontline managers and rank-and-file workers alike, have become proficient at doing more with less. Moreover, I strongly suspect that the USPS' alarmist number has been counterproductive – I believe

that it scared away postal business, which has compounded the Postal Service's financial problems and dampened the enthusiasm for constructive legislation.

It is also important to note that the specter of the "great recession" continues to haunt the Postal Service. Business and consumer confidence has depressed mail volume. Moreover, the negative impact of flat or shrinking postage revenue on the Postal Service has been exacerbated by the unfair and inequitable financial burden to fully prefund its retiree health costs, a requirement made of no other public or private enterprise.

Mr. Chairman, NAPUS fervently believes that section 2 of S. 3831 takes a definitive and vital step in the right direction to address this inequity. In addition, section 2 is crucial for the Postal Service's immediate operational needs. NAPUS believes this section so important to the Postal Service that we respectfully encourage you to separate section 2 from the rest of the bill, and favorably report it as an independent bill. This provision provides immediate financial relief to the Postal Service and has considerable support among most, if not all, postal stakeholders.

Permit me to return to the Post Offices that my members manage. The ongoing fiscal and operating challenges of the Postal Service have placed mounting demands on front-line manager to fill the void created by unfilled postal positions, particularly in the area of customer and delivery services. This personnel void places excessive burdens on Postmasters of large and small Post Offices. Postmasters must work hours that far exceed the standard workweek to maintain postal accessibility. In addition, over 3,000

Postmaster positions remain unfilled, requiring working Postmasters to cover "vacant" locations and supervise postal personnel at those locations. Moreover, we know full well that the agency seeks statutory changes, which could dramatically change the nature of a universal postal service. Indeed, Postmasters fully understand the depth of the fiscal crisis confronting the Postal Service. However, Postmasters and many of your colleagues on Capitol Hill are trying to understand why, in this fiscal environment, the Postal Service awarded certain highly-compensated postal executives significant retention bonuses – that is "pay before performance"; while, frontline managers, including supervisors and Postmasters, the managers who actually ensure postal services, suffered through the arbitrary lowering of earned pay-for-performance ratings for fiscal year 2009, and are in limbo over pay-for-performance for the previous fiscal year, as well as the current one.

NAPUS recognizes that fiscal year 2010 ended with the Postal Service losing $8.5 billion. However, it should be understood that of the total loss, $5.5 billion is attributable to the congressionally-mandated requirement that the Postal Service prefund its retiree health benefits and another $2.5 billion is the result of a recalculation of the assumptions underlying workers' compensation. Permit me to think out loud about why the White House cannot recalculate the Postal Service pension liability with as much ease as it recomputed the USPS' worker compensation obligations.

Notwithstanding the level of the fiscal year 2010 losses, it would be inaccurate to declare that the Postal Service has failed to respond to those losses. Over the past two years, the Postal Service cut $9 billion from its operating budget, including the elimination of

105,000 full-time positions. These actions have come at a price, which is being acutely felt by frontline managers, their personnel, and our customers. In addition, large and medium size Post Offices do not have adequate staffing to adequately market postal products to an under-tapped and potentially underserved customer base – small community-based businesses.

The Postal Service is considerably handicapped by the 4-year-old statutory requirement that the agency fund its future retirees' health care obligations through 2016, at an average annual rate of $5.6 billion. As this Committee knows, there exists no other institution, public or private, that voluntarily or forcibly, remits such payments. This one-of-its-kind obligation impairs postal operations and renders postal sustainability questionable.

Consequently, NAPUS strongly supports section 2 of S. 3831, which modifies the methodology for calculating the Postal Service's retirement liability. This modification is similar to the one contemplated legislation introduced by Representative Stephen Lynch in H.R. 5746. The House Subcommittee on the Federal Workforce, Postal Service and the District of Columbia favorably reported H.R. 5746, earlier this year. Two independent evaluations of the currently used methodology – one review commissioned by the Postal Service Office of Inspector General and the other commissioned by the Postal Regulatory Commission – concluded that the Postal Service has been required by law to overfund its pension obligations from $50 billion to $70 billion. NAPUS would have hoped that the Chairman and Senator Collins would have persuaded the White House to use its

administrative prerogative to revise the pension formula on its own; regrettably, the Office of Management and Budget has not yielded to logic and equity.

The S. 3831-prescribed formula follows the PRC mythology that yields surplus contributions of at least $50 billion. In addition, the provision permits the Postal Service to recover the surplus and transfer the amount, over time, to the Postal Service Retiree Health Benefits Fund. This would help cover the Postal Service's future retiree health coverage obligations. At the same time, this health liability is grossly overstated, resulting from an Office of Personnel Management assumption of a 7 percent health care inflation; the industry standard is 5 percent. We understand that OPM has revised the projected inflation rate by gradually reducing the assumption over a period of years. Nevertheless, the Inspector General has projected that the Postal Service could potentially recover $6.8 billion.

Also, NAPUS believes that the legislation should enable the Postal Service to recover approximately $3 billion in surplus agency contributions on behalf of Federal Employee Retirement System (FERS) participants. This overfunding was documented by a recent Postal Inspector General audit, which was based on Office of Personnel Management data.

Although NAPUS believes that this legislation should focus on this key element of postal fiscal health, we would like to share our views on several other provisions included in S. 3831.

NAPUS also supports the provisions within section (3)(b) that would allow the Postal Service to make available additional profitable products and services. Currently, the Postal Service is restricted to the acceptance, processing and delivery of hard-copy communications. More flexibility with regard to parcels and authorizing its re-entry into limited financial services would be constructive and could generate much-needed revenue. In addition, commercial partnerships that could benefit from the Postal Service's retail network that reaches into small towns and rural communities would be a win-win-win for the Postal Service, interested organizations and postal customers. For example, a joint venture with a company such as the Automobile Association of America could reap rewards for the American public, the triple-A and the Postal Service. It is vital to remember that although the agency is still the world's largest "wireless communications entity", it is unable to productively participate in the communications, financial, real estate and logistics marketplace. Legislation should address this void. Furthermore, NAPUS supports the provision that encourages cooperative agreements between the Postal Service and federal agencies, and state and municipal governments. NAPUS believes that, under current law, the Postal Service has had the latitude to enter into arrangements such as the one that exists with the State Department, relating to passport applications. We believe that the Postal Service, through its Post Offices, is fully capable of providing identity verification and licensing services for a wide variety of governmental agencies, including local motor vehicles agencies, park services, and municipal permitting services. In addition, Post Offices can be exploited for their ability to promptly and efficiently distribute information and emergency products that ensure the

safety of the American public and help secure homeland security. NAPUS also supports the provision that allows the Postal Service to convey wine and beer. To the extent other parcel shippers are permitted to carry these products, there is no reason why the Postal Service should be prohibited from delivering these commodities.

Regrettably, NAPUS is deeply concerned about those provision is section 3, which, in our view, would jeopardize universal postal service. In the mid-1970's, after the enactment of the Postal Reorganization Act, the Postal Service suffered a volume decline that spurred the agency to arbitrarily change the Post Office closing criteria to facilitate a major reduction of small and rural Post Offices. Even at that time, the prohibition against closing small rural Post Office solely for operating at a deficit was the law of the land. Apparently, the statutory restriction was insufficient to protect these governmental touch points for rural and small town communications and commerce. Consequently, the Senate, in 1976, overwhelmingly passed legislation that compels the Postal Service to solicit the views of the impacted community, and to take those views into consideration, prior to a Post Office closing. This 1976 "Randolph Amendment", combined with pre-exiting prohibition against closing a Postal Office solely for having expenses that exceed revenue and the requirement to provide full postal service to rural communities, provides the legislative firewall against closures and consolidations that would otherwise devastate rural communities. It has been suggested that section 3662 of Title 39, Rate and Service Complaints, is a safeguard against closures and consolidations that undermine universal service. On its face, it does not appear that the PRC has the authority to order the reopening of a Post Office, should the PRC find that the Postal Service is in

noncompliance with its universal service obligation. Of course, NAPUS would support an amendment to rectify this omission.

I would point out a certain irony in the Postal Service's concerted effort to reduce delivery-frequency from 5 to 6 days a week. If the agency succeeds, there would be an increased need for accessible Post Offices, particularly in rural areas. In fact, the Postal Service website and Postal Regulatory Commission filings provides assurance that Post Office Box service and counter service will be available through local Post Offices. In rural communities and small towns this accessibility is paramount. However, Post Office closures would deny the very "Plan B" that the Postal Service is heralding.

NAPUS believes that current law already provides the Postal Service with sufficient authority to shrink its retail, distribution and processing network, responsibly and transparently. The current law is not an insurmountable hurdle for the Postal Service to recalibrate its retail network – and just as importantly – satisfy the needs of the serviced community. It is not NAPUS' position that all postal retail facilities are "untouchable"; in fact, NAPUS state officers are actively involved in the review of retail locations that have been identified for discontinuance. And, if a community does not need a Post Office, or does not object to its closing, NAPUS would support the closure. In addition, NAPUS has been consulting with the Postal Service over the efficiency of Post Offices, through a new initiative, Delivery Unit Optimization (DUO). The USPS' DUO goal is to consolidate delivery functions within designated postal facilities. It is important to note,

however, that the majority of Post Offices do not have a delivery function; instead they are limited to window and post office box service.

NAPUS does not object to the Postal Service seeking out retail locations that may not necessarily be in a Post Office, in order to boost revenue and accessibility. These efforts can help to minimize wait times in congested postal locations, so long as the transactions are fairly simple and straight forward. However, I have cautioned Postal Headquarters and I caution the Subcommittee that we must protect the security of the mail and ensure the accountability of individuals who conduct business on behalf of the Postal Service. It was not too long ago that the Postal Service began to prohibit depositing large envelopes and small parcels into neighborhood collection boxes. The mail is required to be personally presented to a postal employee at a postal facility. The reason is our homeland security, and the safety of postal employees and delivery point customers. Authorizing collection of such mail by an individual other than a postal employee, in NAPUS' view, could compromise the safety of our national mail stream and of the American public. So, services offered at alternative retail locations need to be limited. In addition, as a Postmaster, many times, I have found myself having to correct mistakes made by individuals who staff postal contract units and have, in a number of cases, suspended their contract for cause. Finally, it is important that co-location of postal services not be used as a ploy for closing a Post Office.

NAPUS believes that eliminating the prohibition against closing a Post Office solely for having expenses that excess revenue, or that would diminish a community's entitlement

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to the same level of postal services as other communities, undermines universal service. An individual Post Office's profit or loss is virtually meaningless. Mail revenue that is collected at the originating Post Office is not credited to the destination Post Office, though both facilities are essential and add value to mail matter. In economic terms, the valued-added benefit at any particular Post Office or stop along the way is not calculated by the U.S Postal Service. Neither is the imputed processing or delivery costs assigned to any individual Post Offices. Consequently, net revenue or net expenses are not a key determinant to a Post Office's viability.

Even if the Postal Service was able to successfully close the 10,000 smallest Post Offices it would not make a meaningful contribution to reducing the Postal Service's operating costs. The cost of maintaining these public service outlets hovers at about seven-tenths of one percent of the Postal Service's operating budget. Ironically, the Postal Service has been resistant to aggressively consolidating its bloated area and district field office structure, a structure which contributes no value to the mail. In 2009, the USPS eliminated one area office and consolidated six district offices, leaving eight areas and seventy-four district offices, costing approximately $1.5 billion – about three times the cost of maintaining small and rural Post Offices.

Ironically, the "profitability standard" penalizes communities served by Postmasters who manage large Post Offices. Large Post Offices tend to have expansive delivery and processing operations, which are not revenue producers. The Post Office might generate revenue through window operations; however, that revenue is insufficient to cover the

Post Office's operating costs. Hence, the Post Office is characterized as a money-loser. As a result of this "deficit" the Postal bureaucracy may grant the Postmaster inadequate resources to maintain services, or generate revenue.

In the past, the Postal Service provided NAPUS with a listing of all Post Offices in the United States. The data included revenue and expense data for each Post Office. On the bottom of each page, the Postal Service cautioned about using net revenue as an indicator for Post Office profitability, since the Post Office is part of a network. In late October, NAPUS requested the same data sheets as had been provided in the past. NAPUS felt that this data would be useful, since Postal Headquarters has not been bashful in seeking legislative authority to close "unprofitable" Post Offices. The Postal Service treated NAPUS' inquiry as a Freedom of Information Act application. In response to the "application", the Postal Service denied NAPUS' request for Post Office revenue numbers. I would suggest that it may come to light that the numbers would demonstrate the foolishness of using Post Office profitability as the "sole" criteria for closure.

Mr. Chairman, I think it is important to underscore this point – individual Post Office profitability is not and should not be the metric by which Post Offices are evaluated for closing or consolidation. Rather such drastic and irreparable decisions, which could undermine universal service, should use a device that fairly evaluates the importance of the Post Office to the serviced community, as well as its contribution to the universal postal network. This is the reason that I believe that the overwhelming majority of Americans oppose closing Post Offices – 86% according to a 2010 Gallup Poll.

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I believe that the Postal Regulatory Commission will make a valuable contribution in creating criteria to measure Post Office importance. The PRC has commissioned a series of studies that may provide greater understanding of the value of Post Offices, and may offer some guidance as the Committee considers the scope and importance of the postal retail network. The PRC will attempt to measure the economic value of Post Offices on the communities they serve, and how a postal presence moderates the cost of postal-related products and services offered by competitors. In addition, the PRC is interested in the relationship to homeland security and a postal presence. Finally, the PRC is looking at the importance of Post Offices to the unbanked, a particular issue in rural areas and small towns.

In part, I think that the efforts to curtail small town and rural postal services are rooted in the mistaken assumption that broadband services have rendered brick and mortar postal locations obsolete. Just last month, the Department of Commerce's National Telecommunications and Information Administration found that more than one-third of American households lack high-speed internet connectivity. The Department also found that one in four households completely lacked internet connections, dial-up as well as broadband. Within the data, it is uncovered that approximately one-half of citizens who live in rural areas do not have access to broadband connections. This rural digital disadvantage underscores the necessity of accessible full service Post Offices.

Mr. Chairman, our nation's Postmasters commend you and the Committee for the continued attention you have given to maintaining a viable Postal Service. We believe that an accurate accounting of the agency's retirement liability, with the authority to use the surplus to prefund its retiree health retirement is fundamental. The effort to close and consolidate Post Office should be tempered with the recognition that an individual Post Office's profitability should not be the sole criteria for such an irrevocable action; current law recognizes this fact and it should be maintained. Discontinuance determinations should be based on the value of the Post Office to the community and how the Post Office furthers the universal service obligation. NAPUS looks forward to continuing to work with you and your staff as we seek out ways to fortify a universal postal system.

BEFORE THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
UNITED STATES SENATE

"FINDING SOLUTIONS TO THE CHALLENGES FACING THE U.S. POSTAL SERVICE"

DECEMBER 2, 2010

TESTIMONY OF

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
DIRECT MARKETING ASSOCIATION, INC.
ON BEHALF OF
AFFORDABLE MAIL ALLIANCE

Jerry Cerasale
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202/861-2423

Good morning, Senator Carper and members of the Subcommittee, I am Jerry Cerasale, Senior Vice President for Government Affairs of the Direct Marketing Association, and I thank you for the opportunity to appear today on behalf of the Affordable Mail Alliance concerning the future of the Postal Service.

