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PUSHING THE ENVELOPE: THE LOOMING CRISIS AT USPS

HEARING

BEFORE THE

SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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PUSHING THE ENVELOPE: THE LOOMING CRISIS AT USPS

WEDNESDAY, MARCH 2, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 1:33 p.m., in room 2154, Rayburn House Office Building, Hon. Dennis A. Ross (chairman of the subcommittee) presiding.

Present: Representatives Ross, Amash, Jordan, Chaffetz, Mack, Walberg, Gowdy, Lynch, Norton, Connolly, and Davis.

Also present: Representatives Issa and Cummings.

Staff present: Ali Ahmad, deputy press secretary; Robert Borden, general counsel; Molly Boyl, parliamentarian; Lawrence J. Brady, staff director; Benjamin Stroud Cole, policy advisor and investigative analyst; Howard A. Denis, senior counsel; Gwen D'Luzansky, assistant clerk; Adam P. Fromm, director of Member liaison and floor operations; Linda Good, chief clerk; Ryan Little, manager of floor operations; Justin LoFranco, press assistant; Jeffrey Post and James Robertson, professional staff members; Laura L. Rush, deputy chief clerk; Peter Warren, policy director; Kevin Corbin, minority staff assistant; Jill Crissman and William Miles, minority professional staff members; Carla Hultberg, minority chief clerk; and Mark Stephenson, minority senior policy advisor/legislative director.

Mr. ROSS. Good afternoon. I would like to welcome everybody to the inaugural subcommittee meeting of the Federal Workforce, U.S. Postal Service and Labor Policy.

I will ask the committee to come to order and, as we have done in the Oversight Committee and its subcommittees, I will start by reading our mission statement. We exist to secure two fundamental principles: first, Americans have a right to know that the money Washington takes from them is well spent; and second, Americans deserve an efficient and effective government that works for them. Our duty on the Oversight and Government Reform Committee is to protect these. Our solemn responsibility is to hold government responsible to taxpayers, because taxpayers have a right to know what they get from their government. We will work tirelessly in partnership with citizen watchdogs to deliver the facts to the American people and bring genuine reform to the Federal bureaucracy. This is the mission of the Oversight and Government Reform Committee.

I will start off. We will do opening statements from the chair, from the ranking member, then the chair of the whole committee and the ranking member of the whole committee I think may be here. We may have to adjourn for votes in the middle. If we do, I just ask for your patience. It will take about a half hour or so, and then we will be back and continue on.

With that, I will start off with my opening statement.

We are here today to discuss the looming crisis at the U.S. Postal Service. Today, the demand for traditional first class mail continues to decline. Postal Service deficits continue to rise, and competition and benefit costs continue to account for approximately 80 percent of the Postal Service's operating expenses.

The Postal Service has said it will lack the necessary funds to make a required payment to pre-fund its retiree health care benefits that is due at the end of September. The continued imbalance between revenues and expenses means the taxpayers could ultimately be asked to bail out the Postal Service.

This hearing presents an opportunity for lawmakers to hear important testimony from the front lines of the postal industry on how best to strengthen the Postal Service.

For many years the Postal Service has delivered mail 6 days a week to virtually every home in America, including over 170 billion pieces of mail in 2010 alone. But the Postal Service suffered from an operating deficit of $8½ billion in 2010 and projects further losses into the future.

The ever-increasing reach of the Internet and digital media, and the deep economic recession are the primary drivers of a rapid recent decline in mail volume. It is now clear that the need for work force reductions and other cost-cutting measures must be the primary focus of the Postal Service, its labor unions, and this Congress in order to improve the financial stability of this venerable institution.

Everyone that has a stake in the viability of the Postal Service must work together to find solutions. Postmaster General Patrick Donahoe recently outlined the Postal Service vision for a return to profitability. I commend you, sir, on that report and your commitment to reducing costs by undertaking major organizational restructuring, reviewing how best to provide retail postal services and implementing automation to improve delivery efficiency.

Today, the Postal Service is negotiating labor contracts with two union groups representing postal employees. While some postal employee unions have cooperated on efforts to reduce the work force through attrition and incentives for early retirement, those efforts simply have not resulted in the changes necessary to maintain a self-funding Postal Service. Realigning the postal work force by reexamining labor agreements must be part of the strategy to improve the Postal Service fiscal foundation.

Congress has an obligation to make statutory changes, if necessary, which will allow the Postal Service to address its own budget imbalance. We need to empower you. However, proposals for providing short-term fiscal relief, such as modifying retiree health benefits, pre-funding payments, or refunding so-called overpayments over the Civil Service Retirement System and the Federal Employee Retirement System do not address the long-term systemic

problem and solvency issues that must be tackled in order to address the Postal Service will achieve long-term financial stability.

Without a thorough reform of all aspects of the Postal Service's business model, there could be little hope that it will return to profitability in the near- or long-term future. The looming fiscal crisis of the Postal Service can no longer be ignored; we have kicked that can far enough. I have the responsibility, no, we have the responsibility to change course and must consider all possible solutions.

I thank the witnesses for appearing here today and I look forward to their testimony.

I now would like to recognize the distinguished ranking member from Massachusetts, Congressman Lynch, for his opening statement.

[The prepared statement of Hon. Dennis A. Ross follows:]

Ross opening Statement

We are here today to discuss the looming crisis at the United States Postal Service.

Today, the demand for traditional First-Class mail continues to decline, Postal Service deficits continue to rise, and compensation and benefit costs continue to account for approximately 80% of the Postal Service's operating expenses. The Postal Service has said it will lack the necessary funds to make a required payment to prefund its retiree health care benefits that is due at the end of September. A continued imbalance between revenues and expenses means that taxpayers could ultimately be asked to bail out the Postal Service.

This hearing presents an opportunity for lawmakers to hear important testimony from the front lines of the postal industry on how best to strengthen the Postal Service.

For many years, the United States Postal Service has delivered mail – six days a week – to virtually every home in America, delivering over 170 Billion pieces of mail in 2010 alone. Yet, at the same time, the Postal Service suffered an operating deficit of $8.5 Billion in 2010, and projects further losses into the future.

The ever-increasing reach of the Internet and digital media and the deep economic recession are the primary drivers of the rapid recent decline in mail volume.

It is now clear that the need for workforce reductions and other cost-cutting measures must be the primary focus of the Postal Service, its labor unions, and this Congress, in order to improve the financial stability of the Postal Service.

Everyone that has a stake in the viability of the Postal Service must work together to find solutions. Postmaster General Patrick Donahoe recently outlined the Postal Service's vision for a return to profitability. I commend the Postmaster General for his commitment to reducing costs by undertaking major organizational restructuring, reviewing how best to provide retail postal services and implementing automation to improve delivery efficiency.

Today, the Postal Service is in negotiations with labor contracts with 2 union groups representing postal employees. While some postal employee unions have cooperated on efforts to reduce the work force through attrition and incentives for early retirement, those efforts simply have not resulted in the changes necessary to maintain a truly self-funding Postal Service. Realigning the Postal workforce by examining labor agreements must be part of the strategy to improve the Postal Service's fiscal foundation.