The Affordable Mail Alliance (AMA) is a coalition of more than 1,200 Postal Service customers who joined together this summer to oppose the Service's postage request that was in excess of the inflation-based CPI cap. AMA is pleased that the Postal Regulatory Commission rejected the Postal Service's proposed postage increases, which would have precipitated a further decline in mail volume and caused additional job losses throughout the mailing community.

AMA members account for approximately 80% of mail volume in all classes of mail and contribute 90% of the revenue of the U.S. Postal Service. It is our postage—our money, not taxpayers' money—that pays the bills of the Postal Service. That is why we are pleased to have been invited to testify before you today on the financial health of the Postal Service. Our financial health and the financial health of our employees are equally at stake.

AMA thanks this Subcommittee, and particularly Senators Carper and Collins, for your past commitment to the Postal Service and its customers. We are pleased with your continued involvement and look forward to working with you to find solutions for the challenges facing the United States Postal Service. We applaud Senator Carper for S. 3831, the POST Act, and Senator Collins for her draft legislation, the Postal Service Improvement Act of 2010 (PSIA).

Postal Pensions and Retiree Health Benefits

We note with approval that both Senators Carper and Collins begin their legislation with the postal pension and retiree health benefits issue. Through the postage we pay, postal customers have been funding Postal Service employee pensions since July, 1971. Recently, both the Postal Service Inspector General and the Postal Regulatory Commission determined that postal customers have overfunded pension obligations for postal retirees under the Civil Service Retirement System (CSRS) by between $50 billion and $75 billion. Without this overpayment, postage would have been lower, and there

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would have been much more that businesses could have done with mail to stimulate economic development and job growth. We could have employed more than the 7.5 million Americans we currently employ—prior to the recession we employed 9 million Americans. Excess CSRS payments have affected businesses and consumers in the same manner as any overpayment of taxes. This tax hits small businesses, the job creation engine in the American economy, particularly hard.

In addition to this $50 billion to $75 billion tax on postal customers, the Postal Accountability and Enhancement Act of 2006 (PAEA) has required postal customers to fund future postal retiree health benefits with a steep 10-year payment schedule averaging approximately $5.5 billion per year. As with the CSRS tax, this payment schedule suppresses economic activity and job creation in the private sector. This schedule was created prior to the discovery of the CSRS overpayment. We again commend Senators Carper and Collins efforts to account for this overpayment.

Both S. 3831 and PSIA, in effect, would eliminate the CSRS tax on postal customers and would allow, not require, the Board of Governors of the Postal Service to utilize relief from this burden to fulfill the postal retiree health benefits obligations required by PAEA. We believe the Postal Board of Governors should be required to use any CSRS overpayments to fund all retiree health benefit obligations. This would improve the fiscal well-being of the nation's postal infrastructure and eliminate the subsidy of Federal Government retirees by postal customers.

There is another postal pension issue that we urge the Subcommittee to include in any postal legislation. We understand that our payments to the Federal Employee Retirement System (FERS) are overfunded by approximately $6.8 billion and growing. Moreover, the Postal Service's FERS contribution percentage is being increased, potentially creating an even greater overpayment. This simply does not make sense. As included in PSIA, we ask that any legislation provide for a full review of the FERS payments by the Postal Service to determine whether or not postal customers are also subsidizing Federal Government employees through the FERS payments that we fund.

Collective Bargaining

Since postal employees are barred from striking, postal law requires postal employees and postal management to submit to binding arbitration if there is a failure to

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reach a negotiated labor contract. S. 3831 and PSIA provide that any arbitrator must consider the financial condition of the Postal Service in any arbitration award. S. 3831 adds two additional factors for the arbitrator to consider—that rates are inflation capped and that postal wages must be comparable with the private sector.

As customers, we are not at the bargaining table. It is important to note that employee compensation and benefits still comprise 80% of Postal Service expenses after almost 40 years, billions of dollars of capital investment (particularly the billions spent on automation equipment), productivity gains, cost reduction programs, mailer worksharing, additional mail preparation requirements, and reductions in the Postal Service employee complement. No private sector business could ever hope to avoid bankruptcy with that kind of track record. Something is not working properly. We cannot afford to pay higher and higher postage, which will suppress our businesses. For the Postal Service to survive, its customers must reap the benefits from our investment in capital improvements. It is time for Congress to examine every idea to improve the collective bargaining process.

Delivery Service

Business-related transactions provide over 90% of all postal revenue. Businesses use the mail to reach their customers and potential customers with information, offers and product, much as political candidates use mail to communicate with voters. Mail is a valuable channel for business communication and commerce. That value, however, depends upon both price and service. Any change in delivery service must be based upon the needs of postal customers. This is imperative. We do not take a specific position on delivery days, but the financial viability of a Postal Service funded solely by customers requires service that meets the needs of those customers. Congress, moreover, should refrain from placing unfunded mandates on the Postal Service (and, thus, its customers) when that which is mandated is not necessary to meet customer needs.

Facilities

S. 3831 eliminates the prohibition on the Postal Service from closing a Post Office solely for economic reasons. It is important to understand that this prohibition does not apply to processing facilities or, in the view of the Postal Service, to stations and branches. Little progress has been made, sadly. The Postal Service should be actively consolidating its facilities while maintaining a commitment to service. The current mail

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processing, transporting and delivering network has a capacity of well over 200 billion pieces of mail per year. (It may be as high as 300 billion.) The Service projects mail volume to be 150 billion pieces by 2020. We cannot afford to maintain excess capacity. It is important for Congress to require the Postal Service to right-size its network.

PSIA includes a provision requiring a Postal Service plan to ensure that postal customers have ready access to postal retail facilities by collocating postal retail operations within private retail locations within communities. This provision should allow for the economic use of private retail facilities to provide postal retail services.

New Products

In order to survive in the 21st century, the Postal Service must provide services that customers need at a price customers are willing and able to pay. The Service should be aggressively seeking to offer new products that meet customer needs. For postal related products, the Service should continue to poll its customers to discern the demand for new postal products that will enhance the ability of customers to improve their businesses.

Where non-postal products are concerned, some caution is required. Postal Service employee expertise is in collecting, sorting, transporting and delivering physical mail. Non-postal products do not fall within their expertise, and efforts to gain that expertise will reduce focus on efforts to improve performance dealing with postal products.

There is one caveat that needs to be addressed for any new product offered by the Postal Service. As former Deputy Postmaster General Michael Coughlin earlier stated before this Congress, the financial difficulties facing the Postal Service are huge—the Service had an $8.5 billion loss in 2010. To cover that loss with net proceeds from new products, the Service would need 85 new products producing $100 million annual net revenue or 850 new products producing $10 million net revenue. New products will help, but they will not bring the Postal Service out of its financial difficulties.

The Postal Service should focus on increasing mail volume and avoiding actions that force mail out of the system. To do this effectively, it should look first very aggressively at removing barriers for customers to use the mail. In the past few years the Postal Service has placed many new requirements on business customers that

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necessitated the reengineering of address placement on catalogs and magazines, new barcoding, new paper weight for lightweight flats and new demands on customers' IT systems in hopes of reducing costs of the Postal Service. Sadly, those Postal Service costs keep rising right along with the mailers' costs of compliance for the new requirements. All of those requirements should be reexamined by the Service in constant consultation with its customers. The cost of postage, coupled with a steady increase in costly and complex requirements to use the mail, has driven mail out of the system. This is not "good business." As the current experience has shown, these compliance costs remain whether or not mail volume is present to cover them.

We request that Congress include in any postal legislation the provision in PSIA that encourages the Postal Service to seek Negotiated Service Agreements (NSAs) for market dominant products. We also urge that this encouragement extend to NSAs to services that combine both market dominant and competitive products.

In conclusion, Congress must resolve the issue of the tax on postal customers for the overpayment of pension benefits and postal retiree health benefits. Failure will simply put the brakes on a slow and weak economic recovery, particularly job creation recovery.

I thank you and look forward to any questions you may have.

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Post-Hearing Questions for the Record
Submitted to Patrick R. Donahoe
From Senator Thomas R. Carper
"Finding Solutions to the Challenges Facing the U.S. Postal Service"
December 2, 2010

1. I pointed out in my opening statement that the vast majority of the Postal Service's losses in recent years – including fiscal year 2010 – can be attributed to the retiree health pre-funding payments. When those payments were written into law in 2006, a number of us thought they were too aggressive but that the Postal Service could afford them. What we didn't know back then was that we were essentially standing at the edge of a cliff and that mail volume and the economy as a whole would fall over that cliff. What kind of shape do you think the Postal Service would be in if the retiree payments were eliminated or were lowered to a more reasonable level?

   Since the pre-funding requirements of the Postal Accountability and Enhancement Act (PAEA) became effective for our fiscal year 2007, Postal Service's losses for the four completed fiscal years aggregated to $20.2 billion. That included the effects of paying $20.9 billion to pre-fund Retiree Health Benefits (RHB). If we operated in a manner similar to the rest of the government, without a pre-funding requirement, we would have had an aggregate net income of $700 million for 2007 through 2010 and would have saved nearly $21 billion of cash-flow.

   That is why we fully support your proposal to transfer the $50 to $75 billion of over-payments from the Civil Service Retirement System (CSRS) to resolve our statutory pre-funding obligation for RHB.

   If that is not possible, to level the playing field, we believe RHB should be funded on a "pay-as-you-go" basis. This method requires entities to fund only the premiums for retirees as they come due and is the method used by the rest of the government and most private sector companies. We currently follow this method, but also pre-fund approximately $5.5 billion per year for a total cost in FY 2010 of $7.75 billion. This double-funding, combined with the effects of the recent recession, have left the USPS in a dire financial state. In the near term, we cannot afford to pay the annual pre-funding installments. However, in future years, as we continue improving our revenue and cost positions, we may be able to pre-fund RHB. The amount of pre-funding that will be affordable will be largely influenced by the implementation of fundamental changes such as five-day delivery. Additionally, we believe any pre-funding should be amortized over 30 to 40 years. This would create less of a financial burden than the unique and draining 10 year schedule currently imposed by PAEA.

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2. Do you think the Postal Service should be required to put away money for retiree health and other unfunded obligations, such as workers compensation? Why or why not?

My views of retiree health benefits pre-funding are covered above. My views on workers' compensation are similar and also seek a level playing field. We believe workers' compensation costs should be funded on a "pay-as-you-go" basis. This is our current practice and the accepted method in both the public and private sectors. Some features that are prevalent in the private sector that we would endorse for the Postal Service's workers' compensation program include: (1) the ability to offer injured workers lump-sum payments, so the liabilities and administration of such cases don't consume resources for decades; and, (2) the ability to move injured workers from the workers' compensation rolls and into the pension programs when they reach normal retirement age. We believe that the Government should make these two changes to the entire Federal Workers' Compensation program as a whole as a way to reduce Government spending. Certainly the Postal Service would benefit from these changes.

3. The bill I've introduced – S. 3831, the Postal Operations Sustainment and Transformation (POST) Act – would allow the Postal Service to use funds it has likely overpaid into the Civil Service Retirement System to make its retiree health payments. What are your thoughts on this approach? Is there anything else we should keep in mind as we decide how the Postal Service should use the money it might be owed?

The Postal Service strongly supports your proposal to rectify the overpayments into the Civil Service Retirement System (CSRS) which have been continuing for some 40 years. A transfer of funding from CSRS to the RHB fund, as you have proposed, could fully fund our long-term RHB obligations which were under-funded by $49 billion as of the end of FY 2010. Additionally, the CSRS overpayments could repay our borrowings from the Treasury which will be $15 billion by the end of FY 2011. This would help relieve the Postal Service of the past and future financial burdens associated with RHB pre-funding and correct the inappropriate allocations of CSRS pension costs that have been in place since 1971. The ultimate value of the CSRS overpayments will depend on the revised calculations, as estimates range from $50 to $75 billion.

An over-funding situation also exists with our pension obligations in the Federal Employees Retirement System (FERS). The Postal Service has made its bi-weekly contributions to the plan, as dictated by the Office of Personnel Management (OPM) to all government agencies. However, as our actual pension cost experience has been less than that of the rest of the federal government, we accumulated a funding surplus of $6.9 billion as of September 30, 2009, the last year for which OPM provided us with an actuarial analysis. Current law does not provide that such amounts be refunded to us or even used

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to offset future required payments. We have asked OPM and the Board of Actuaries to assist us with putting this surplus to better use. This would allow our pension obligation to remain fully funded and help our dire financial condition in the near term.

For your information, OPM recently increased our required funding to the FERS program by approximately $130 million per year, despite our over-funded position and despite the fact that our independent actuary calculated our normal cost to be less than the amount we are being charged. This increase will perpetuate, and indeed exacerbate, our overfunded status. We appealed this increase on December 21, 2010.

4. The POST Act aims to remove the restrictions in current law that prevent the Postal Service from exercising its authority to reduce delivery frequency. This would allow the Postal Service to carry out its proposal to eliminate Saturday delivery. As you know, this is a proposal that has been greeted with a great deal of concern. What has the Postal Service done to address the concerns that have been raised in recent months by those who want to maintain Saturday delivery? What would you say to those out there who have argued that the enactment of my language would give the Postal Service the authority to go beyond its current proposal and move to four, three, or two day-delivery?

Since 1970, Title 39, United States Code has authorized the Postal Service to determine the general frequency of mail delivery, subject to the requirement that it request a non-binding advisory opinion from the Postal Regulatory Commission (PRC) a reasonable time before implementing any such nationwide service change. Congress has attached riders to each fiscal year (FY) omnibus appropriations bill since the early 1980's barring the Postal Service from exercising that authority during the fiscal year to which the appropriations bill applied. The restriction that prevented the Postal Service from exercising its statutory authority during FY 2010 to change the general frequency of mail delivery is included in the Continuing Appropriations Act of 2011, which funds the government through March 4, 2011.

Reducing delivery frequency to five-days a week is a difficult decision and one that postal management has reluctantly made to address present and future deficits and improve the agency's financial stability in the face of perilous long-term volume and revenue trends. We would not be proposing five-day delivery if six-day delivery could be supported by current volumes. However, there is no longer sufficient volume to sustain six days of delivery. In addition, the change in the mix of mail has affected mail revenue. First-Class Mail volume continues to decline, while Standard Mail volume continues to increase. However, this has serious financial implications because it takes roughly three Standard Mail letters to produce the same profit, or contribution, as one First-Class Mail letter.

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We proposed reducing delivery frequency because most customers will accept a reduction of delivery frequency to five-days a week to support the Postal Service's financial stability. This is shown in market research conducted by Opinion Research Corporation (ORC) and by Maritz Research on behalf of the Postal Service and by independent public opinion polls.

The research conducted by ORC on behalf of the Postal Service was extensive qualitative and quantitative market research of urban, suburban and rural residential customers, as well as businesses, including, advertising mailers, pharmaceutical shippers, parcel shippers, periodicals publishers and billing and remittance processors. That research was presented to the PRC for review. It demonstrates that the overwhelming majority of customers see the planned service change as a vital trade-off to preserve the financial stability of the Postal Service. The overwhelming majority of these customers also expressed their willingness to adjust their habits and practices to deal with the elimination of delivery to street addresses on Saturdays. This is not to imply that all customers are in favor of the five-day delivery proposal. Rather, most are.