Congress has an obligation to make statutory changes, if necessary, which will allow the Postal Service to address its budget imbalance. However, proposals for providing short-term fiscal relief, such as modifying retiree health benefits prefunding payments or refunding the so-called overpayment of the Civil Service Retirement System and the Federal Employees Retirement System, do not address the longer-term solvency issues that must be tackled in order to ensure the Postal Service will achieve long term financial stability. Without a thorough reform of all aspects of the Postal Service's business model,

there can be little hope that it will return to profitability in the near or long term. The looming fiscal crisis of the Postal Service can no longer be ignored. We have a responsibility to change course and must consider all possible solutions.

I thank the witnesses for appearing here today and I look forward to their testimony.

Mr. LYNCH. Thank you, Mr. Chairman. Let me begin by congratulating you, Chairman Ross, on your selection as the chairman of this important subcommittee, and I want to thank you for holding today's hearing, which shows your keen awareness of the critical state of affairs currently confronting the U.S. Postal Service.

While we have recently seen a moderate uptick in the economy and there are some indicators that suggest that standard mail or advertising mail is rebounding, our Nation's most trusted and prominent public institution continues to fall upon very difficult times. It is no secret that as more Americans use the Internet and email to conduct business and communicate, the less they use hard copy mail.

Yet, even in light of declining mail volume, I am sure there are scores of people that would agree with me that there is still great value in the traditional mail system. The Postal Service generated over $67 billion in annual revenue in fiscal year 2010 and employed roughly 58,000 workers in the delivery of 170.6 billion pieces of mail to some 150 million residences, businesses, and post boxes 6 days a week. Overall, the Postal Service is the cornerstone of a trillion dollar industry and supports over 7½ million private sector American jobs, which highlights the vital role that the Postal Service plays in our overall economy.

Given the extraordinary financial challenges the Postal Service presently faces, it is absolutely necessary, and I agree, that we collectively, and by collectively I am referring to postal management, workers, mailers, as well as the administration and this Congress, come to the realization that there will have to be some difficult decisions made rather quickly in order to address the Postal Service's current financial situation.

However, before we tackle issues such as changing delivery frequency and cutting services, laying off hardworking Americans, there are certainly some more palatable actions we should consider first. For example, we need to revisit the Postal Service's arbitrary and fixed retiree health benefit payment schedule, which prevents the organization from accounting for the dramatic shifts in demand of work force size that it has experienced in recent years. Simply requiring the Postal Service to tackle the obligations at such an aggressive pace is unheard of in the private sector and continues to be a driving force behind the Postal Service's dismal fiscal performance.

Additionally, questions continue to remain regarding both the Postal Service's actual Civil Service Retirement System and its Federal Employee Retirement System obligations. For this reason, I intend to reintroduce legislation in the coming days similar to what I offered last Congress on these issues, as well as on a couple of other substantive postal-related policy matters. However, in the meantime, I expect the Postal Service to continue to use its existing authorities to lower expenditures, raise revenues, and put forth fresh innovation in terms of both its competitive and its market dominant products and services.

Further, the Government Accountability Office has recently competed work on a report that I had requested last Congress on the modernization of foreign posts and lessons learned, which I hope

will also provide some useful information and novel ideas as we work on the Postal Service's long-term viability.

Mr. Chairman, I look forward to hearing from today's witnesses about their tangible and pragmatic suggestions or solutions for how best to return the Postal Service to financial solvency. After 4 years of operating deficits amounting to a cumulative loss in its 4 years of $20 billion and a nearly tapped out borrowing authority, we can no longer afford to kick this can down the road on this issue. Again, I thank you for holding this hearing and I again congratulate you on your chairmanship, and I look forward to hearing from our witnesses and I yield back the balance of my time.

Mr. ROSS. Thank you, Mr. Lynch, and I too look forward to working with you in this regard.

Now I would like to recognize the distinguished gentleman from California, Chairman of the Oversight and Government Reform Committee, Mr. Issa.

Mr. ISSA. Thank you, Chairman. Thank you for holding this important hearing.

Above all else, the Government Oversight and Reform Committee is in fact the legacy committee of the Postal Committee. We take that seriously, that it is a primary piece of legislative authority and responsibility.

Since 1970, this committee has overseen an independent agency responsible for its own balance sheet and profitability. There have been good years and bad years in that time, but no decade has been harder on the Post Office than the last decade. There has been a 20 percent drop in postal volume over that period. The Post Office has lost $20 billion, going from having a relatively handsome surplus to being up against its borrowing limit.

We are here today to begin a process with the postmaster and other stakeholders in finding a way to maintain certain prerequisites that this committee and the American people have counted on for over 200 years. First of all, the delivery of mail to every point in America. Second of all, the delivery of a level of service that Americans have come to expect. If at all possible, we want that to include all categories of mail, all types, and all delivery dates, meaning 6 days a week is a goal if we can achieve it.

We also have an obligation to the American people to deliver value. The cost of mail is a cost to American commerce and to the American people, so every time there is an increase in postal rates, it is to the detriment of American efficiency and disposable income to the American people.

Last, and most importantly, this committee is dedicated to sustainability. The Post Office is not an organization you can have 1 day, not have the next, and put back up again. It has been there since our founding. It is a mandate of Congress, in my opinion, since our founding, and it is memorialized in the Constitution. No Congress has ever suggested that we don't need a Post Office, and this will not ever be one in this committee.

Postmaster general, I appreciate the fact that you have come in and re-looked anew at your predecessor's initial ideas, and I have seen some innovative and, I think, very worthwhile suggestions you have made, and some of them are tough. As we were talking before we came out here, the good news is there are at least two post of-

fices that need to be closed in every congressional district in America. Let's hope there is not one or three in mine. [Laughter.]

I want to commend the Post Office legacy of finding ways to pare down over 200,000 positions through attrition and buyouts. I might note, though, that today there are examples the American people, if aware of, would be surprised. There are over 15,000 postal workers 65 years old who are on disability and not expected to return, and yet they are paid a full salary. That is an area that we expect will be addressed during our negotiations.

It is an area in which we want to be fair to these long-working and longstanding employees, but at the same time, if you can no longer do the job and you are over 65, there is a reasonable expectation that your status will change and you will not be counted among the active members of the postal system. I think this is particularly good in union negotiations because, in fact, what we want are workers who can be productively put to work, and those who cannot we want to be fair to in any transition, whether they are over or under 65.

Mr. Chairman, I would ask unanimous consent that my Washington Times op-ed of last year be included in the record.

Mr. ROSS. No objection.

[The information referred to follows:]

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The Washington Times

September 20, 2010

ISSA: Time for another government bailout

By Rep. Darrell Issa

The declining demand for traditional mail delivery service presents a crisis for the U.S. Postal Service (USPS). A continued imbalance of costs and revenues means taxpayers could be asked to bail out the independent government agency, which is required by law to be self-funded.

As labor contract renegotiations between USPS and its employee unions commence this fall, Congress should reject requests to delay again billions of dollars in future retiree health insurance obligations that USPS is required to meet annually. The problems need to be addressed now. Postponing billions in unmet obligations won't help.

The predicament in which USPS finds itself is not uncommon. Because of the ever-increasing reach of the Internet and digital media, bookstores, record stores and DVD rental chains have all seen their customer base and profits decline dramatically. Unlike these other affected businesses, USPS cannot simply go out of business or declare bankruptcy. The need to downsize the labor force and reduce costs to reflect declining demand and new market conditions needs to be the first priority of both workers and management.

Labor costs account for 80 percent of USPS operating expenses. Yet because of union contracts that contain "no-layoff" clauses, thousands have less than a full day's work, and some are even paid to sit in empty rooms.

Last year, USPS revenues declined 9.1 percent, and without permission from Congress to delay requirements to pre-fund some worker benefit plans, the Postal Service would have lost $5.2 billion. A $7 billion loss is anticipated this year.

While postal employee unions have cooperated on efforts to reduce the work force through attrition and incentives for early retirement, those efforts simply have not resulted in the kind of change and transformation USPS needs to cover its costs. Unions have balked at the idea of changing contracts that refuse to allow necessary layoffs even if workers would be offered the opportunity to be retrained and fill other positions in the federal government.

The difficulty and uniqueness of the situation for USPS is that there is little incentive to cut costs. Under current labor agreements, if USPS and its employees have a dispute over compensation, the negotiations are sent to a binding arbitration board. Unlike almost any normal labor arbiter in a private business, this board does not have to consider the financial condition of USPS when deciding compensation questions.

Postal employees have incentives for holding tight to negotiating positions. They correctly recognize that USPS is too important to shutter. Moreover, they know that a deeply indebted Postal Service leaves the

federal government with no real alternative to a taxpayer bailout as the situation approaches insolvency. Indeed, a sheep's-clothes argument already is being put forward by the postal lobby and some Democratic lawmakers for a $75 billion taxpayer bailout of USPS.

No union has or ever will lobby for a layoff, so it's up to USPS management and Congress to demand concessions. Congress must protect the clear interests of taxpayers and postal customers and demand an agreement between labor and management that lays the foundation for a viable business plan for a truly self -funding Postal Service. Allowing USPS to postpone billions in obligations just makes a bailout easier and takes away one of the few inducements for a compromise between USPS and postal worker unions.

If compromise fails, Congress has an obligation to fix the Postal Service's budget imbalance not through a bailout, but through new mandates to cut costs and revise labor agreements.

Rep. Darrell Issa of California is the ranking Republican member of the House Committee on Oversight and Government Reform.

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Mr. ISSA. I thank you.

In closing, this is not easy. Most of government needs are growing; yours is not. Most of government has found new places in order to find authority and services; your has not and has not been offered the opportunity. This committee is willing to hear, though, about new services that create a value for the American people, opportunities for the Post Office to have further authority to find nexus in savings with other agencies or even the private sector. I believe that we can be entrepreneurial on both sides of the aisle for the betterment of the American people.

I look forward to your testimony. I appreciate all of you here testifying and the many stakeholders that are also in the audience today.

Mr. Chairman, I yield back.

[The prepared statement of Hon. Darrell E. Issa follows:]

DEI Statement

"Pushing the Envelope: The Looming Crisis at USPS"

Subcommittee on Federal Workforce, U.S. Postal Service, and Labor Policy

The United States Postal Service stands today at a historic crossroads

Throughout the Nation's history, the Postal Service – in its various forms -- has fulfilled a critical role by ensuring that every American has a physical link to every other American.

The Postal Service has operated without taxpayer subsidy since 1970, when it became an independent agency. But the Digital Age has fundamentally changed the way Americans communicate, undermining the existing business model of the Postal Service.

No one should underestimate the challenges confronting this Postmaster General. A steady decline in First Class mail -- exacerbated by the current recession -- is projected to continue even after the economy recovers.

Mail volume has dropped 20 percent over the last four years, and the Postal Service has lost more than $20 billion dollars during that time. This year, it is projected to max out its $15 billion in borrowing authority with the U.S. Treasury.

The Postal Service has reduced its workforce by 200,000 over the past decade, but it has been unable to cut costs fast enough to keep up with declining revenue. Clearly, fundamental change is needed – and fast.

I commend Chairman Ross for holding this hearing at this critical juncture, and assembling in one room representatives of so many key stakeholders in postal reform.

Those of us up on the dais also represent key stakeholders – the American public. People and businesses all over the Nation continue to rely on the Postal Service. At the same time, they do not want to be stuck with the bill for a costly bailout – particularly one that would only kick the can down the road a bit, until another huge installment payment comes due.

I want to submit for the record a *Washington Times* Op-Ed I wrote last year, about the need to avoid such a bailout.

The President's recent budget submission proposes short-term financial relief to help the Postal Service avoid insolvency in FY 2011. This includes, for instance, a reamortization of payments the Postal Service is statutorily required to make to the U.S.Treasury, in order to ensure its employee's retiree health care benefits will be funded.

One reason I am disappointed with the President's budget is that, in my view, the discussion should be centered around a wholesale restructuring of the USPS. Specifically, a restructuring that will provide for real savings and make the USPS a viable entity for the next 100 years.

The President's budget also failed to offer any concrete reform proposals. Rather, the President outlines 3 goals for reform and indicates specifics should arise from discussions with Congress. Well, we're here, and we've been here, ready to discuss potential reforms. However, how can these reform discussions take place when the Administration even rejects an invitation to testify about its own budget proposal?

What I am hoping we hear today from the Postmaster General and the other witnesses is what the Postal Service can do – and what it will do – to make necessary changes in its cost structure in order to deal with current realities and to create a future for the Postal Service in which it will continue to fulfill its mission as a self-funding entity.

If there are statutory barriers that this Congress can remove in order to expedite the necessary transformation, we want to know what they are. We have already identified several of these potential statutory obstacles, but I look forward to hearing more such recommendations from the stakeholders here today.

Mr. ROSS. Thank you, Mr. Chairman.

I would now like to recognize the gentlewoman from the District of Columbia, Congresswoman Norton, for her opening statement.

Ms. NORTON. Thank you very much, Mr. Chairman. I will be pleased to be working with you as a member of the committee, and I am particularly pleased to welcome our new postmaster, Postmaster Donahoe.

Mr. Chairman, it was interesting to hear you, I know you read this, the mission, and that mission applies most of the time, but it was really interesting to hear you say that you wanted to make sure that the money that comes from Washington is well spent. Well, of course, the Post Office hasn't gotten any money from Washington for decades now, and won't get any. Indeed, we told the Post Office that it should run like a business, but the problem is that they report right here to the Congress, and they have never been given the kinds of latitude that a business indeed has, and probably doesn't feel that it could do what a business could do.