The most recent poll about five-day delivery that we are aware of was conducted in July 2010 by Rasmussen Reports. This poll confirms the market research conducted on behalf of the Postal Service and the prior polls. In this poll, sixty-eight percent said that they would rather see delivery cut from six days to five days to avoid stamp price increases.

In addition to considering the results of this market research and polls, the Postal Service has sought and received the input of its customers, unions and management associations. This outreach has continued to the present time and is consistent with the research and polls.

The concerns raised recently are similar to concerns raised since the summer of 2009. Based on customer input, we revised the initial five-day delivery implementation plan. This plan resolved or mitigated almost all major customer concerns.

The language in the POST Act would allow the Postal Service to exercise its authority and reduce delivery frequency. However, there are business and legal limits to the exercise of this authority. There are several business reasons why the Postal Service is not seeking to reduce delivery frequency to less than five days a week at this time.

There is sufficient volume to support five-day delivery and restore the financial stability of the Postal Service. Eliminating another day or more of delivery is not needed to restore our financial stability and might cause operational problems and larger volume losses than are estimated with the elimination of Saturday delivery. There is little support by customers for a reduction of delivery days of less than five-days a week. The July 2010 Rasmussen poll shows

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that only 25 percent of Americans are in favor of cutting delivery service to three days a week. Finally, we have been told by the remittance industry (i.e., banks, credit card issuers and insurance companies) that the elimination of another day or more of collections and delivery would disrupt the flow of money and payments and, as a result, harm the American economy. These conditions would have to change for the Postal Service to consider a further change in delivery frequency.

If these conditions were to change, and your provision became law, the Postal Service would engage in a robust dialogue with its Board of Governors, the PRC and other stakeholders prior to implementing any nationwide service change.

5. The POST Act would also give the Postal Service more freedom to close post offices, including post offices that operate at a deficit. It is my goal with this language to give you the ability to close outdated facilities that may not be in the best location and replace them with retail locations that might be cheaper and more convenient for your customers. The ideal outcome, in my view, would be more – not less – access to retail. There is some concern, however, that my language would lead to the Postal Service completely abandoning some communities, especially rural communities. If the POST Act were enacted, how would you use the new authority granted to the Postal Service regarding post office closings? In your view, are there provisions in current law unchanged by the POST Act that would prevent the Postal Service from closing an excessive number of post offices or denying communities reasonable access to retail?

As background, the changes in the POST Act would eliminate the prohibition in Title 39 that prevents the USPS from closing a small rural post office solely because it operates at a deficit. The POST Act would, however, leave in place provisions in 39 USC 404(d) that require that the Postal Service consider various criteria before determining whether to close or consolidate a post office, such as the effect on community, employees, and economic savings. Thus, postal management would continue to apply almost all of the same processes in place governing the collection of information to make an informed decision as to whether to discontinue a post office. The primary difference would be that post office discontinuance actions could be justified solely on grounds of operation at a deficit (i.e., if the revenue earned at a post office is grossly disproportionate the cost of continuing the operation). Moreover, the Postal Service would still be subject to various notice requirements, and any interested person served by a post office subject to discontinuance would still have the right to appeal a final determination to the Postal Regulatory Commission.

All of these procedural steps would aid in assuring that the Postal Service carefully selects candidate offices for discontinuance and furnishes suitable justification in favor of the final determination, and management's actions would still be subject to checks and balances afforded by the appeal process.

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If the POST Act is enacted, whenever management determines to close or consolidate a post office, it would still be subject to legal requirements in Title 39 that compel it to serve as nearly as practicable the entire U.S. population, and to provide effective and regular services in rural areas.

As part of an overall effort to expand access to retail services throughout the country, the Postal Service has created a number of alternate access channels throughout the country. For example, we have (insert number) of CPU's. We have invested in creating online services, such the sale of postage stamps online, and our "Click 'n Ship" channel, which enables customers to print postage and shipping labels for packages from their home computers. The Postal Service has also heavily promoted flat-rate priced boxes, which simplify determination of postage, and convenient, free carrier pickup services for packages. To improve customer service in retail installations, since 2005, the Postal Service has deployed 2,500 automated postal kiosks throughout the country. Utilization has expanded rapidly since the 2005 implementation. Today, the average kiosk receives more revenue than the revenue earned at 19,000 Post Offices. The Postal Service intends to expand kiosks over the next 5 years to over 10,000 sites, and plans to deploy them not only in postal retail units, but also in public places and private retail locations. The additional expansion of Approved Shipper and Contract Retail locations will continue to provide service to customers where they shop and work, thereby promoting customer convenience.

Today, retail customers purchase over 30% of their postal shipping and products outside a traditional Post Office. We expect that customers will continue to choose the convenience of postal products where they work and reside, in lieu of traveling to a Post Office. We estimate that over 60% of customers will elect to conduct postal retail transactions outside traditional postal retail outlet locations by 2020. Instead, we expect that customers will utilize online channels, convenient alternate access or contractor-operated locations, and new, dynamic, self service options, for quick, convenient, and cost-effective service.

To summarize, Postal Service management intends to provide regular and effective services in rural communities through a variety of measures, such as:

a) alternate access – services offered through a strategic relationship with another retailer, or through a small contractor-operated retail counter (for example, service through a local store)

b) carrier retail services - provision of collection and delivery through rural carriers and highway contract carriers, who can offer retail services through transactions conducted via the customers' mailbox;

c) telephone and web-based applications – provision of services through toll free access, and our website, usps.com; and

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d) **service through post offices in neighboring communities.**

6. Would the service standards the Postal Service was required to develop under Title III of the Postal Accountability and Enhancement Act provide some protection to communities who fear that closing their post office could leave them without reasonable access to retail?

The service standards in section 3691 are intended to establish transit times for market dominant services. These service standards apply regardless of whether a post office is situated in a rural community or the community is served through alternate means, such as a rural carrier or contract postal unit. So, a customer in a rural area would receive the same level of service for that class of mail as any other customer in the country.

7. In the Postal Accountability and Enhancement Act, Congress largely restricted the Postal Service to hard-copy mail. The POST Act would loosen these restrictions and allow the Postal Service to engage in certain non-postal activities that might take advantage of the Postal Service's retail, processing, and transportation network. There is some fear, however, that this change in law might lead to the kinds of failures that were seen in years past when the Postal Service dabbled in e-commerce activities. There is also concern about the impact on private businesses. How exactly would you use the new authority given to the Postal Service in the POST Act in this area?

If the Postal Service is granted new authority in the POST Act, we will provide more complete solutions to improve customer convenience, and modernize the services we provide to meet the needs of customers in an increasingly changing world. These services are all natural extensions to the Postal Service's charter of binding the nation together through communications and commerce extended to the digital world.

We note that although the Postal Service's initial efforts to provide purely electronic services did not produce revenues in the amounts that we had hoped, our experience was not dissimilar from that of many private sector enterprises. Simply put, it was just an idea ahead of its time. This fact, however, should not deter the Postal Service from making reasonable, calculated ventures into that market at this time where technology has reached an adoption point and consumers more than ever require a trusted 3rd party to secure their correspondence and transactions.

TRANSACTIONS AND CORRESPONDENCE

Our customers have told us that our core products need updating to meet their needs in a digital world. Therefore, we will augment our hybrid product offerings and introduce Digital Communications Services to modernize our

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portfolio. These services will enable our customers to do the same things they currently do in hard copy with the added convenience of digital – they can provide their Transactions and Correspondence mail to us digitally, receive it digitally, or both. Virtually all messages are hybrid in nature. Messages begin on a computer and frequently develop in to a piece of mail. Large companies have access to significant IT departments to organize this process. It is our vision to make this same functionality available to the average consumer and small / medium business.

While we believe that we have authority under current law to provide hybrid products (e.g., Digital-to-Physical products in which a digital file is turned into a mail piece, or Physical-to-Digital products in which a mail piece is turned into a digital file), our authority in this regard would be clarified by the POST Act. Beyond hybrid products, we have received requests to bring the security of sending bills and statements to purely digital communication. The Postal Service will provide a secure electronic mailbox capable of receiving and storing digital mail from any sender -- the same service for the US public that we have for 200 years. Similar products have recently been introduced by some European posts. We will also develop the capability for these mailboxes to enable customers to pay any bill in the mailbox from the financial institution or other source of their choosing without going to other websites. These services will provide consumers greater convenience, and billers the opportunity to reduce hard copy printing and handling costs.

MARKETING MAIL AND SERVICES

In recent years, advertisers have recognized the value of multi-channel campaigns that combine components such as Direct Mail with email and online elements. While large, sophisticated companies have the resources and expertise to develop and manage such campaigns, many small and medium-sized businesses (SMBs) do not. Because these companies are resource-constrained, particularly in time, they are seeking tools and a one-stop-shopping user experience that provide them easy and convenient access to the creation and execution of multi-channel campaigns. The Postal Service currently is developing an online tool that facilitates the creation of Direct Mail, which we believe to be authorized by current law. Passage of the POST Act would allow the Postal Service to work with our partners to extend that tool to other media to provide multi-channel and multimedia campaigns to meet the needs of this important segment of businesses. Failures in entering these new lines of business would be minimized, because they would be first provided to the SMB customer base that the Postal Service would already be serving through the Direct Mail Online Tool, should sufficient demand exist. This could be a significant enhancement for small businesses to develop and communicate their advertising messages.

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Additionally, the Postal Service also has the potential to collect a variety of both mailing and non-mailing related data through its processing and delivery networks. One example of data that the Postal Service could collect would be to add GPS or other sensors to the nearly 200,000 delivery vehicles to collect and transmit information on weather, location, road conditions, and/or cell tower signal strength. Competition with the private sector would be minimal as few companies have the physical, daily presence to provide such data as cost-effectively as the Postal Service would be able to.

SHIPPING SERVICES

The Postal Service will also leverage usps.com to make mailing and shipping more convenient and help American manufacturers to sell their goods. The first phase of this effort will be to leverage the Postal Store on usps.com to provide a one-stop-shopping opportunity for a wide variety of mailing and shipping related products for our customers. The next phase will be to help domestic companies expand their reach internationally by creating a Made in America shopping site for foreign customers to shop in. To simplify the experience for small businesses, the Postal Service will store products and ship them to the end customers if the shipper wishes. Also, the USPS is prohibited in leveraging and passing customer data, which is a significant liability in the world of eCommerce. The USPS should be allowed to utilize and share data with the customers' approval.

Small businesses are increasingly serving customers in other states and other countries and are looking for ways to do this more conveniently. The Postal Service will enable our customers to simplify their shipping experience while at the same time enabling us to better leverage our underutilized processing and transportation assets once the POST Act clarifies the extent to which we are authorized to provide warehousing and fulfillment services. Offering warehousing services will enable infrequent shippers to outsource all of their shipping to a single centralized facility and larger shippers to cost-effectively improve their delivery speed to customers by enabling them to deploy inventory closer to their customers.

RETAIL PRODUCTS AND SERVICES

The Postal Service will better leverage our retail locations and make our retail experience more of a one-stop-shopping solution for our customers by increasing the number of consumer products available to purchase, and introducing a suite of financial services targeted to the needs of the underbanked / underserved. We believe that we have authority under current law to provide financial services, and have done so internationally; the Postal Service will address the needs of the underbanked/underserved by introducing a suite of financial services. These services will include bill payment, check cashing, and electronic funds transfer. These services are natural extensions of and will build off of our Money Order

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service and international financial services, and primarily will serve customers whose needs are not currently being met by the private sector.

As we have done in the past, the Postal Service will offer many of these services in partnership with the private sector.

8. If the Postal Service is given enhanced authority to provide non-postal products and services, what role should the Postal Regulatory Commission play in approving or regulating these products and services?

The Postal Service does not believe that Postal Regulatory Commission (PRC) regulation would be necessary, if the Postal Service is given this enhanced authority, subject to normal antitrust and other unfair competition rules in the provision of these new nonpostal activities. Continued oversight would be provided by the Governors, Congress, GAO, and the OIG. But, if a regulatory role for the PRC is deemed to be important, that role should be carefully constructed. By its very nature, regulation can stifle innovation as the regulated entity focuses its product development efforts more on meeting regulatory requirements than on what it perceives as the most valuable service offering. Therefore, if the PRC is given a role, it should be well-defined by the statute. In particular, the PRC should be authorized to conduct a yearly review of any of these nonpostal activities, culminating in a report to Congress and other stakeholders in which the Commission makes any recommendations it deems to be important. The Commission could also be allowed to hear complaints about these activities, commensurate with its current authority under 39 U.S.C. 3662. With these safeguards in place, the Postal Service does not believe that prior review procedures would be necessary.

9. I've long argued that, in order for us to get a good, comprehensive, effective postal bill done, all of the stakeholders involved in postal issues would probably need to feel a little bit of pain. This should include the Postal Service itself and postal management and executives in particular. There is a sense among some out there, however – including some of our other witnesses – that this message hasn't made it to postal headquarters. This feeling is probably fueled by recent media reports about executive compensation and benefits at the Postal Service.

There is also a feeling, I understand, that the management and administrative facilities spread across the country haven't received the same level of scrutiny as the retail and processing facilities the Postal Service would like to close or consolidate. Can you respond to these concerns and talk about how you're finding savings at headquarters and across the country at the executive and management levels?

The Postal Service has already proactively announced a pay freeze for senior level management on November 15, 2010, in advance of the announcement by the Federal government. This is the second such freeze on base pay enacted over the past three years. At this point, we have done everything under our control to

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limit salary increases. The remaining employee's pay will be addressed through collective bargaining and consultation with the Postal Service's management associations.

We are in the process now of rightsizing our entire organization, including executive and administrative functions. This includes Headquarters, Area and District offices. We believe that this restructuring will result in savings across-the-board and will better position the Postal Service for the future.

We've brought in the "Boston Consulting Group" (BCG) to work with us through this change. BCG has significant experience in restructuring corporations and other posts around the world. BCG has worked with us before and knows the Postal Service. To date, BCG has interviewed managers at all levels of the organization. They are taking a careful look at our current organizational design, researching other businesses in similar situations, and other posts, and recommending best practices.

10. The POST Act would give the Postal Service the authority to ship wine and beer. It is my intention with this language to give the Postal Service the same authority private shippers such as UPS and FedEx currently have to ship these items under the same restrictions imposed on those shippers. I've heard concerns, however, that the language in my bill may not do enough to ensure that the Postal Service complies with laws in the various states and localities with respect to the sale and shipment of alcoholic beverages. If the POST Act is enacted, is it your understanding that the Postal Service will be subject to the same restrictions in the shipment of wine and beer that others carriers are subjected to? How would you train postal employees to comply with the various state and local alcohol laws?

Yes, the Postal Service will be subject to the same restrictions in the shipment of wine and beer as other carriers. A comprehensive training program would be launched to ensure postal employees comply with various state and local laws. These steps will include:

- **Training for both retail and delivery employees to assist them in acceptance instructions**
- **Training for sales and Business Service Network employees to help them answer questions from shippers**
- **Guides for retail acceptance and delivery operations**
- **Standard operating procedures**
- **Services talks to employees to ensure employee awareness**
- **Posters, videos and other internal communications**
- **FAQs and quick reference guides based on information in the *Domestic Mail Manual*, *Postal Bulletin*, *Management Instructions* and other postal policy communication vehicles**

11

Post-Hearing Questions for the Record
Submitted to Patrick Donahoe
From Senator Mark Pryor

"Finding Solutions to the Challenges Facing the U.S. Postal Service"
December 2, 2010

1. One of the items in the USPS' business proposal is eliminating Saturday delivery. If such a plan was implemented, what other services, such as kiosks and products sold in other retail venues, should be made available to minimize the impact on constituents and businesses?

   As part of an overall effort to expand access to retail services throughout the country, the Postal Service has invested in creating online services, such the sale of postage stamps online, and our "Click 'n Ship" channel, which enables customers to print postage and shipping labels for packages from their home computers. The Postal Service has also heavily promoted flat-rate priced boxes, which simplify determination of postage, and convenient, free carrier pickup services for packages. To improve customer service in retail installations, since 2005, the Postal Service has deployed 2,500 automated postal kiosks throughout the country. Utilization has expanded rapidly since the 2005 implementation. Today, the average kiosk receives more revenue than the revenue earned at 19,000 Post Offices. The Postal Service intends to expand kiosks over the next 5 years to over 10,000 sites, and plans to deploy them not only in postal retail units, but also in public places and private retail locations. The additional expansion of Approved Shipper and Contract Retail locations will continue to provide service to customers where they shop and work, thereby promoting customer convenience.

   Today, retail customers purchase over 30% of their postal shipping and products outside a traditional Post Office. We expect that customers will continue to choose the convenience of postal products where they work and reside, in lieu of traveling to a Post Office. We estimate that over 60% of customers will elect to conduct postal retail transactions outside traditional postal retail outlet locations by 2020. Instead, we expect that customers will utilize online channels, convenient alternate access or contractor-operated locations, and new, dynamic, self service options, for quick, convenient, and cost-effective service.

2. While the recession exacerbated problems faced by the USPS, one reason given for declining mail volume is a greater utilization of technology to communicate. However, I do have concerns with access in rural areas. Many rural areas straggle to have adequate internet services or access to that latest technology. This makes some areas more reliant on the services provided by the USPS than others.

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How is the USPS taking into account the needs of rural areas in their decision making process for operational changes?

Postal Service management intends to provide regular and effective services in rural communities through a variety of measures, such as:

a) **alternate access – services offered through a strategic relationship with another retailer, or through a small contractor-operated retail counter (for example, service through a local store)**

b) **carrier retail services - provision of collection and delivery through rural carriers and highway contract carriers, who can offer retail services through transactions conducted via the customers' mailbox;**

c) **telephone and web-based applications – provision of services through toll free access, and our website, usps.com; and**

d) **service through post offices in their or in neighboring communities.**

3. As you know the USPS is conducting Area Mail Processing (AMP) studies in facilities across my state to determine if facilities should be consolidated. I have heard concerns from constituents across the state about this process and its implications.

   a) How is the Postal Service determining which facilities to review?

USPS utilizes two methods in determining which consolidation opportunities to review. The first is a bottom-up approach, whereby a District Manager identifies a potential opportunity and requests approval to conduct an AMP study. The second is a top-down approach, whereby Headquarters evaluates the entire network to determine if potential consolidation reviews should be conducted at facilities where sophisticated network modeling suggests opportunities for consolidation may exist. The top-down approach analyzes the entire processing and distribution network using national optimization models trading off capacity, distance, service and cost factors. These models and analyses are then reviewed with each Area office and a list of potential consolidations for further review is determined. Regardless of the method used to identify a particular consolidation opportunity the formal AMP process, which is governed by USPS PO-408 Handbook, *Area Mail Processing Guidelines*, is conducted to determine if the opportunity is a good business decision for the USPS.

   b) What criteria is the Postal Service looking for when making a decision and do these criteria include reviewing regional and local economic data?

The USPS considers a variety of criteria, including customer service impact, mail volume, labor cost, equipment and facility maintenance costs, transportation requirements, and real estate expense. These criteria are

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evaluated as part of the formal process established by the USPS PO-408 Handbook, *Area Mail Processing Guidelines.* Systemically, postal mail processing network requirements are driven by mail volume, which has some correlation to the state of the economy in general. However, broad non-postal regional or local economic data provide no reliable basis for decisions regarding the efficient deployment of postal personnel and equipment or the optimal locations at which to concentrate specific postal processing operations.

c) Is there a target that the Postal Service is hoping to achieve in terms of processing efficiency or cost savings?

Like any other business, the USPS' goal is to reduce costs and achieve maximum efficiency. This is a continuous process of reassessment and improvement in order to reduce assets and right-size the network, and to reduce workhours, all to match changing workload. This will ensure that the USPS sustains a viable business model, remains competitive, and maintains universal service. For FY 2011 our target is to reduce over 40 million workhours which would result in over $1.5 billion in cost reductions.

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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

"Finding Solutions to the Challenges Facing the U.S. Postal Service"

Mr. Patrick Donahoe: Deputy Postmaster General and Chief Operating Officer
United States Postal Service (USPS)

1. According to fiscal year 2011 projections, the Postal Service will continue to have liquidity issues and anticipates a net loss of $6.5 billion. Excluding the retiree health benefit trust fund payment and workers compensation liability, the Postal Service is still projected to have a true operating loss of almost a billion dollars at the end of this fiscal year. The operating loss for FY 2010 was half a billion dollars out of a staggering $8.5 billion in total losses for the year. What are you forecasting for FY2012 and beyond?

   a) (If it is a profit) Considering that declines in total mail volume are predicted for the next decade and beyond, how can you be sure the Postal Service will turn a profit?
   b) (If it is a loss) How can the American people be assured that the Postal Service ever be financially viable without further federal intervention?

In the Postal Service's March 2010 Action Plan, we forecast cumulative losses (before prefunding of Retiree Health Benefits) of approximately $14 billion for the four-year period FY2012 through FY2015. If the $1 billion loss forecast for FY2011 is included, the forecast is for a cumulative loss of $15 billion through 2015.

This projection does not include costs to pre-fund Retiree Health Benefits (RHB), which amount to approximately $28 billion over the next five years. Combining the RHB prefunding requirement with the $15 billion projected loss results in an aggregate net loss of $43 billion for the five fiscal years ending September 2015.

We are currently updating our Action Plan. The forecast for the next five years may improve, but the losses will certainly not be eliminated without additional flexibility and legislative changes. The potential improvements will largely depend on the result of our labor negotiations along with the value of recently designed revenue enhancements and cost saving initiatives.

At this point, the American people cannot be assured of the financial viability of the Postal Service without changes in restrictive laws, as we face insolvency in September 2011. As we stressed in the Action Plan, the solution is a balance of aggressive measures within management's existing authority combined with

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essential statutory and regulatory flexibility. In the near term, given our dire financial position, we seek assistance from Congress and the Administration on matters such as rationalizing the funding of RHB and our pension liabilities, along with reducing delivery frequency to five days. The combination of these legislative measures and our aggressive management plan would help return the Postal Service to a firm financial footing.

2. Back in the spring, consultants hired by the Postal Service found that mail volume is expected to decline to 150 billion pieces by 2020. Though standard mail is predicted to make modest gains, First-Class Mail will continue to decline at a significant rate over the next ten years.

   a) Since First-Class Mail is the Postal Service's most profitable product, will the gains in revenue from an increase in standard mail ever offset the losses in First-Class Mail? If not, why not?

   b) With a decline in overall volume expected for the foreseeable future and the Postal Service's efforts to reduce service and increase postal rates, regardless of any legislative hurdles, how is the Postal Service to remain viable under such an unsustainable business model?

The mail volume forecasts included in our Action Plan were largely based on the opinions of customers solicited via interviews and surveys performed by the consultants. That work forecast the 2020 volume of First-Class Mail (FCM) to decrease by 26 billion pieces from 2010 volume. The profit margin on FCM is three times that of Standard Mail. So recovering the profit lost from 26 billion fewer FCM pieces would require 78 billion additional pieces of Standard Mail. Unfortunately, Standard Mail is forecast to increase by only 6 billion pieces.

In response to the mail volume declines of the past few years and those forecast for the future, management has initiated a number of changes to reduce costs while not reducing service, including the following:

- **Addressing labor costs, through the collective bargaining process, to achieve a smaller, more flexible workforce that matches the postal workload;**
- **Increasing the automated sorting of flat mail pieces into delivery sequence;**
- **Expanding access to postal products and services so they are available when and where customers want them, including 24/7; and,**
- **Optimizing our network to take advantage of technology and process improvements while reducing excess capacity in plants, post offices and delivery units.**

However, to remain fully viable the postal business model, and related laws and regulations, must be updated to reflect the realities of the markets we serve and our financial circumstances, as we set out in the Action Plan. For example, the Postal Service should have the flexibility to reduce delivery frequency as a prudent

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response to the unprecedented volume declines that have occurred — reductions due in large measure to enormous changes in customer behavior and the use of mail. Additionally, the Postal Service should not be forced to pre-fund its RHB obligations over ten years when our workers tend to stay with us for as many as 30 years, or more. Lastly, as we have over-funded our CSRS and FERS pension liabilities, we should redeploy those funds to better uses to help us avoid insolvency in nine months.

3. In the PRC's Advisory Opinion on Postal Facility Closures from March, it recommended several improvements to the Postal Service's process for closing facilities, including standardizing review procedures nationwide and extending customer notification.

   a) Is the Postal Service implementing the PRC's recommendations?

   b) Which ones?

   c) Did the Postal Service consider a moratorium on facility closings until the recommendations could be implemented, especially those on standardization? (If not, why not?)

The Postal Regulatory Commission offered the Postal Service three recommendations from its March Advisory Opinion. First, the Commission finds that the Postal Service should improve customers' opportunity to offer input. The Commission noted that customers served by a facility receive ten days to comment. Further, public comments often are not sought until after the initial decision to close the facility has already been made. The Commission stated that Postal Service decision-making will be improved if it establishes a notice and comment period that provides an adequate opportunity for public input before an initial decision to close a facility is made.

The Postal Service process for review of a proposal to discontinue a retail station or branch that exists to supplement the operations of a Post Office requires the solicitation and review of public input before a final decision is made. If an internal review of customer service, operations and financial data establishes that discontinuance of a station or branch is operationally feasible, the review process requires that the public be given 10 business days notice of the deadline for receipt of comments. After cross-functional review of relevant data and public input at both the Area office and Headquarters levels, the matter is then forwarded to the Vice President, Delivery and Retail Operations at USPS Headquarters for a final agency decision. The Postal Service understands that this process does afford the public a meaningful opportunity to provide comments before a decision is made to discontinue a station or branch.

The service change review process established by Congress in 39 U.S.C. 3661 gives the Postal Regulatory Commission an opportunity to offer non-binding advice in response to requests by the Postal Service regarding plans for nationwide service changes. At the same time, we believe that section 3661 has reserved to postal

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management the authority to make final decisions regarding such service changes. In the course of opining in 2009 whether the discontinuance of as many as 162 stations and branches out of a total 3,300 constituted a nationwide service change within the meaning of section 3661, the Commission offered advice on how the Postal Service could change its long-standing station/branch closure review process. The Postal Service respects the advisory role assigned by Congress to the Commission in such matters and has given thoughtful consideration to the Commission's views.

As we move forward with station and branch discontinuance review, we will continue to allow 10 days for public input on a proposal to discontinue a station or branch. Consistent with what the Postal Service believes is both best and consistent with long-standing practice, such input will be solicited only after an internal assessment has been made that discontinuance of a particular retail facility warrants any further attention . Otherwise, solicitation of public input before such an assessment would unnecessarily raise public alarm when discontinuance was not feasible. Accordingly, notwithstanding the Commission's recommendation, the Postal Service intends to continue the practice of soliciting public input regarding a discontinuance proposal only after it has made a preliminary feasibility assessment.

The Postal Service considers that its current process for public comment on the proposed discontinuance of stations and branch affords is reasonable, sufficient and meaningful, even though it is not the same as the lengthier process required by 39 U.S.C. 404 for Post Offices.

Second, the Commission stated that the financial analysis used to estimate the cost savings if a facility closes should be improved. The Commission recommends that the Postal Service adapt an improved financial analysis model, which will allow more accurate evaluation of essential policy considerations.

The Postal Service has created a standardized web-based process to aid in the development of proposals to consider discontinuance of the operations of a particular station or branch. This improvement will ensure that appropriate up-to-date financial and operational data are taken into consideration.

Third, the Commission finds that the Postal Service should provide local managers responsible for developing proposals to close facilities with written guidance on how to obtain relevant information and how to apply the qualitative decision factors. This will allow consistent, nationwide application of relevant factors and produce more well-reasoned, and less arbitrary decisions.

Although we were authorized to initiate discontinuance of station and branch operations in July 2009, we deferred any such action until receipt and review of the Commission's non-binding advisory opinion in March 2010. Since that time, we have implemented improvements to our discontinuance review process to ensure consistent reliance on up-to-date financial and operational data in the development

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of discontinuance proposals. The written guidelines for discontinuance review have been clarified accordingly. The above-referenced web-based application improves standardization in the local development and review of pertinent data relevant to discontinuance proposals, as well as the management of each stage in the decision-making timeline. We consider that we exercised an abundance of deference, and in-depth review, before finally announcing plans in September 2010 to discontinue station and branch operations that have been under review since as far back as the spring of 2009.

The Postal Service has changed its approach and moving forward is now developing a web based application to help the Postal Service track the existing 145 SBOC offices proposed for closure called Consolidation Suspension Discontinuance Center (CSDC) tool. Additionally, the CSDC tool has in it the process steps to follow to assure community input is received, financial analysis is quantified, and guidance is provided.

This will allow local postal districts to have uniform tools on which to base their consolidation decisions.

Regarding question 3 (c) whether the Postal Service will consider a moratorium on facility closings until the recommendations can be finalized the answer is that for more than one year the Postal Service engaged in a moratorium on Station and Branch Office Closings while researching the Postal Regulatory Commission's concerns.

4. According to the Postal Regulatory Commission's press release from September 30, 2010 announcing its denial of the Postal Service's exigent rate request, "the Postal Service's cash flow problem is not a result of the recession and would have occurred whether or not the recession took place." It goes on to say, "it is the result of other, unrelated structural problems and the proposed exigent rate adjustments would neither solve nor delay those problems."

    a) The Postal Service has recently filed a motion with the Court of Appeals to fight the PRC's ruling. Why does the Postal Service disagree with the PRC's argument for its decision?

While we agree that structural change to the Postal Service is necessary to insure our long term viability, the need for such structural change is not a relevant or appropriate basis upon which the PRC can rely to deny our request for an exigent price increase. Since the enactment of the *Postal Accountability and Enhancement Act of 2006* (PAEA), the general rule for regulation of Postal Service prices for market-dominant products is that increases are limited to the rate of inflation. Congress recognized, however, that inflation-based increases might not be sufficient to enable the Postal Service to achieve Congress's overarching goal of maintaining quality, nationwide postal services. Congress thus provided a safety valve that directs the Postal Regulatory Commission (PRC) to allow larger increases under

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exceptional circumstances. The PRC's decision in connection with the exigent rate increase request by the Postal Service effectively nullifies that critical safety valve, and it does so despite the Postal Service's ongoing — and undisputed — financial crisis.