For example, let's take something that under Chairman Lynch we discussed over and over again, and that was whether or not to reduce the 6-day week to a 5-day. Now, that would cause some hardship in some parts of the country, of course. Of course, if it is a private business, they have to take that into account and do what they have to do. I know in large parts of the country people, according to the polls, no longer say that they need a 6-day delivery and appear to be ready to give that up. We haven't even discussed whether or not, OK, at least for the parts of the country that are willing, that don't need it, which looks like most of the country, why not at least then have a 5-day work week.

What is really frustrating to me as a member of this committee is that the steps, even the baby steps, which wouldn't solve the problem, seem to be very difficult to take, and the case of the 6-day work week is difficult to take for no reason except one reason, and that is the Members of the Congress of the United States. No business would have to bother with that.

I will be very interested in this testimony and what you expect to be doing, Postmaster Donahoe, because this notion of a looming crisis, which is what this hearing is called, is also an interesting title. Ever since I have been on this committee, and I have been here since I have been a Member of Congress, it has been a looming crisis. I am not sure what we are waiting for. If the Post Office truly collapses, you will have people rushing to the floor to say let's pick up the Post Office one way or the other; I can't go home and tell people that there is going to be no postal delivery. I don't know whether excess payments to the trust funds, even if used for operational purposes, and we know that is very unlikely to occur, would be anything but a stopgap measure. I have always felt that somehow one has to pull back altogether and redesign entirely what we mean by Postal Service of the United States of America.

Thank you very much, Mr. Chairman.

Mr. ROSS. Thank you very much.

Congressman Connolly.

Mr. CONNOLLY. Thank you, Mr. Chairman. And I also want to welcome you as chairman of the committee.

Mr. ROSS. Thank you.

Mr. CONNOLLY. I would ask at this point unanimous consent to insert in the record my opening statement describing a new business model legislation I will be introducing in this Congress, an excerpt from the April 15, 2010 hearings we had last year, and a copy of the testimony of the National Rural Letter Carriers Association.

Mr. ROSS. Well, without objection, it is so ordered.

[The prepared statement of Hon. Gerald E. Connolly follows:]

Statement of Congressman Gerald E. Connolly

"Pushing the Envelope: The Looming Crisis at USPS"

March 2nd, 2011

Thank you, Chairman Ross for holding a hearing on the Postal Service early in this session. Last year, Chairman Lynch held a series of hearings on the Postal Service and, based on the findings from those hearings, introduced legislation to correct USPS employees' overpayment to CSRS. At these hearings, we learned that the USPS's projected $238 billion loss was, in the words of former Postmaster General Potter, a "theoretical" number, and that we should be cautious in gutting the Postal Service under false premises. I have included the transcript from that hearing last year for the record, because it should inform our prospective legislative efforts.

Fortunately, President Obama's budget includes a $4 billion down payment to correct part of the overpayment and keep the Postal Service solvent in the short term. This temporary solution must be accompanied by more fundamental reforms to the Postal Service, however, which create a new Postal Service business model that protect the interests of its business constituents, employees, and customers.

I will be introducing legislation entitled "Reform the Postal Service for the 21st Century Act." This legislation contains numerous provisions to expand revenue and volume for the Postal Service, to complement ongoing efforts aimed at reducing personnel costs. It builds on what this Subcommittee learned last year and on Senator Carper and Senator Collins' postal reform bills introduced in the Senate. For example, it expands the Postal Service's ability to expand its business in existing Post Offices by offering packing and other services. It reforms Postal contracting practices, consistent with proposals offered by Senator Collins. It repeals the antiquated prohibition on wine and beer shipment, following Senator Carper's leadership on this issue. It fixes permanently the entire CSRS overpayment, replicating language from Chairman Lynch's bill last year. Taken as a whole, my legislation is designed to create new Postal Service business model for the 21st century.

We cannot afford to tinker around the edges. While some personnel efficiency improvements are necessary, they are not sufficient. In fact, a myopic focus on cutting costs could lead to what Don Hall, CEO of Hallmark Cards, characterized as a potential "death spiral" for the Postal Service, in which declining volume and higher per-unit prices are self reinforcing. My legislation incorporates the suggestions of Hallmark, Amazon, and other companies to focus on expanding revenue and volume to ensure that mailers and other business constituencies can continue to use the Postal Service in a profitable manner.

The Reform the Postal Service for the 21st Century Act also will build on sound advice offered by the Postal Regulatory Commission Chairman Ruth Goldway during hearings last session. For example, it promotes voting by mail and increased use of electric vehicles to reduce USPS gasoline expenses. It creates new financing opportunities for the Postal Service to replace older delivery vehicles and upgrade facilities to reduce electricity and other utility expenses. If we are to create a 21st century Postal Service, we will have to ensure that these revenue-enhancing, cost-cutting provisions are synchronized to reduce overhead without crippling the business.

In 2006 Congress passed the Postal Accountability Enhancement Act to encourage the Postal Service to be more business-like. My legislation, emulating far-sighted suggestions of Ranking Member Lynch, Senator Carper, and Senator Collins, would update and modernize this business-oriented approach to create a new business model for the Postal Service, one that will allow it to thrive in the 21st century.

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JOINT HEARING ON CONTINUING TO
DELIVER: AN EXAMINATION OF THE
POSTAL SERVICE'S CURRENT FINANCIAL
CRISIS AND ITS FUTURE VIABILITY
Thursday, April 15, 2010
House of Representatives,
Committee on Oversight
and Government Reform,
joint with
Subcommittee on Federal Workforce,
Postal Service, and the District of
Columbia,
Washington, D.C.

[Rep. Connolly excerpts]

The Chair now recognizes the gentleman from Virginia, Mr. Connolly, for five minutes.

*Mr. Connolly. I thank the Chair and I thank both of our panelists for being here this morning.

Mr. Chairman, I will, with your permission, enter my full statement into the record, but I must say I continue to be bothered by the fact that the approach to trying to deal with the issues of solvency and long-term viability of the Postal Service continue to be ad hoc. I must confess to some disappointment in the GAO report, in particular, that we are not looking at a more comprehensive new business model approach. Ad hoc cuts to delivery service may save money in the short run, at long-term cost in terms of customer base. I think Mr. Chaffetz raised some very legitimate concerns about going from six to five days a week.

I would note with historical interest that this discussion occurred in 1976, where a similar situation was faced and the Postal Service again said if we don't go from six to five we will never make it, and subsequently, of course, the Postal Service actually experienced some record profits without cutting service from six to five days.

I would like to ask the GAO rep, we keep on talking about this $238 billion in cumulative losses, and I bring to your attention the thoughtful testimony of CRS which says you have to look behind that number. First, there are certain assumptions made about what will or will not happen in terms of economic growth and customer base for 238 billion. Secondly, you would have to ignore the statute that says there is a statutory debt limit actually in USPS, and then you would have to assume Congress does absolutely nothing for ten years and that you would borrow $231 billion from the U.S. Treasury.