The PRC's misreading of the statute caused it to reject the Postal Service's rate request despite the PRC's finding that the Postal Service faces extraordinary or exceptional circumstances. As a result of recession-related volume losses and other factors, the Postal Service has suffered multi-billion dollar losses and will not be able to pay its final fiscal year 2011 obligations on September 30, 2011 — a date that is now a little over nine months away. Moreover, these volume losses will have a negative impact on revenue for years to come. The PRC agreed that the recession and its impact on the Postal Service was "extraordinary or exceptional" as required by PAEA in order to increase prices above the rate of inflation. And the PRC did not fault the Postal Service's management's use of "best practices," but rather found that the Postal Service had effectively cut the costs that are within its control. This therefore should have been a textbook case for resort to the safety valve that Congress provided to the PRC and the Postal Service.

Based on its misreading of the statute, however, the PRC concluded that it lacked the authority that Congress plainly gave it, and it instead passed the problem for dealing with the Postal Service's financial crisis back to Congress. The PRC found that its hands were tied by an exceedingly unlikely restraint: the prepositional phrase "due to" in the statutory direction for the PRC to "establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances." 39 U.S.C. § 3622(d)(1)(E). The PRC read "due to" as barring the use of the safety valve absent detailed economic evidence showing that the proposed increase would generate income equal to the losses caused by the extraordinary or exceptional circumstances. It further relied on the "due to" clause to question whether it even had the power to grant such an increase in light of the fact that the increase sought would not itself solve the Postal Service's financial crisis.

The PRC's interpretation of "due to" is inconsistent with statutory text and structure, and cannot be what Congress intended. To reiterate, the PRC found that recession-related volume declines were "extraordinary or exceptional" and that, notwithstanding the Postal Service's "commendable job" of cutting costs, it was facing a looming "liquidity problem" that would render it insolvent in short order. The PRC nonetheless denied all relief on the ground that the Postal Service's rate request was not "due to" the recession. The PRC's interpretation of "due to" eviscerates the safety valve, and leaves both the PRC and the Postal Service powerless to act to relieve financial pressure.

Congress, by contrast, provided a meaningful safety valve. Congress granted the Postal Service wide latitude to raise rates in a "reasonable and equitable and necessary" manner to ensure that it remains solvent when extraordinary conditions

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threaten its ability to continue providing service, notwithstanding its use of best management practices to avoid such a crisis in the first place. The PRC transformed this broad, functional safety valve focused on the Postal Service's continuing ability to provide service into an inflexible, accounting-focused provision that provides the least relief when the Postal Service's ability to continue to provide service is most threatened.

b) The PRC argues that the Postal Service's liquidity issues are mainly due to the mandated prefunding of the retiree health benefit fund and the lack of any retained earnings or future borrowing authority. If an appropriate legislative fix is found to mitigate the prefunding requirement, is the main reason for the Postal Service's liquidity problem fixed?

i. If not, why not?

ii. If so, why is the exigent rate increase still necessary?

As noted in the response to your first question, even with no RHB pre-funding over the next five years, the Postal Service projects cumulative losses of approximately $15 billion. The exigent price increase by itself would have improved our annual loss position by approximately $3 billion, or $15 billion over five years. Hence, the exigent price increase is one element of our balanced approach to restore the financial viability of the Postal Service.

5. The Postal Service has proposed moving to a 5-day delivery schedule, which is estimated to save more than $3 billion annually. What are the projected losses in revenue from both First-Class and standard mail?

With the implementation of five-day delivery, annual revenue is projected to reduce by approximately $400 million, with most of the reduction coming from First-Class Mail and Standard Mail. The estimated annual savings of $3 billion is net of this lost revenue and its contribution margin.

6. Will going to 5-day delivery speed up an already significant decline in First-Class Mail, the Postal Service's most profitable product? If not, why not?

No. Before filing our request for advisory opinion from the Postal Regulatory Commission regarding the elimination of Saturday delivery to street addresses, we employed Opinion Research Corporation to conduct extensive qualitative and quantitative market research on postal residential and business customers regarding such a change. We filed the results with the Commission for examination. That research shows that elimination of Saturday delivery to street addresses and the collection of mail on Saturday would have little impact on most consumers and businesses' use of First-Class Mail.

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We took into account the results of this market research in calculating an estimate of the potential adverse impact of five-day delivery on mail volume. We presented our estimate to the Commission for review. It shows that the impact of implementing five-day delivery operations would result in 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 approximately $200 million. The market research also showed that since significant diversion of First-Class Mail has already occurred to the Internet, most customers would not accelerate their shift to it, if five-day delivery is implemented. It shows that over 60 percent of business customers and over two-thirds of consumers said it was extremely unlikely that five-day delivery would result in them changing their use of the mail. As a result, the elimination of Saturday delivery to street addresses will only have a negligible impact on existing negative First-Class Mail volume trends.

7. In the Postal Service's recently released 2010 Annual Report, the success of the Priority Mail Flat Rate Shipping campaign is highlighted. It is assumed that a big draw to Priority Mail is Saturday delivery, since it is significantly cheaper than the commercial carriers' Saturday rates. A switch to 5-day delivery would impact this success story, so how does the Postal Service reconcile that loss with the projected savings in dropping Saturday delivery?

Currently, Priority Mail has a variety of features that make it attractive to household and business mailers. They include the availability of flat rate envelopes and boxes for which one low price is charged for shipping to any address in the United States. Ancillary services such as Delivery Confirmation also are available for Priority Mail. Easy to use online tools enable mailers to pay for postage and receive Delivery Confirmation on the Internet or through their mobile phones. The current service standards, which range from one to three delivery days after acceptance, are also an attractive service feature.

The Postal Service recently introduced a new Hold for Pickup Service that allows shippers to send merchandise to be held securely for pickup by the recipient at designated Post Offices. This new service includes automated notifications to customers about the status of their shipments. In comparison to competitors' products, Priority Mail is delivered to more domestic addresses. Priority Mail envelopes and small parcels, under 13 ounces, can be deposited in conveniently located blue collection boxes. Priority Mail prices are not surcharged in response to spikes in fuel costs. Nor are there surcharges for residential or Saturday delivery.

The current long-standing practice of Saturday street address delivery is a feature that some Priority Mail senders and recipients find attractive. However, our extensive market research does not support the assumption that it is <u>the</u> distinguishing service feature for customers. Instead, our research shows that the elimination of Saturday delivery to street addresses will not result in a significant loss of volume.

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Before filing our request for advisory opinion from the Postal Regulatory Commission regarding the elimination of Saturday delivery to street addresses, we employed Opinion Research Corporation to conduct extensive qualitative and quantitative market research on postal residential and business customers regarding such a change. We filed the results with the Commission for examination. That research shows that elimination of Saturday delivery to street addresses and the collection of mail on Saturday would have little impact on most consumers and small businesses' use of the mail. A large majority of customers indicated that they would adapt to the planned service change. This is not to imply that the change would have no impact. Rather, mail senders generally indicated that they would 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. Customers said that Saturday is similar to the other five days in terms of the mail sent and received, and they did not consider the absence of Saturday delivery to be a major issue.

Some consumers did acknowledge that Saturday provided them an opportunity to receive some packages and other mail (that required signature) if they were home at the time of mail delivery on Saturdays. However, most indicated that, in contrast to weekdays, their Saturday routines typically were not organized around the delivery of mail or expectation of particular mail pieces being delivered that day. In other words, consumers indicated that they generally tend to run errands or take care of other matters away from home without waiting for mail delivery on Saturdays.

In the planned five-day delivery environment, we would continue to deliver to Post Office Boxes on Saturdays. As is the case today, retail units would remain open on Saturdays, thus permitting customers to retrieve packages for which they received attempted delivery notices during the week. As an essential element of our five-day delivery implementation plan, local offices will continue to be authorized to expand weekday evening retail hours in response to demand for package pick-up. And, Hold for Pickup Service will allow customers to go to a Post Office on a Saturday to pickup packages.

Commercial organizations also have a regular routine for receiving and sorting mail Monday through Friday when they are open. But many are not open on Saturday. For these organizations, the lack of Saturday delivery would have little to no impact. For those companies open on Saturday, many said in the market research that they normally do not process incoming mail on that day, deferring that task until the following Monday. So, the elimination of Saturday delivery would have little to no impact on them. Companies who do need Saturday delivery indicated they would use a premium service. As some competitive package delivery companies charge a fee for Saturday delivery, most customers indicated they would use Express Mail®. The market research also showed that since significant diversion has already occurred to package service competitors and the Internet, most customers would not accelerate their shift to these alternatives if five-day delivery is implemented.

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We took into account the results of this market research in calculating an estimate of the potential adverse impact of five-day delivery on mail volume. We presented our estimate to the Commission for review. It shows that the impact of implementing five-day delivery operations would result in a reduction of -0.7 percent of total volume or 1.238 billion pieces, most of it First-Class Mail. The loss of Priority Mail would be rather small because consumers said they would increase their usage to ensure timely delivery for important materials, which largely offsets the decrease in volume sent by businesses. The loss in contribution resulting from this loss of volume would be almost $200 million.

8. With respect to 5-day delivery, the mailing community is impacted differently than mail recipients. In answering a question for the record on this issue from our April hearing, former Postmaster General John Potter said that "mailers have not told us the cost of making the changes to their operation of implementing five-day delivery."

   a) Since April, have you received any feedback on the potential cost to the mailing community to adjust their business operations to a 5-day delivery schedule? Have you asked?

The Postal Service confers with mailers and mailer's associations about issues affecting their use of the mail on an on-going basis. We continue to talk to them about implementation of Five-Day Delivery. Beginning in the fall of 2009, we asked mailers to provide us with their reaction to our implementation concept and plan. We have repeatedly asked: what will you need to do to implement Five-Day Delivery? We have recommended to large mailers that they follow our lead and establish an implementation team to evaluate what they need to do to implement to Five-Day Delivery.

Their general response was to express reluctance to establish such a team until they hear that Five-Day Delivery will definitively happen. These mailers have indicated that the tasks that need to be performed to implement Five-Day Delivery include changing their transportation, paper, and printing contracts, and information technology systems. They have said they will have to dedicate resources to do these tasks and that they need a lead time of about six months to complete necessary preparations. Accordingly, from the outset, our plan has been to provide six months notice of the implementation date that we choose.

During the course of the Postal Regulatory Commission's review of our Five-Day Delivery plan, mailers were given an opportunity to provide empirical evidence relating to any implementation costs and burdens. The few mailers who filed testimony opposing the elimination of Saturday delivery to street addresses offered no estimates of the costs associated with adjusting to the planned change. In addition, we have not received cost estimates in our conversations with mailers.

   b) Considering the dependence of so many businesses on Saturday delivery, so you think this should be considered? Why or why not?

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We would not be proposing five-day delivery if six-day delivery could be supported by current mail volumes. However, there is no longer sufficient volume to sustain six days of delivery. Elimination of six-day delivery will result in an annual cost savings of $3.3 billion and a net cost savings of about $3.1 billion. We need to realize these net cost savings as one of the fundamental changes in our business model to help us close the gap between revenues and costs.

Reducing delivery frequency to five-days a week is a difficult decision that we have reluctantly made to reduce the present and future deficits for the Postal Service to be financially stable and solvent. It is absolutely necessary to ensure the Postal Service's financial stability.

Bear in mind that we engaged in nearly a year of consultations with every significant component of the mailing industry before filing our request for an advisory opinion with the Postal Regulatory Commission in March 2010 and we continued those consultations during the course of the Commission's review. In addition, we hired the highly respected firm of Opinion Research Corporation to conduct extensive qualitative and quantitative market research to measure the effect on businesses of eliminating Saturday delivery to street addresses. We presented this market research to the Commission for review.

The research shows that an overwhelming majority of customers recognize the importance of a financially stable Postal Service and will accept a reduction of delivery frequency to five days a week to significantly improve the Postal Service's bottom line. These market research results are consistent with the results of independent public opinion polls conducted in 2009 and 2010.

During the mailer consultations referenced above, we identified more than 20 concerns that different components of the mailing industry had with our initial proposed operating concept. We carefully considered each of these concerns and were able to resolve or mitigate almost all of them. In general, the mailer concerns that could not be resolved centered on the preferences of some mailers that the proposed changes not be implemented at all.

In this process, we carefully considered the effect of eliminating Saturday delivery on our customers. We recognize that a relatively small number of relatively low-volume mailers have a strong preference for the continuation of Saturday delivery to street addresses. However, on balance, we and according to market research and independent opinion polls, the American public consider that there is a stronger public interest in and support for a financially viable postal system.

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PRC CHAIRMAN RUTH GOLDWAY RESPONSES
TO
SENATOR CARPER'S "QUESTIONS FOR THE RECORD"
DECEMBER 2, 2010, SENATE SUBCOMMITTEE HEARING

1) *The bill I've introduced – S. 3831, the Postal Operations Sustainment and Transformation (POST) Act – aims to remove the restrictions in current law that prevent the Postal Service from exercising its authority to reduce delivery frequency. This would allow the Postal Service to carry out its proposal to eliminate Saturday delivery. As you know, the Postal Regulatory Commission's role in proposals to eliminate a day of delivery is limited to the issuance of an advisory opinion. Assuming that the POST Act is enacted and the Postal Service were free to carry out its proposal, do you think the Commission's role in reviewing and giving views on proposals such as this one is enough? Do you think the Commission's role should be enhanced in some way?*

A: The Advisory Opinion process is an important protection in the Nation's postal laws that provides for a public review of proposed changes in the nature of postal services on a nationwide or substantially nationwide basis. The law mandates the Commission to hold a hearing on the record in which users of the mail, the Postal Service and an officer of the Commission representing the interest of the general public may participate. This enables users of the mail to have a voice in shaping major changes to the access, quality and value of the postal services they depend on to manage their lives and businesses.

The Commission issues its Advisory Opinion in writing to the Postal Service at the conclusion of the public hearing process. Presumably, the substantial evidentiary record, public input and objective analysis reflected in the Opinion will have a beneficial impact on Postal Service decision making and the outcome of proposed changes. However, the Postal Service is not required under the law to act on the Opinion or even to respond on the merits of any issues that are indentified or modifications that may be proposed.

In anticipation of receiving the Commission's pending Advisory Opinion on its proposal to reduce the frequency of mail delivery service nationwide, the Postal Service has emphasized that the Commission's Advisory Opinion is "non-binding." While this may be true, and although the Commission has no desire to usurp Postal Service authority for managing the delivery of postal services to the Nation, the Opinion is not insignificant. Advisory Opinions embody the intent of Congress that users of the mail and the general public should have a meaningful role in the process when major changes to their postal services are contemplated. Furthermore, they provide critical, objective advice for consideration by Congress and the Postal Service. At the end of this lengthy, public process, however, there is no obligation for the Postal Service to respond in any manner.

Congress may wish to require as a final step in the process, that the Postal Service respond within a reasonable period of time on any recommendations, issues and concerns that are noticed in the

Advisory Opinion. This would provide a more robust outcome for participants, and enhance the transparency and accountability of the Postal Service.