That is a little hard to believe, so I am a little concerned that in bandying about this $238 billion number we are ignoring some obvious things that are going to happen, and it looks, frankly, a little bit like a scare tactic to get us to make some decision that may or may not be popular. And they may, in fact, be viable decisions, but how real really is that $238 billion number? And would you care to respond directly to the Congressional Research Service report, page 11, that lays out the flaws in this $238 billion?

*Mr. Herr. I appreciate the question. In looking at that number, we realize that is the number that says if nothing else changes. I agree, things will change. There is attrition that is expected. Given the drop in volume and revenue, the idea that the Postal Service would be self-financing, one would expect that that number was probably by far the worst-case scenario.

It is the number that is put out there to provide some context for what happens if nothing were to change, but it is understood that things would have to change in the interim.

*Mr. Connolly. And we would do nothing for ten years.

*Mr. Herr. I would assume that would not be the case.

*Mr. Connolly. Right. So how real then is the $238 billion number that has been bandied about in testimony here and in the press and -- I mean, one begins to conclude it has no basis in fact at all, other than to scare people.

*Mr. Herr. Well, I think that it is a starting point. I mean, again, this is a number that the Postal Service came up with, but it is, I think, to provide an illustrative case of not doing anything. And if nothing is done, then you will face those kind of challenges.

*Mr. Connolly. Could I ask Postmaster General Potter to respond to that?

*Mr. Potter. Well, I agree with what he just said. It is what happens if nothing is done. We did lay out a way of closing $123 billion of that gap, and, again, through aggressive management, focus on productivity. There is an element of growth that is built into that $123 billion. However, there is a sizeable gap beyond that.

*Mr. Connolly. Can in interrupt you for just one second there, Mr. Postmaster General, because you make a very good point. You would have to assume, for $238 billion to be real, we do nothing, including you. You already said you are going to use the authority you have to make reductions totaling $123 billion; is that correct?

*Mr. Potter. That is correct.

*Mr. Connolly. So the $238 billion number is already not real.

*Mr. Potter. It is a theoretical number.

*Mr. Connolly. A theoretical number. Except that you have already announced here you are taking steps to make sure that theoretical number is never real.

*Mr. Potter. Exactly.

*Mr. Connolly. Thank you.

*Mr. Lynch. I thank the gentleman.

The Chair now recognizes the gentleman from Indiana, Mr. Burton, for five minutes.

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The Chair recognizes the gentleman from Virginia, Mr. Connolly, for five minutes.

*Mr. Connolly. I thank the Chair, and, gosh, I am surprised that my friend who is so concerned about personal conclusions would cite a bogus number, $238 billion. We have already established in this hearing at best that is a theoretical number GAO admits, and the Postmaster General, himself, admitted under questioning by this Member that it assumes they are not going to make the $123 billion cuts he announced this morning they are going to make, and so it is a made-up number designed to scare us into breaking faith with communities across the United States, breaking faith with organized labor and the workforce, breaking faith with consumers in order to make

decisions they have decided a priori they want to make, irrespective of whether there is an empirical basis to justify making those decisions or not. That is what that $238 billion figure is -- it is made up. It assumes nothing will happen. Nothing will happen over ten years.

Mr. Kosar, you detailed this really well in the CRS report. Could you refresh our memories, going to page 11 of the CRS report? I assume that is your writing?

*Mr. Kosar. Correct. Are there particular aspects on it, or is it the three main points? Are there particular aspects of the point I made, or just kind of generally encapsulate what I was getting at here?

*Mr. Connolly. Well, if I recall your analysis, it says in order to believe $238 billion, you have to believe, A, this Congress will lift the statutory debt ceiling limit, right?

*Mr. Kosar. Correct.

*Mr. Connolly. Which right now is $15 billion?

*Mr. Kosar. Correct.

*Mr. Connolly. Secondly, you have to assume this Congress will take no action whatsoever for ten years with respect to any kind of fiscal red ink problem the Postal Service might experience; is that correct?

*Mr. Kosar. Correct.

*Mr. Connolly. Absolutely no action?

*Mr. Kosar. Absolutely no action.

*Mr. Connolly. Thirdly, you would have to assume that the $123 billion of cuts that the Postmaster General announced today and said is already within his authority, he doesn't need new legislation or legislative authority to make those decisions, will, in fact, be rescinded, will not be made; is that correct?

*Mr. Kosar. Absolutely correct.

*Mr. Connolly. And then you would have to assume that everything goes to hell in a handbasket. Apparently, there is no economic recovery that could influence up or down the volume of mail, even though we know from history that, as a matter of fact, the opposite is true: economic conditions most certainly do influence whether mail goes up or down volume; is that not correct?

*Mr. Kosar. That is correct.

*Mr. Connolly. Other than that, the $238 billion number is real.

*Mr. Kosar. Depends how you define real, I suppose.

*Mr. Connolly. Would you refresh our memory, Ms. Goldway, in terms of the statutory role of the Postal Regulatory Commission?

*Ms. Goldway. The Postal Regulatory Commission is a regulatory body overseeing the activities of the Postal Service to ensure that it does provide universal service at a fair and efficient level for all citizens. We provide an annual compliance determination every year, and should we determine that they don't meet universal service obligations we can institute proceedings to require them to change their activities to meet universal service obligations.

*Mr. Connolly. Apparently, because we don't like some of your testimony, we want to relegate it to the realm of personal opinion. Does the statute in any way invite the Postal Regulatory Commission to comment on proposals with respect to quality of service or fiscal savings? Is that a role under the statute for the Postal Regulatory Commission?

*Ms. Goldway. Yes. Our reports do that and we are asked to do studies, to report to Congress, to suggest legislation, and to make changes in -- suggest changes in the universal service obligation over a period of up to ten years.

*Mr. Connolly. Were you invited here today in your capacity as chairman of that Commission?

*Ms. Goldway. Yes, I was. Thank you.

*Mr. Connolly. And did the Committee ask you to, in fact, share your views on the pending proposals, good, bad, and indifferent, with respect to savings and cost efficiencies?

*Ms. Goldway. Yes, they were. Thank you.

*Mr. Connolly. Thank you.

Thank you, Mr. Chairman.

*Mr. Lynch. I thank the gentleman.

The Chair recognizes the gentleman from Illinois, Mr. Davis, for five minutes.

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Mr. CONNOLLY. I thank the Chair.

Mr. ROSS. Also, Members will have 7 days from today to submit opening statements and extraneous material for the record.

Now I would like to get into our hearing for today. We do have two panels. For those of you who are following spring training, I like to refer to it as a double header today. So, without further ado, I would like to introduce our first panel.

To my immediate right is Mr. Patrick Donahoe, the postmaster general and chief executive officer of the U.S. Postal Service. In the middle is Ms. Ruth Goldway, the chairman of the Postal Regulatory Commission. Welcome. And Mr. Herr, to my left, is the Director of Physical Infrastructure Issues at the U.S. Government Accountability Office.

We have your written statements before us, but what I would like to do first is to swear everyone in, and if I could ask you all to rise and raise your right hands.

[Witnesses sworn.]

Mr. ROSS. Thank you.

Let the record reflect that all witnesses answered in the affirmative.

Please be seated.

In order to allow time for discussion and questions, please limit your testimony to 5 minutes. As you know, your entire written testimony will be made part of the record.

Now I will recognize, first, Mr. Donahoe. Thank you for being here.

STATEMENTS OF PATRICK DONAHOE, POSTMASTER GENERAL, U.S. POSTAL SERVICE; RUTH GOLDWAY, CHAIRMAN, POSTAL REGULATORY COMMISSION; AND PHIL HERR, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE

STATEMENT OF PATRICK DONAHOE

Mr. DONAHOE. Good afternoon, Mr. Chairman and members of the subcommittee. I am honored to be testifying before you for the first time as the postmaster general and chief executive office of the U.S. Postal Service. I appreciate the opportunity to testify and thank you for the invitation. Today I would like to discuss our financial challenges, steps we are taking to improve our competitive position, and improvements to our business model that require changes in the law. My view is that many of our challenges today can be recast as opportunities to create a profitable and more market responsive Postal Service that competes for and wins customers, and that propels American commerce.

The Postal Service remains at the heart of a crucial segment of our economy. If the Postal Service was a private sector company, it would rank 29th in the Fortune 500. We provide the platform for a mailing industry that pumps $1 trillion into the economy every year and employs 7½ million Americans. We are not taxpayer funded; we generate our revenue through the sale of postage. And so, if we are to be successful at our core function of delivering to the American public, we must operate by having a strong business model and effective business strategies.

For its part, the Postal Service is focused on managing what it controls. In 2010, we trimmed $3 billion in costs, on top of $6 billion in savings in 2009, and our plan this year is to take another $2 billion out, further reducing work hours by 40 million. Our achievements in the work force reduction have been accomplished through attrition. We are unsurpassed in public and private sectors in that manner. We have reduced our work force by almost 230,000 employees since the year 2000, and have dramatically increased total productivity.

We have accomplished this all without sacrificing service. Performance levels are at the highest level ever, and those results lie squarely with our dedicated, knowledgeable, and committed employees, and I could not be any more proud of them.

We are aligning every aspect of the Postal Service around four key strategies: one, strengthening the business consumer channel; two, improving the customer experience by making every transaction a positive transaction; three, competing for the package business; and, four, continuing to become leaner, faster, and smarter. We are committed to ensuring that we will be successful in these business strategies and that we will be able to serve the American public better as a result.

While we are being very aggressive within the constraints of our current business model, the fact is without some important changes to the law that shape our business model, we cannot survive as a self-financing entity. Mr. Chairman, the losses experienced by the Postal Service last year alone are a staggering $8½ billion. This year we are projected to lose another $6.4 billion. Certainly, these results reflect the migration to electronic communication and shifting customer habits. But upon closer examinations, our losses are a result of an inflexible business model due to the laws that govern the Postal Service.

The most serious challenge is to our unique obligation to prefund retiree health benefits. This pre-funding requirement, borne by no other entity, public or private, places an incredible burden on Postal Service. To understand the full effects, you just have to look at the last few years before and after the enactment of the Postal Accountability and Enhancement Act. In the 4-years before, the PAEA, the Postal Service showed a positive net income every year.

In the 4-years since, we have seen billion dollars in losses every year. Even during the two worst years of the recession, 2007 and 2008, had it not been for the pre-funding requirement, the Postal Service would have realized a net profit of $3.3 billion and $2.8 billion, respectively. The effects of the retiree health benefit pre-funding are profound. This trend continues into 2011. Our first quarter results showed a loss of $329 million. Excluding retiree health benefits, pre-funding costs, and along with worker's compensation adjustments, we would have a net income of $226 million.

In addition to the retiree health benefit obligations, overpayments into the Civil Service Retirement System and Federal Employee Retirement System have taken a significant toll on our finances. Restoring these funds to the Postal Service would obviously benefit our financial position. This year, the Postal Service will reach statutory debt limit. Liquidity concerns are looming because

of a $5½ billion payment for retiree health benefits due on September 30th of this year. The Postal Service will not have the cash available to make these payments. We need legislation this year to address that fact.

I also encourage the subcommittee to provide greater flexibility to the Postal Service regarding our proposed transition to a 5-day delivery schedule, enabling greater latitude in the way that we provide access to postal products and services. Several bills were introduced in the 111th Congress that did just that. We would appreciate those efforts and are looking forward to working with each of you in the 112th Congress.

I believe strongly that the path forward requires that we embrace fundamental change and that our employees, our labor unions, management associations, the mailing industry, all of our customers and business partners play a constructive role in shaping our future. I am committed to this approach.

The next few years will bring significant change, but I am confident that we will be able to look back and say that, working together, we took advantage of a challenging time to create a stronger organization and a stronger industry, developing a true 21st century Postal Service.

Thank you for your continued efforts on behalf of the Postal Service. I look forward to working with each of you and will be happy to answer your questions today. Thank you, Mr. Chairman.

[The prepared statement of Mr. Donahoe follows:]

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Written Statement of
Don Cantriel, President
National Rural Letter Carriers' Association

Before the

Oversight and Government Reform Subcommittee on Federal Workforce, U.S. Postal Service, and Labor Policy

March 2, 2011

Chairman Ross, Ranking Member Lynch, and members of the U.S. Postal Service, Federal Workforce, and Labor Policy Subcommittee, my name is Don Cantriel, and I am President of the National Rural Letter Carriers' Association (NRLCA), which represents 123,000 bargaining unit rural letter carriers. Our members work in rural, suburban, and urban areas throughout the United States and function as a "post office on wheels" because rural letter carriers offer Postal customers all of the services performed over the counter at a post office. We sell stamps and money orders, accept express and priority mail, offer signature and delivery confirmation, registered and certified mail, and, of course, collect our customer's parcels.

We are living in a truly challenging time. Our Country continues to be in a recession and the Postal Service is a bellwether of the nation's economic well-being. Mail volume has declined in recent years and this has hit the rural carrier craft extremely hard. Rural carrier pay is based on an evaluated compensation system, which is unique not just to the Postal Service but to American industry in general. In the evaluated compensation system, each rural carrier is paid an annual salary, based upon the estimated amount of time it will take to deliver the mail on his or her individual route. This evaluation of the individual route is based upon an annual mail count lasting from two to four weeks, whereby over 30 separate elements – compromising mail volume and various work activities – are counted, timed, or measured. The result is an evaluated average weekly time required to service each individual route. That time is equated to one of several evaluated time levels, each with a separate annual salary. Among the most important elements in the evaluated compensation system is the volume of mail delivered by the rural carrier. It is fair to say then that when volume is up, rural carriers make more money but when volume is down they make less and the Postal Service pays less to get the mail delivered on rural routes.

Since the establishment of the evaluated pay system, rural letter carriers have the incentive to work as rapidly and efficiently as possible with the merit reward of returning home once their route and work is complete. According to United States Postal Service (USPS) figures, rural deliveries cost USPS $7.83 per delivery point less than a city delivery which operates at a set hourly rate.