2) *You and I have discussed my frustration with the amount of time it has taken the Commission to issue its advisory opinion on the Postal Service's proposal to eliminate Saturday delivery. That said, I've learned a lot in recent months about the Commission's workload and the procedural and other restrictions and requirements you and your colleagues must work under. I know that the Postal Service's recent exigent rate request was a particular strain on the Commission's staff and resources. The enactment of the POST Act or of Senator Collins' legislation would give the Commission even more responsibilities. Is there anything that Congress should do to lessen the burden we've placed on the Commission in recent years? Are the resources you receive sufficient to enable you to be effective at the role you and your colleagues have been given?*

A: As noted in the Commission's Annual Report for Fiscal Year 2010, it has been a remarkable and challenging year marked by unprecedented public interest in the Commission's work and a dramatic increase in our workload and exercise of responsibility. This accelerated activity reflects both the efficiency of the regulatory framework established by the Commission in accordance with the PAEA and the urgency of the Postal Service's situation caused by the severe recession and its mandated financial obligations.

During the year, the Commission handled its routine work promptly even in the face of an increased workload. For example, in the past year the Commission approved 127 Negotiated Service Agreements (NSAs), a 98 percent increase from 2009. (Ninety-eight percent of the 127 NSAs involved competitive products, requiring issuance of a Commission decision within 15 days of receipt.) At the same time, the Commission dealt effectively with many unique and complicated demands, including two Advisory Opinion inquiries, special studies provided for by the PAEA involving Postal Service funding of employee pensions and future retiree health benefit payments, and the first exigent rate case under the PAEA. The Commission also continued to refine its regulatory oversight processes and improve its internal administrative procedures.

The Commission should have adequate resources to face the foreseeable challenges ahead. We are also ready and willing to accept new responsibilities as needed. We look forward to working with the Congress as it develops specific reform proposals to ensure that the Commission remains capable and equipped to handle the expanded responsibilities.

3) *The POST Act would also give the Postal Service more freedom to close post offices, including post offices that operate at a deficit. It is my goal with this language to give you the ability to close outdated facilities that may not be in the best location and replace them with retail locations that might be cheaper and more convenient for your customers. The ideal outcome, in my view, would be more – not less – access to retail. There is some concern, however, that my language would lead to the Postal*

Service completely abandoning some communities, especially rural communities. What tools does the Commission have at its disposal to review the Postal Service's post office closing and consolidation decisions to ensure that affected communities continue to have reasonable access to retail?

A: The Commission has authority to review customer appeals of post office closings. The Commission's role under Section 404(d) of Title 39, U.S.C. is primarily to ensure due process for postal customers and to preclude Postal Service closing decisions that are arbitrary, capricious or unlawful. Under current law, when a post office is proposed for closing, the Postal Service must show how adequate services – retail and otherwise – will be maintained for the community. There are no hard and fast rules for how this may be done. Depending on local circumstances, the Postal Service has provided alternative retail services from nearby, existing facilities; by contract with a local business; via rural carrier at the time of mail delivery; and through other means. It is important to note that the Commission and the Postal Service disagree on the applicability of Section 404(d).

The Post Act proposes to eliminate the prohibition against closing post offices solely for operating at a deficit. While this might tend to increase post office closing activity by the Postal Service, it would still require the Postal Service to provide "effective and regular postal services" to the community. The Commission interprets this to mean that adequate retail services must be provided through an acceptable alternative means.

Current law, however, dictates that the Postal Service provides "*a maximum degree of* effective and regular postal services." It is not clear to the Commission what the operative effect would be in this case of eliminating the modifier "a maximum degree of." Congress may wish to clarify its intent if this modification is included in the final legislation.

4) *Would the service standards the Postal Service was required to develop under Title III of the Postal Accountability and Enhancement Act provide some protection to communities who fear that closing their post office could leave them without reasonable access to retail?*

A: The Commission worked collaboratively with the Postal Service to adopt modern service standards for market-dominant products as required under Title III. While these product standards incorporate the objective "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," current service standards apply to the speed and reliability of delivery services, rather than the availability of retail services. In my view, greater emphasis should be placed on assuring that regular and effective access is preserved in all communities. I am confident that the Commission and the Postal Service could promptly develop and implement such standards.

5) *In the Postal Accountability and Enhancement Act, Congress largely restricted the Postal Service to hard-copy mail. The POST Act would loosen these restrictions and allow the Postal Service to engage in*

certain non-postal activities that might take advantage of the Postal Service's retail, processing, and transportation network. At the hearing, you and I discussed some ways that I could improve the Act to protect against potential waste and damage to the private sector. Can you provide some details on what should be changed or added to my language?

A: The PAEA was carefully crafted to ensure effective oversight of all revenue generating activity. The Act required the Commission to review each non-postal service offered by the Postal Service and determine whether that service should continue, taking into account the following: (1) the public need for the service; and (2) the ability of the private sector to meet the public need for the service. If the Commission allowed a nonpostal service to continue, the Commission then designated the service as either market dominant, competitive, or experimental.

The PAEA also authorizes the Postal Service to "conduct market tests of experimental products," provided the product satisfies several conditions, including that: "The product will not result in undue market disruption, especially for small business concerns (section 3641(b)(2))."

If Congress were to expand the Postal Service's ability to offer new nonpostal services, it is the Commission's belief that new non-postal services should also satisfy these standards, and then be subject to the same level of review as other Postal Service products and services by the Commission.

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PRC CHAIRMAN RUTH GOLDWAY RESPONSES
TO
SENATOR MCCAIN'S "QUESTIONS FOR THE RECORD"
DECEMBER 2, 2010 SENATE SUBCOMMITTEE HEARING

1) In his testimony from June's bicameral hearing, the CEO of Hallmark Cards, Donald Hall, described the Postal Service's dual strategy of reducing services and increasing prices as a "death spiral'" as both actions will lead to more volume losses. Would you agree or disagree with Mr. Hall? How would you characterize this strategy? If the Postal Service had to either reduce service or increase prices, which action do you believe would have a lesser impact on mail volume?

A: As noted in the Commission's exigent rate decision, Docket R2010-4, the primary cause of the Postal Service's current liquidity crisis is the required annual payments to prefund future payments for retiree health benefits.

The Postal Service's financial challenges have been exacerbated by large mail volume declines, which have resulted primarily from the recession and its effects on key mailing sectors like housing and finance, and secondarily due to increasing diversion of mail by technology and changes in customer mailing practices and preferences. As mail volume has fallen, however, the Postal Service has responded by reducing work hours to match the workload, saving $6 billion in costs in 2009 alone. As it enters the second quarter of FY 2011, the Postal Service continues to make aggressive work hour and complement reductions, even as preliminary figures reported to the Commission show that overall mail volume is increasing.

At the time of Mr. Hall's testimony, the Commission had recently completed an Advisory Opinion on station and branch closings and was engaged in hearings to evaluate a Postal Service proposal to eliminate Saturday mail delivery service. Further, the Postal Service was in the process of preparing a request to the Commission for an "exigent" price increase to exceed its statutory price cap due to effects of recession and its liquidity crisis. This may be the basis for Mr. Hall's concerns regarding the "death spiral." I believe his record of business success gives his evaluation of those postal proposals great credibility.

Subsequently, the Commission unanimously denied the exigent request on September 30, 2010. The Postal Service recently requested a 1.7 percent average increase -- the amount that is allowed under the statutory price cap. The Commission is now reviewing that request.

The Commission also is finalizing its Advisory Opinion on the Postal Service's "five-day" delivery proposal. In that Opinion, we will discuss the potential benefits and liabilities of the proposal. Ultimately, Congress will need to decide whether or not to adopt this reduced delivery proposal.

Mail volume, which grew consistently in the three decades following postal reorganization in 1971, has declined in seven out of ten years in the first decade of the 21st century. These declines correlate with the recessions that began and ended the decade. From 2004-2006, when the economy recovered, mail

volume grew, reaching a record 213 billion pieces in 2006. During the 2007-2009 recession, mail volume declined during the 2007-2009 recession at the fastest rate since the Great Depression.

Although econometric studies show that the prices for some mailing services are relatively inelastic, sizeable changes in either price or service involve risk.

And while it is appropriate and necessary for the Postal Service to adjust its networks to provide more efficient and effective service, the Service must consider whether it is consistent with changing customer preferences and demand. The Commission's Advisory Opinion process and its exigent rate review procedures, mandated by law, allow interested users of the mail and the public in general to have an opportunity for meaningful comment when major service changes or price increased are contemplated. This has proven to be particularly beneficial in recent years to guide the Postal Service to consider and protect consumer concerns.

2) According to the PRC's press release announcing its denial of the Postal Service's exigent rate request, "the Postal Service's cash flow problem is not a result of the recession and would have occurred whether or not the recession took place." It goes on to say that, "it is the result of other, unrelated structural problems and the proposed exigent rate adjustments would neither solve nor delay those problems." The PRC argues that the Postal Service's liquidity issues are largely due to the mandated prefunding of the retiree health benefit trust fund and the lack of any retained earnings or future borrowing authority. If an appropriate legislative fix is found to mitigate the prefunding requirement, is the main reason for Postal Service's long term liquidity problem fixed? Why or why not?

A: As the past ten years have shown, the future is difficult to predict. Nevertheless, it appears that the Postal Service's current liquidity crisis could be resolved for the immediate and foreseeable future if an appropriate "legislative fix" is found to mitigate the prefunding requirement.

During the past year, the Commission produced actuarial studies as authorized under the PAEA, related to the Postal Service's Retiree Health Benefit Fund (RHBF) and to possible overpayments to the Civil Service Retirement System (CSRS). These studies indicated that the annual RHBF payments could be reduced by $2 billion per year, while meeting the original objectives of the annual payment requirement, and that the Postal Service would benefit by $50-55 billion if its CSRS obligation were recalculated. These findings provide substantial information to Congress, which may wish to address the Postal Service's liquidity crisis.

The ongoing economic recovery appears finally to be driving an increase in overall mail volume, led by strong growth in Standard Mail. Profits from the array of competitive products now offered by the Postal Service are increasing. First-Class Mail, however, continues to decline, though at a slower rate.

A substantial amount of First-Class Mail has been displaced by technology, such as electronic bill payment and presentment. However, the newly appointed Postmaster General, Pat Donahoe, has announced plans to offer new products to meet the nation's economic and technology changes.

Recent history suggests that the recent increases in mail volume augur stronger financial performance in the future. The Commission will monitor and evaluate emerging trends and long-term growth forecasts in our Annual Compliance Determination.

For the immediate future, it is imperative that the Postal Service continue to increase its efficiency, pursue growth and promote the value of its services. However, without congressional action to address the current liquidity crisis, which the Commission believes is a result of the health benefit prefunding requirement, the Postal Service cannot pursue these essential efforts.

3) In your written testimony, you ask whether the language in Senator Carper's proposed bill would allow the Postal Service to reduce service beyond five days without prior review. What do you think would be the appropriate process for preventing that from happening?

A: Section 3 (g) of the POST Act would authorize the Postal Service to adjust the frequency of mail delivery "Notwithstanding any other provision of law." This provision of the bill may invalidate important customer protections now provided to users of the mail under Title 39.

Currently, the Postal Service is required under 39 USC 3661(b) to seek an Advisory Opinion from the Commission when it proposes to make changes in the nature of postal services on a nationwide or substantially nationwide basis. The Commission is mandated by that statute to hold a hearing on the record (in compliance with Sec. 556 and 557, Title 39, U.S.C.) in which users of the mail, the Postal Service and an officer of the Commission representing the interest of the general public participate. Users of the mail should have a voice in shaping major changes to the access, quality and value of the postal services they depend on to manage their lives and businesses.

Section 3 (g) could also be viewed as exempting the Postal Service from Commission review should it make discriminatory, regional adjustments in delivery.

Modifying the language in Section 3 (g), such as "Subject to the provisions of Title 39, but notwithstanding any other provision of law" might help to resolve this concern.

4) In GAO's written testimony, Mr. Herr stated that "the Congressional Budget Office has raised concerns about how aggressive USPS's cost-cutting measures would be if prefunding payments for retiree health care were reduced." Both legislative proposals provide a process for the pension overpayment to cover the annual retiree health benefit prefunding payment. What effect do you think this would have on the Postal Service's initiative to continue needed reforms in the future? What impact would this have on the Postal Service's ability to seek concessions over enhanced workforce flexibility and cost reductions in future labor contract negotiations?

A: Postal Service wages and the governing labor agreements have never been within the purview of the Commission, either under the PRA or the PAEA. They are set through a negotiation process established by law and subject to binding arbitration when there is an impasse. The Commission does not take a position on that process.

The Commission believes the statutory cap on price increases for the Postal Service's market dominant products has proved itself to be a strong incentive for continued cost control efforts. In the past two years alone, the Postal Service has reduced its costs by $9 billion, while market-dominant prices remained stable due to the price cap.

Postal management has demonstrated its ability to lower costs and reduce the workforce in both good times and bad. From 2002 to 2006, for example, when mail volume was rising and the Postal Service had a cumulative $9.5 billion net income, employee rolls were reduced by five percent.

Overall, the postal career ranks have dropped 27 percent from a peak of 798,000 in 1999 to 584,000 last year. This trend appears likely to continue under new Postmaster General Donahoe, who recently announced plans to cut 7,500 administrative positions.

Given this ten year record, the growth of competitive alternatives to the mail and the discipline imposed by the statutory price cap, the Postal Service should be relied upon to continue to control costs.

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Post-Hearing Questions for the Record
Submitted to Jonathan Foley
From Senator Thomas R. Carper

Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

Committee on Homeland Security and Governmental Affairs

"Finding Solutions to the Challenges Facing the U.S. Postal Service"
December 2, 2010

1. The bill I've introduced – S. 3831, the Postal Operations Sustainment and Transformation (POST) Act – would recalculate the Postal Service's Civil Service Retirement System (CSRS) to account for a new formula for dividing responsibility for former Post Office Department employees' pension costs using a methodology based on recommendations by the Postal Regulatory Commission and the Postal Service's Office of Inspector General. It was our intention in drafting the Postal Accountability and Enhancement Act (PAEA) that the Office of Personnel Management (OPM) be empowered to make these kinds of changes on its own without congressional action. I know that OPM does not believe it has the appropriate authority to make the changes the POST Act envisions. Can you explain why you believe OPM doesn't have the authority we intended it to have? How can we change the relevant language in the PAEA so that OPM has the authority to make the kind of changes called for in the POST Act?

We believe that the implication that OPM has the discretion to make basic changes in the allocation method between the Postal Service and the Treasury goes beyond the intent of, and the authority provided to OPM in the 2006 Postal Accountability and Enhancement Act. That law included a provision, section 802(c), allowing the Postal Service to appeal to OPM its annual determination of the Postal Service CSRS supplemental liability under 5 U.S.C. 8348(h)(1).

Section 802(c) provides in pertinent part:

> (A) Request for review.--Notwithstanding any other provision of this section (including any amendment made by this section), any determination or redetermination made by the Office of Personnel Management under this section (including any amendment made by this section) shall, upon request of the United States Postal Service, be subject to a review by the Postal Regulatory Commission under this subsection.