The mail count also results in our routes being continually re-evaluated. For example, prior to the 2009 mail count, over 42,000 rural carriers delivered on routes designated as K routes; meaning they deliver 10 out of the 12 delivery days per pay period. After the mail count, the number of rural carriers who delivered on K routes dropped to just over 27,000. The number of J route carriers (who deliver 11 out of the 12 delivery days per period) and H route carriers (who deliver 12 out of the 12 delivery days per pay period) all increased significantly. What does this mean? It means after the mail count, thousands of rural carriers had to work an extra 26 days per year just to receive the same salary they made prior to the evaluation.

But this annual adjustment mechanism does not stop with salaries. Most rural letter carriers still provide their own delivery vehicle for which they are paid an equipment maintenance allowance (EMA). That allowance or "EMA" is adjusted quarterly by measuring fluctuations in the CPI-W Transportation Index. Currently, rural carriers serve on roughly 77,000 routes, traveling 3.4 million miles a day. The average distance driven for a rural route is 45 miles, but can range from 10 miles to 175 miles. Sixty-seven percent, or roughly 51,000, of those rural route carriers provide and deliver mail with their own personal vehicle. With the average price of a barrel of oil setting new records every time the price increases, and gas averaging about $3.50 per gallon, our vehicle reimbursement has not kept pace with the rising costs of delivering the mail.

Mr. Chairman, as the NRLCA's National President it is in our members' best interests to work toward the creation of a financially stable Postal Service. Toward this end, our union, together with the Postal Service, established a revenue-generation program harnessing the sales and marketing talents of our members called "Rural Reach." Rural Reach was created to attract new customers to the Postal Service who are currently using our competitors. It is also aimed at attracting customers who can benefit from using additional USPS services and products. What the Rural Reach program does is allow rural carriers to better serve our customers by initiating conversations with them about the products and services the Postal Service offers in an attempt to grow more revenue in the small to midsize customer base.

Mr. Chairman, I urge you in the strongest way, not to support the Postal Service's proposal to eliminate the congressionally-mandated 6-day delivery language provision. The provision stating that "6-day delivery and rural delivery of mail shall continue at not less than the 1983 level" *must* again be included in the annual Appropriations bills. The Administration's budget proposal recommends the inclusion of the mandated 6-day delivery provision, while recognizing the USPS is facing real financial challenges. I encourage you to follow the Administration's lead by supporting the 6-day delivery language in the 2012 bill and allow the Postal Service to do what it does best – serve the American public.

Recently, the Postmaster General of the U.S. Postal Service unveiled a plan to eliminate Saturday mail delivery. While the Postmaster General argues the elimination of Saturday mail delivery will save money, the detrimental impact it would have on customers who utilize the USPS for Saturday delivery would be much worse. In our view, this would only further exacerbate the Postal Service's problems by pushing much needed business out the door which could be replaced by private

enterprise. The Postmaster General claims that a move to 5-day mail delivery would save the USPS approximately $3 billion annually, although many speculate that number to be flawed because it does not consider the loss in volume and business as a result. With mail volume at its lowest point since the 1930s, everyone is debating whether the volume is ever going to come back. I believe once the financial, advertising, mortgage, and banking industries get back on their feet, mail volume will pick back up. Mr. Chairman, if the Postal Service drops a day of delivery, it will drive businesses away during a time where the focus should be on bringing more business in the door.

If five-day delivery were implemented, our evaluated compensation system, which is often praised by the Postal Service and OIG for its efficiencies, would need to be reengineered and the rural craft could lose 50,000 Rural Carrier Associate (RCA) jobs. An RCA is a non-career employee working as a substitute for a regular rural carrier. An RCA does not have their own route, but instead fills in when a regular rural carrier is off, sick, or on vacation. RCAs represent 40% of the rural carrier craft, and do not receive health or retirement benefits until they become a regular carrier. On average, it takes an RCA six years to become a regular carrier.

Saturday mail delivery is an important communication and marketing tool utilized by millions of citizens and mailers across the country, especially in rural areas. Many customers rely on the USPS to deliver prescription medications on Saturday for the simple reason that they know they will be home to sign for the package. If the USPS eliminates Saturday delivery, the customers are left with two options; the first is to possibly pay a higher price and a surcharge to have another carrier deliver their mail on Saturday, or in some rural areas to drive 40 miles round trip to the Post Office to pick up their mail.

Take CVS/Caremark, as an example. CVS/Caremark is the largest retail pharmacy chain in the country and has a substantial mail order operation. CVS/Caremark spends roughly $13 million annually to use the Postal Service to deliver 90% of their medications.

These medications range from the normal prescription drug, to specialized temperature-sensitive medications mailed in specially-designed containers. The computer system CVS/Caremark uses to mail these temperature sensitive medications is remarkable. In order to mail these types of medications, the computer takes numerous variables into account, from the time and day the package is put into the mailing system, to a four-day weather forecast of the area of the country the package is being shipped to. The computer system can calculate down to the hour when the package must arrive before it loses the temperature the medication must be stored at.

If we lose a delivery day, normal CVS/Caremark operations will be greatly affected. We know that postal customers prefer to have their prescription drugs or medications delivered on Saturdays, for the simple reason that a majority will be home to receive them. On my route alone, some of my customers are 18-20 miles from the nearest Post Office and many of them, especially the elderly, may not be able to travel this distance to the Post Office in order to pick up their medications.

CVS/Caremark is a good example but by no means the only example. It is just one of thousands of business that will be adversely affected if five-day delivery is implemented. Even small, local businesses who rely on the Postal Service to advertise coupons for special sales will also be affected.

We urge you to co-sponsor any forthcoming legislation that will support the continuation of 6-day mail

delivery. By supporting this legislation, you will help to save over 50,000 Rural Carrier jobs.

By supporting the continuation of 6-day mail delivery, you will also help preserve the level of service the American public and businesses have come to expect. Citizens and businesses will not pay to use a Postal Service with inconsistent Saturday mail delivery. Reducing delivery from six to five days goes against the principal of the very foundation of the Postal Service, "To give universal service to the American people".

Mr. Chairman, I know that times and finances are tough right now, especially for the Postal Service. But in my opinion, moving from six to five day delivery will only make the situation worse. This idea will not save the Postal Service. It will only hurt the business model and make other delivery options more attractive to the customers it so desperately needs to attract and retain.

Thank you for the opportunity to present a written statement. I am available anytime for questions or comments about the rural carrier craft.

UNITED STATES
POSTAL SERVICE

STATEMENT OF
POSTMASTER GENERAL/CEO PATRICK R. DONAHOE
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE, U.S. POSTAL SERVICE AND LABOR POLICY
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 2, 2011

Good morning, Mr. Chairman and members of the subcommittee. It is an honor for me to be testifying before the House for the first time as Postmaster General of the United States Postal Service. I assumed the Postmaster General responsibilities in December 2010 and was officially sworn into office on January 14, 2011. I appreciate being entrusted with such an immense responsibility and thank the Postal Service's Governors for choosing me for this position. I am so proud to be a part of an organization that is vitally important to our country. I look forward to working with all of our stakeholders – the mailing industry, our unions and management organizations, employees and of course, members of Congress – to ensure the future of the nation's postal system.