Our view is that section 802(c) is intended to permit review of specific calculations made by OPM of the annual and ongoing supplemental liability determination according to the established Fund allocation methodology. There is no mention in that section of a review

of the prior year determinations or the methodology of apportioning Postal obligations between it and the Treasury.

To recap, in 2003, Congress directed OPM to make changes to the accounting of Postal Service CSRS obligations that led to a $78 billion decrease in future Postal CSRS funding payments. Then in 2006, Congress directed OPM to change how military service costs should be allocated under CSRS that led to a $28 billon adjustment. In both cases, the magnitude of the adjustment was understood by Congress when the laws were passed. It appears to OPM that when Congress intends to make adjustments of this magnitude, it does so by taking specific legislative action.

After careful review by counsel, we have concluded that OPM does not have the authority to make a reallocation in the manner suggested in the Segal report. However, if Congress determines that another methodology is more appropriate, OPM will of course comply with any changes in the current law.

If Congress chooses to assign to OPM the delegated authority to reallocate obligations of this magnitude, authorizing language should explicitly authorize OPM to make the reallocation and specify in detail the standards that OPM should apply in making the determination. A failure to do so could result in a future redetermination under different standards that would transfer the financial obligation back to the Postal Service.

2. Does OPM or the administration have views on the CSRS language included in the POST Act? Are there any technical or substantive changes you would recommend?

OPM offers the following technical comments on the bill:

Because not all necessary data is available by March 31, we suggest that the date in section 8348(h)(2)(B) be changed to June 30, which will still give the Postal Board of Governors three months for consideration prior to the funds transfer date. A June 30 deadline would also be consistent with the OPM reporting deadline for Postal FEHB liabilities under 5 USC 8909a.

With regard to Section 2(a)(1)(B(iii) of the bill, there should be a deadline by which the Postal Board of Governors must notify OPM of the transfer amount. This bill gives USPS the authority to use CSRS surplus to offset statutory retiree FEHB payments, which are due on Sept 30. Thus, the USPS Board of Governors should be required to notify OPM prior to Sept 30 of the amount of surplus they recommend to have transferred.

With regard to Section 2(a)(2) of the bill, those provisions are generally, but not completely, consistent with the Segal concept. However, they are drafted as if OPM has data available to track the full career path for each individual Postal annuitant from July 1, 1971, forward. OPM does not have data available to employ such an approach. Accordingly, in order to be consistent with the PRC-Segal recommendation, those

provisions should be drafted to provide that in determining the Postal Service liability, the amount shall be prorated to reflect only that portion of total service which is attributable to civilian service performed by the current or former postal employee after June 30, 1971, as estimated by the Office of Personnel Management

The Segal report recommended that Treasury be responsible for CSRS costs associated with pre-1971 Post Office service, including the effect of all future salary increases on the value of the annuity. This new provision takes that approach one step further in that it would require that OPM look at each Postal employee to determine whether they had pre-Postal Government employment at any time prior to retirement, whether before or after 1971. This would require an employee-by-employee analysis of individual work history for anyone retiring after June 1971, which is not possible.

Under both our current allocation method and the Segal method, USPS funds the liability related to all post-1971 civilian service of each employee retiring from the Postal Service, and the federal government funds the liability for all other CSRS costs. For employees transferring during their career between non-Postal and Postal agencies, their final agency is the party responsible for the liability. This reciprocal treatment implicitly assumes that the frequency of employees moving one direction or the other is relatively equally balanced. We have no reason to know otherwise. Our annuity roll data captures only the agency from which the employee retired. OPM does not currently have data that would allow us to track a retiree's career progression between agencies.

Moreover, the bill's 8348(d)(4)(B) provisions contain no reciprocal requirement that the Postal Service fully fund the CSRS cost of USPS service for any employee who later transferred to a non-Postal federal position. The Treasury would be responsible for full funding of any transferred service, both in the case of an employee transferring to, but also from, the Postal Service. Accordingly, the 8348(d)(4)(B) provisions should be deleted.

3. Senator Collins has introduced legislation – S. 4000, the U.S. Postal Service Improvements Act – that requires OPM to make a CSRS recalculation similar to that called for in the POST Act. However, her bill requires that the recalculation be made using authority granted to OPM in the PAEA. Do you think that the language in S. 4000 would give OPM sufficient authority to make the recalculation that Senator Collins envisions?

In the view of OPM, S. 4000 of the 111th Congress would neither permit nor require it to reallocate the obligation in the manner envisioned by Sen. Collins. We believe that the implication that OPM has the discretion to make basic changes in the allocation method between the Postal Service and the Treasury goes beyond the intent of, and the authority provided to OPM in, the 2006 Postal Accountability and Enhancement Act. That law included a provision, section 802(c), allowing the Postal Service to appeal to OPM its annual determination of the Postal Service CSRS supplemental liability under 5 U.S.C. 8348(h)(1).

Our consistently stated view has been that section 802(c) is intended to permit review of specific calculations made by OPM of the annual supplemental liability determination according to the established Fund allocation methodology. The Segal report is something entirely different: a review of which methodology should be employed generally in evaluating one aspect of Postal Service CSRS obligations. After careful review by counsel, we concluded that section 802(c) does not give OPM the authority to make a reallocation in the manner suggested in the Segal report. Accordingly, a directive to make a redetermination "in accordance with section 302(c)(2)," does not give OPM authority to reallocate $50 billion in obligations from the Postal Service to the U.S. Treasury.

Post-Hearing Questions for the Record
Submitted to Jonathan Foley
From Senator John McCain

Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security

Committee on Homeland Security and Governmental Affairs

"Finding Solutions to the Challenges Facing the U.S. Postal Service"
December 2, 2010

1. In the Postal Regulatory Commission's written testimony, Ruth Goldway commented that, last year, the PRC, the Office of Personnel Management, and the Postal Service Inspector General forecasted the Postal Service retiree health benefit trust fund liability differently. OPM projected a liability in 2016 of $147.9 billion. The USPS IG came out with a projection of $90.5 billion, while PRC projected a liability of $113.2 billion. Please comment on OPM's approach versus the PRC and Postal Inspector General's calculations, and whether or not you disagree with Ms. Goldway?

There is substantial confusion in this area because the Postal Regulatory Commission's (PRC) cited $147.9 billion estimate in its report was in fact not computed by the Office of Personnel Management. (See attached PRC Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General, July 30, 2009). OPM has not issued an estimated Postal Service retiree health benefit trust fund liability for the end of 2016. This is explained by examining current law requirements. The amount of Postal retiree FEHB pre-funding payments through 2016 are not dependent on OPM calculations but are fixed by law. Current law was not designed to target a certain funded percentage by close of 2016, but was rather designed for budget neutrality through that period to offset changes to Postal

pension funding payments under the 2006 Postal Act. However, beginning in 2017, the law will target 100% pre-funding of Postal retiree FEHB liabilities and the Postal Service will be required to make payments based on liability determinations that OPM will compute at that time. Such computations must take into consideration many factors, including growth in health care costs and the assumed rate of return used for discounting.

In its July 30, 2009 report, PRC analyzed the approaches used by the U.S. Postal Service Office of the Inspector General (OIG) and OPM to calculate the present value of the Postal Service's obligations related to the Postal Service Retiree Health Benefit Fund. PRC contracted with Mercer Health and Benefits LLC (Mercer) for actuarial assistance on the determination of projected Postal retiree health liabilities.

PRC appears to have extrapolated the $147.9 billion figure from an OPM estimate of 2008 liabilities and incorrectly attributes this extrapolated figure to a calculation made by OPM. Specifically, the PRC appears to have taken OPM's liability estimate of $86.082 billion (as of September 30, 2008), and applied a 7% health care trend resulting in an increased liability estimate of $147.906 billion as of September 30, 2016. This is not an approach taken or approved by OPM and the values used were not OPM values. In addition, the method used is inconsistent in that PRC factored in a larger population compared to the population used in the OIG estimate. OPM is unable to perform a more detailed review of PRC's method used at this time as we do not have access to the Hay valuation program or the population upon which they performed the estimates.

Additionally, PRC appears to have derived its $113.2 billion estimate cited in your question by modifying the Mercer health care trend assumption, resulting in a downward revision of Mercer's original liability estimate of $123.1 billion.

2. The most significant sections of the legislative proposals discussed during the hearing dealt with using the Postal Service's pension overpayment to pay down its retiree health benefit prefunding obligation. As GAO mentioned, however, in its testimony at the hearing, "such an increase could impact the federal budget deficit and require funding over time."

a. How would these legislative proposals impact the federal deficit?

b. What can and should be done to mitigate this consequence?

OPM is not the authority on the budgetary effect of legislation, and we defer to the expertise of OMB and CBO for such matters. However, we do note that the change in pension cost allocation policy (inaccurately described by some parties as an "overfunding") would result in an increase of at least $50 billion in the present value of future Treasury obligations for the Civil Service Retirement System (CSRS), as estimated by PRC's consulting actuaries.

United States Government Accountability Office
Washington, DC 20548

January 20, 2011

The Honorable Thomas R. Carper
Chairman
Subcommittee on Federal Financial
Management, Government Information,
Federal Services, and International Security
Committee on Homeland Security
and Governmental Affairs
United States Senate

Subject: *Responses to Questions for the Record; December 2, 2010 Hearing on "Finding Solutions to the Challenges Facing the U.S. Postal Service"*

Dear Mr. Chairman:

This letter responds to your December 21, 2010, request that we address questions submitted for the record related to the December 2, 2010 hearing entitled, *Finding Solutions to the Challenges Facing the U.S. Postal Service*. Our answers to these questions are enclosed and are based on our previous work, updates to that work, and our knowledge of the areas addressed. Our previous work was conducted in accordance with GAO's quality assurance framework for assuring compliance with generally accepted government auditing standards. Because our responses are based in large part on previously issued products for which we sought and incorporated agency comments, we did not seek agency comments on our responses to these questions.

If you have any questions or would like to discuss our responses, please contact me at (202) 512-2834 or herrp@gao.gov.

Sincerely yours,

Phillip Herr
Director, Physical Infrastructure Issues

Enclosure
cc: Senator John McCain

Enclosure

Responses to Post-Hearing Questions for the Record
Finding Solutions to the Challenges Facing the U.S. Postal Service
December 2, 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 John McCain

1) **In your testimony, you point out that the Postal Service "expects revenue to stagnate in the next decade as continued declines in mail volume are offset by rate increases." Do you believe that the Postal Service's plans for cost reductions are flexible and aggressive enough to make up for the lost revenue resulting from future declines in mail volume?**

No. According to the Postal Service's plans for cost reductions over the next decade, the Postal Service would not close the gap between its projected costs and revenues in 2020. Although we have not assessed the cost and revenue projections or estimated savings included in the Postal Service's March 2010 Action Plan, the Plan states that even if the Postal Service achieved all the savings in its Plan that are within the Postal Service's control, its losses would continue to grow, with considerable risk that the projected losses could be far greater if volumes decline more than projected. As we testified in December 2010, congressional decisions are needed to help the Postal Service undertake needed reforms.[1] Further, including incentives and oversight mechanisms would make an important contribution to assuring an appropriate balance between providing the Postal Service with more flexibility and assuring sufficient transparency, oversight and accountability.

2) **GAO's testimony points out that the Postal Service's financial outlook is poor for fiscal year 2011 and the foreseeable future. In fact, the Postal Service's own projections for fiscal year 2011 forecast almost a billion dollars in operating losses before either the retiree health benefit prepayment or workers compensation are accounted for.**

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[1]GAO, *U.S. Postal Service: Legislation Needed to Address Key Challenges*, GAO-11-244T (Washington, D.C.: Dec. 2, 2010).

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a) Are you confident that the Postal Service is on the road to profitability at some point in the near future?
i) If not, why not?
ii) If so, what will be the key factors towards attaining this objective?

No. According to the Postal Service, revenues from its operations will not be sufficient to cover projected costs and achieve profitability in the near future. The Postal Service cannot fund its current level of service (delivery to about 151 million addresses) and operations (about 584,000 career employees and 88,000 noncareer employees, 528 processing facilities, and 32,528 retail and delivery facilities) from its current revenues and urgently needs to restructure its operations, networks, and workforce to reflect changes in mail volume, revenue, and use of the mail.

In our April 2010 report, we stated that the Postal Service's business model is not viable because the Postal Service is unable to reduce costs sufficiently in response to continuing declines in mail volume and revenue.[2] Our report includes selected strategies and options for action by Congress and the Postal Service to address the Postal Service's financial viability. In December 2010 we testified that Congress and the Postal Service urgently need to reach agreement on a package of actions to restore the Postal Service's financial viability and enable it to begin to make necessary changes.[3]

b) **Based on a review of the Postal Service's and your own analysis, how far into the future would this happen?**

Until Congress and the Postal Service reach agreement on a package of actions and begin necessary changes, it is uncertain how far in the future it may be before, or whether, the Postal Service can achieve financial viability. We have testified that as use of First-Class Mail—the Postal Service's most profitable core product—continues to decline, the Postal Service must modernize and restructure to become more efficient, control costs, keep rates affordable, and meet changing customer needs. To do so, the Postal Service needs to become much leaner and more flexible. Key challenges include: changing use of the mail; compensation and benefit costs that are about 80 percent of total costs; and difficulties realigning networks to remove costly excess capacity and improve efficiency. Action is needed as some changes, such as rightsizing networks, will take time to implement and produce results.

3) **With respect to 5-day delivery, the mailing community is impacted differently than mail recipients. In answering a question for the record from our April hearing on this issue, Mr. Potter said that "mailers have**

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[2]GAO, *U. S. Postal Service: Strategies and Options to Facilitate Progress Toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010).
[3]GAO-11-244T.

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not told us the cost of making the changes to their operations of implementing five-day delivery."

a) **Does GAO have any insight or analysis into the potential cost to the mailing community to adjust their business operations to a 5-day delivery schedule?**

We surveyed mailer associations in the summer of 2010 as part of our review of the Postal Service's 5-day delivery proposal. From the responses we received, we found that the mailing community was divided over the merits of 5-day delivery and had diverse perspectives on how it would affect mail volume and members' finances. About half of the mailer associations we surveyed took no position on the proposal, with some explaining that their members had differing views on 5-day delivery. Given the broad diversity within the mailing community, including differences in the sizes of companies and types of mail sent, it would be very difficult to draw any conclusions about the potential cost of a change to 5-day delivery to the mailing community.

b) **Considering the dependence of so many businesses on Saturday delivery, do you think this is a legitimate issue to be explored before a decision on 5-day delivery is finalized?**

We believe that the effects of eliminating the Postal Service's delivery on Saturdays, including the effect on businesses, have been explored. The Postal Regulatory Commission explored this issue through several channels in its ongoing review of the Postal Service's 5-day delivery proposal including seven public, on-the-record hearings; thousands of public comments; and testimony and input on the proposal by mail users and interested members of the public. The Postal Regulatory Commission is expected to issue its advisory opinion on the Postal Service's 5-day delivery proposal in early 2011. In addition, the House and Senate postal oversight subcommittees held a joint hearing in 2010 in which this issue was discussed by a number of representatives from mailer associations and businesses.

4) **The most significant sections of the legislative proposals discussed during December's hearing dealt with using the Postal Service's pension overpayment to pay down its retiree health benefit prefunding obligation. However, as you mentioned in your testimony, "such an increase could impact the federal budget deficit and require funding over time."**

a) **How would these legislative proposals impact the federal deficit?**

We testified that S. 3831 would require the Office of Personnel Management to recalculate the Postal Service's Civil Service Retirement System (CSRS) pension obligation in a way expected to make the federal government responsible for a greater share of that obligation.[4] Such an increase in the government's pension obligation could impact the federal budget deficit. This view is consistent with a recent assessment by the Congressional Research Service that a reduction in the

[4]GAO-11-244T.

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proportion of CSRS pension expenses allocated to the Postal Service would increase the unfunded liability of the Civil Service Retirement and Disability Fund.[5] A reduction in the amount of CSRS pension expenses allocated to the Postal Service and borne by ratepayers would result in an equal increase in CSRS pension expenses to be borne by taxpayers. However, we have not assessed the impact of specific proposals as we defer to the role and expertise of the Congressional Budget Office in this area.

b) What can and should be done to mitigate this consequence?

In our April 2010 report, we discussed other approaches that Congress could consider, including extending and revising prefunding payments to the Postal Service Retiree Health Benefits Fund, with smaller payment amounts in the short term followed by larger amounts later.[6] Deferring some prefunding of these benefits would provide short-term fiscal relief. However, deferrals also increase the risk that the Postal Service will not be able to make future benefit payments if its core business declines and might ultimately have an impact on the federal budget deficit if Congress was later required to take action to fund these benefits. Therefore, it is important that the Postal Service fund its retiree health benefit obligations—including prefunding these obligations—to the maximum extent that its finances permit. Furthermore, Congress could revisit other aspects of the postal compensation and benefits framework. The Postal Service has options to reduce its compensation and benefits costs in the following four key areas: (1) workforce size, to be aligned with reduced workload; (2) wages, which continue to be a key component of costs; (3) benefits, which in some cases are more generous than those provided by other federal agencies; and (4) workforce flexibility, including the mix of full- and part-time employees and work rules that govern what tasks employees can perform.

5) In your written testimony, you stated that "the Congressional Budget Office has raised concerns about how aggressive the Postal Service's cost-cutting measures would be if prefunding payments for retiree health care were reduced." Both Senator Carper's and Senator Collins' legislative proposals provide a process for the pension overpayment to cover the annual retiree health benefit prefunding payment.

a) What effect do you think this would have on the Postal Service's initiative to continue needed structural reforms in the future?

We have stated that resolving the Postal Service's funding requirements for pension and retiree health benefits is important and that it is equally important for Congress to address constraints and legal restrictions, such as those related to closing facilities, so that the Postal Service can take more aggressive action to reduce costs.[7] We have also noted that restructuring the Postal Service's mail processing and retail networks will be crucial for it to achieve sustainable cost

[5]Congressional Research Service, *The U.S. Postal Service's Financial Condition: Overview and Issues for Congress*, R41024 (Washington, D.C.: Jan. 7, 2011).
[6]GAO-10-455.
[7]GAO-11-244T.

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reductions and productivity improvements. The Postal Service has not specified how it would make structural reforms to its processing and retail networks, which would be helpful to inform the Congress and other stakeholders about its expected progress in this area should other financial relief be provided.

Incentives and oversight mechanisms will be important to ensure that the Postal Service takes appropriate actions. We testified in December 2010 that congressional actions should consider what incentive and oversight mechanisms are needed to assure an appropriate balance between providing the Postal Service with more flexibility and assuring sufficient transparency, oversight and accountability.[8]

b) What impact would this have on the Postal Service's ability to seek concessions over enhanced workforce flexibility and cost reductions in the future labor contract negotiations?

This is another area where, to better inform its discussions with its unions and other employees, it would be helpful for the Postal Service to provide more information about what it expects to do and what level of cost savings it hopes to achieve. Without such clarification, it is difficult to determine what changes the Postal Service will need from its workforce to achieve its cost reduction goals.

[8]GAO-11-244T.

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Statement of Mark Strong
President of the National League of Postmasters

On
S. 3831 The Postal Operations Sustainment and Transformation Act of 2010

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

December 2, 2010

Statement of Mark Strong,
President of the National League of Postmasters
December 2, 2010

Chairman Carper, ranking member McCain, thank you for inviting The National League of Postmasters to submit this Statement today to your Subcommittee for the record of your hearing on S. 3831, the Postal Operations Sustainment and Transformation Act of 2010 ("POST Act of 2010"). Founded in the later part of the 19th Century, The National League of Postmasters is a national trade association representing Postmasters throughout the country. We have a particular concern with small rural post offices and postmasters.

My name is Mark Strong and I am President of the National League of Postmasters. While I have served in many small post offices and other facilities throughout the Western part of the United States, I currently am a Level 24 Postmaster in Sun City Arizona, which is a rather large Post Office. We service not only Sun City, but Sun City West, Dysart and Surprise Arizona. My post offices serve just shy of 110,000 homes and 300 postal employees report to me.

The League very much appreciates the Subcommittee's interest in this matter and commends the Subcommittee for its attention to fixing the vexing problem of applying the Postal Service's pension overpayment to its retiree health benefits.

The League has submitted testimony before this subcommittee and its sister subcommittee on the House side several times in the last two years. These pieces of testimony emphasized that post offices are not mere retail facilities but rather facilities out of which the final delivery of mail is made throughout the country. Consequently, one cannot close down the delivery functions of a post office without significantly modifying and expanding the delivery system, unless you want to create chaos in the delivery system. Many critics don't take this into

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account when they talk about how many post offices there are and push for closing post offices in order to realize cost savings.

In terms of cost savings, those pieces of testimony further pointed out, as does an Op Ed piece that I authored in the current issue of *Federal Times,* that very few post offices "make a profit" because the Postal Service's cost accounting system does not credit delivery post offices with any of the revenue that has been paid by national mailers to deliver their mail in that area. Without any such revenue credit, they lose money. Indeed, as the Postal Service has told the PRC, ninety two percent of Post Offices lose money. How can they not lose money when they bear the costs, but get no credit, for the revenue? Since these points have been made several times before in our prior testimony, I will not re-plow these matters in the rest of this statement but rather focus on S. 3831.

I. Post Offices and The Maximum Degree of Effective and Regular Postal Services

In terms of post offices, S. 3831 makes several changes. First, it eliminates the requirement in the postal policy section of the Act that requires the Postal Service to provide "a maximum degree of effective and regular postal services in rural areas, communities and small towns where post offices are not self-sustaining" 39 U.S.C. §101. It replaces that duty with a much lower standard to provide mere "effective" postal services. Anytime a standard is lowered, and an institution is told that it no longer has to provide the "best services it can provide" and that merely "effective" services will suffice, the result is going to be reduced service. This is particularly true when an institution is under financial stress. While this may not be the intent of this provision in the bill, this is what the consequences of this provision would be. The League very strongly opposes this provision.

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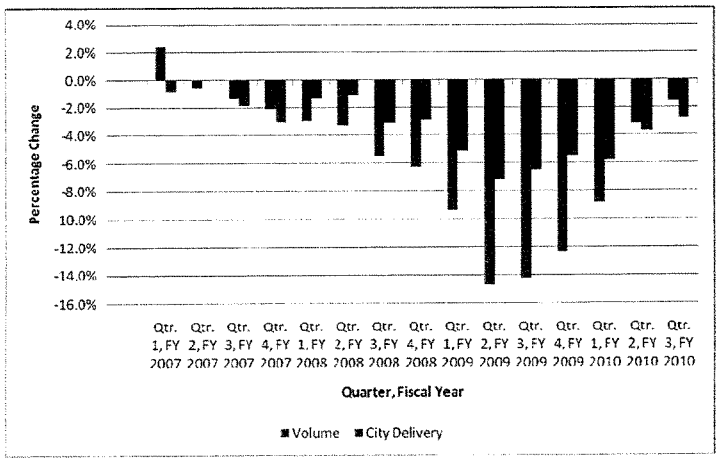
While the Postal Service obviously is under stress, the answer is not to lower the quality of services provided to rural America but to all work together to struggle through these difficult times until the economy reaches robust levels again. In this regard, there is evidence that postal volumes are coming back. As the Postal Regulatory Commission found in its September 30, 2010 Order Denying the Postal Service's Request for an Exigent Rate Increase (Order 547), postal volumes bottomed out in the second quarter of 2009 and have been steadily coming back ever since. This is graphically illustrated in Figure 3 of the PRC's Order, which is reproduced below.

Figure 3
Change in Volume and City Delivery Workhours by Quarter
FY 2007 – Quarter 3, FY 2010



Source: USPS Form 10-K Quarterly Financial Statements
Quarter 1, FY 2007 – Quarter 3, FY 2010

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As this figure shows, volumes are returning. While there is no question that volumes are still in a net decline, the trend on the chart is clear and there is absolutely no reason to think that this positive trend will not continue and that volumes will not turn positive and begin to regain lost ground in the next several quarters.

II. The Standard for Closing Small Rural Post Offices

Due to the critical role that rural post offices play in small towns, as documented in studies discussed below, current law requires the Postal Service, when it is considering closing a rural post office, to give notice to the community served by the post office, listen to the community and take its needs into account in its decision-making process. That policy is embodied in a balancing test in Section 404 of Title 39 that the Postal Service must employ in closing a post office. S. 3831 weakens this test by changing Section 404 and relegating the needs and effects on the community served by the post office to an inferior position in this test and elevating the Postal Service's concerns to a primary position. Such a skewed test follows much in the same line as the change to Section 101 where the message is clearly sent to the Postal Service that lowering service to rural America is acceptable. The League strongly opposes this provision.

As the League has noted countless times, small rural post offices are an integral part and parcel of the system that binds rural America together. Closing a significant number of these post offices would do serious harm to our rural infrastructure and our rural economy. Moreover, the cost of these post offices is less than 7/10 of one percent of the Postal Service's total operating budget. There is a video entitled *Post Roads* that illustrates this relationship and provides real life examples. It can be viewed on the League's website, http://www.postmasters.org/news/family/#111610. We ask the subcommittee to take ten minutes to watch it.

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Whether small poor rural communities like it or not, whether they live or die is often in the hands of the Postal Service, which is why current law requires the Postal Service to take into account those needs when it considers closing a small post office. There is a cost for providing this fundamental service to rural America, but it is only 7/10 of one percent of the Postal Service's revenue. There are far too many other opportunities available to the Postal Service to gain savings before sacrificing universal service, whether be it urban or rural. That is what closing rural post offices will do. Other countries have tried, and chaos in rural areas has followed.

This is because the role that rural post offices play in rural areas has always gone far beyond the actual services provided. In many of these communities the Post Office is the only government building in town. It is the hub of the city and the postmark is the identification for the citizens that goes far beyond a place on the map. Take this away and communities often die. This is not myth but it is documented in a number of studies, including "The Social Ecology of a Rural Community" by Ruth C. Young and Olaf F. Larson. In this study the authors strongly suggest that lack of a village center, where the post office is a key element, leads to community disintegration.

In my area of Arizona, there was a study in 1969 by W. F. Cottrell titled "Death by Dieselization." In it he spoke of Jerome, Arizona, which almost died because its copper deposit and mining operations reached unprofitable levels. The fact is that while the town was close to death, it did not die because the Post Office never closed. With the identity of the town preserved, a core group of people stayed in Jerome, turned the hospital, built for the copper mine workers, into a hotel, renovated the old hotel and revitalized the area. It became a small western town to which many artisans migrated. Today, the town is once again alive and doing quite well,

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and that is because the post office did not close back then but maintained its service and gave the town a chance to heal and renew itself. In terms of Jerome, what would have happened had politicians and outside sources pulled the life support when it was in danger of dying? I believe that Jerome would not have made it.

The Subcommittee should recognize the importance of our rural communities to rural America and not condemn hundreds of them to death, which is exactly what this provision would do.

III. The Postal Service's Prefunding Obligations

S. 3831 alleviates the burden on the Postal service that has been caused by the Postal Service's prepayment obligations during this economic downturn. It does so by allowing the Postal Service to use the overpayment in its pension fund to prefund its retiree health benefits obligation. Allowing a company to use overpayments in one retirement fund to pay obligations in another retirement fund is not a radical action; it is in fact, a good business practice. The League strongly supports this provision.

It is very hard for Postmasters and customers to understand why we would be shooting ourselves in the foot by making cuts in service while in a crisis mode. The truth is that the over payment to the civil service retirement fund was not done with tax dollars. This overpayment came from funds received for the product and services provided by the USPS and its employees and from the paychecks of postal workers. No other company in America would be told they could not use this money. If Microsoft or Apple found in an audit that they had overpaid into their retirement fund, would anyone fault them for moving the surplus into a fund to prefund a retirement health benefit obligation that they might have? Of course not. Why is the Postal Service any different?

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We are not asking to put it in our bank account; we are asking to move it over to prepay our retiree health plan so that it is fully funded. If Congress agrees to this action, then we will have a much clearer picture of the future of the Post Office and what we need to do to make sure we are a viable company well into the future. To cut services before this is accomplished is not good for business, our customers or our future or the American people. The League strongly endorses these provisions of S 3831.

IV. Allowing the Postal Service to offer non-postal services

S. 3831 would allow the Postal Service to offer other non-postal services after determining that the provision of such services utilizes the processing, transportation, delivery, retail network, or technology of the Postal Service in a manner consistent with the public interest. The League strongly endorses this provision with the caveat that such services should not be offered in competition with the private sector, but in conjunction with the private sector.

Many of these services would be particularly relevant to the very small rural post office, in whose distribution area very few services are offered by the private sector, since the area is simply too sparsely populated to justify the capital investment necessary to offer these services. In this regard, the League would like once again to refer the Subcommittee to the video *Post Roads*, noted above, which shows how small rural post offices serve their community and how a post office can sell other items to help offset the costs.

V. Wine and Beer Shipping

S. 3831 also removes the current constraints on shipping wine and beer through the mail. The wine and beer industry is a major industry in this country and allows direct mail shipments of wine and beer to be delivered only by UPS or Fed Ex. This simply is not right. The League endorses these provisions in S. 3831.

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VI. Six Day Delivery

Finally, S. 3831 would remove the existing restriction on five day delivery in the law. While the League has not previously taken a position on this matter, it does seem obvious to us, after months of discussion and debate, that removing the provision would be an unacceptable degradation of service and could ultimately lead to revenue losses greater than any cost savings. One of our major concerns is Priority Mail. Priority mail is a growing product line for the Postal Service. Without Saturday delivery we would open the market up to other companies and reduce our ability to deliver in the normal two to three day window. A priority package taken in Phoenix, AZ on Wednesday normally would be delivered to Tampa, FL on Saturday. This piece under the current plan would not get delivered until Monday.

The plan as it is right now is to have retail service available on Saturday where it available now. The problem is the mail is not going anywhere. There is no plan to move it on Saturday. How long will we provide Saturday service before it is no longer used since it is not going anywhere? What does this do to our Priority Mail product line? We think it would seriously harm it.

We also have reservations about the plants being able to provide manageable mail flows when stopping the normal operations one day a week. We currently see this every Monday holiday and have seen no plan that would provide acceptable service with this same mail flow disruption 52 weeks a year.

Thank you for considering our views.

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