Since taking office in December, I have spent time meeting with many members of Congress, including some of you here today. I would like to take a moment to recognize our new Chairman, Representative Ross, as well as the Vice-Chair, Representative Amash. There are a number of new members assigned to the Postal Service subcommittee. I look forward to working with all of you and discussing our current situation as well as our future innovative plans.

Since I am new to many of you, it may be helpful to spend a few moments explaining my philosophy and my vision for the Postal Service. First, let me begin by emphasizing that a vibrant, thriving and growing Postal Service is important to the nation. One of the most important partners we have is the mailing industry. A healthy Postal Service translates to a healthy mailing industry; at the same time, an ailing Postal Service will result in a weakened industry, with the potential to have far-reaching negative results for a significant portion of the overall economy. Our partnerships run the gamut from huge mailers who send hundreds of millions of pieces of mail each year, to consolidators, transportation companies, envelope manufacturers, printers, and finally to "Mom and Pop" businesses. In fact, mail contributes to approximately $1 trillion in global commerce each year. My commitment to the mailing industry, to customers, and to the nation is to provide service that is second to none. We are changing to better serve the American public.

Our core business will always be delivery. That is the one customer need that will not change and it is the very essence of what we do, day in and day out. The scope of our daily operations is tremendous; driven by the most dedicated and committed workforce in the world. We process and deliver, on an average day, 584 million pieces of mail to more than 150 million locations. Our carriers, 260,000 strong, walk or drive virtually every street in the country. We serve some seven million customers at our 36,000 retail locations and 1.2 million Americans visit our online Post Office at *usps.com*.

And all of that happens in just one day. Then tomorrow, we do it all over again. You may have seen photos or videos of our carriers braving the elements to deliver mail in the wake of serious winter storms. At one point this winter, forty-nine of the fifty states had either snow or ice on the ground. Not many companies were out there, but the Postal Service was. The mail got through, because our people make the difference. Service is at the heart of our organization and that will never change.

In this testimony, I will discuss four very specific strategies we have formulated to take us into the future. One year ago today, the Postal Service unveiled a comprehensive Action Plan, that laid out a roadmap for the next decade and beyond. In the year since that plan was made public, the Postal

Service has aggressively addressed the elements which were under our control. This is especially true in the area of managing costs. For the last year, we focused on, and we continue to target, all of the areas in which we can better manage and control our costs. The plans I will discuss in this testimony fit squarely into what we already have in place. Our focus has not shifted and our commitment to addressing these issues has not wavered. We face tremendous challenges. America is changing and we must change with it. By building on the strategies laid out previously, we can adapt and take the lead on formulating our place in the new digital world. I am confident that we will emerge as a more profitable, nimble, and market-responsive organization that competes for customers and delivers even greater value to the American public.

Since assuming office approximately three months ago, we have taken actions to set us on the road to even greater efficiency and to become an even leaner, faster and smarter organization. These are over and above the changes laid out in our March 2010 Action Plan. In January, I announced a 16 percent reduction in the officer ranks and a realignment of some senior management positions. I believe change should start at the top, which is why we sought to flatten the organization by creating a structure that will enhance and strengthen customer services and relationships. We announced the closure of one Area office and streamlined operations in the areas of products, customer interaction and support, engineering and technology, human resources and sustainability. This is just one of several steps in our evolution toward becoming a forward-thinking, fast-acting company; a company that can better serve the public.

Later this month, we will be announcing additional changes that will further reduce staffing and personnel. We will be working closely with management organizations and other stakeholders to ensure our employees have landing spots available where possible. We will attempt to minimize negative effects on employees, but the necessity of this change is clear, as indicated by the financial results from the most current quarter.

Quarter 1 of fiscal year 2011 began on October 1, 2010 and ended on December 31, 2010. This quarter encompasses the holiday mailing season and historically it has been our most profitable quarter. For the last few years, however, that has not been the case – including this year. We ended the quarter with a net loss of $329 million, compared to a net loss of $297 million for the same period in FY 2010. Absent the cost of prefunding retiree health benefits (RHB) for future retirees and noncash adjustments to the workers' compensation liability, the Postal Service would have had a net income of $226 million in Quarter 1. Of even greater concern is the projection that indicates the Postal Service will reach its statutory borrowing limit by the end of the fiscal year, thus resulting in a cash shortfall. Without changes to the law mandating this onerous obligation, the Postal Service will be forced to default on a financial obligation to the federal government, due at the close of the fiscal year, on September 30, 2011.

To fully understand the significant challenges we are facing, it is worthwhile to look at what has happened with First-Class Mail and the effects of the ongoing shift in the mix of mail being sent through our system. While total mail volume figures for the first quarter showed a modest increase of 1.5 percent, our revenue still declined 2.6 percent. Why is that? Because the mail volume consists of less First-Class mail and more advertising mail – what we call Standard Mail. In Quarter 1, the volume of First-Class Mail was 43.1 percent of total mail volume, down from the same period in FY 2010, when First-Class Mail was 46.4 percent of the total mail volume. This represents a revenue loss of $544 million. Any business that takes this kind of monetary hit is destined to struggle, and the Postal Service is no different. And remember that First-Class Mail has been declining for almost a decade. The continued migration to electronic means of communication is reflected in these numbers. Even though economic indicators suggest that the economy is improving and the precipitous volume declines of the past three years may be behind us, changes in customer habits have long-term effects on our business.

To address these impacts, the Postal Service has continued its aggressive and targeted reductions in work hour costs. We reduced work hours by 6.4 million, or 2.1 percent, in the first quarter of this fiscal year. That is equivalent to approximately 3,600 full time employees. These savings are a continuation of the incredible efforts of the last three fiscal years, resulting in a cumulative reduction in the number

of career employees by 102,721, or 15.1 percent in the past 36 months. In fact, our current employee complement of 574,653 (as of Jan. 31) is similar to workforce figures dating as far back as 1972, when the Postal Service's workforce numbered 570,688. Our productivity gains are even more impressive when you consider that, in 1972, mail volume totaled 87.2 billion pieces, with a much smaller network of delivery points. In 2010, with virtually the same number of employees, the Postal Service processed and delivered 170.6 billion pieces of mail to approximately 150 million addresses. And we don't intend to stop there. Our plans for the remainder of FY 2011 include a total cost savings projection of $2 billion. This includes a reduction of 40 million additional work hours across the organization. In fact, the Postal Service has, in the last ten years, reduced annual work hours by 443 million hours, the equivalent of saving $18 billion in 2010. We are proud of these achievements; of doing more with less, and we have no intention of slowing down!

I am proud to report that, in addition to our success in achieving work hour savings, the first quarter showed continued excellence in service performance. The national score for overnight Single-Piece First-Class Mail is at an astounding 96 percent on-time rate. This is an improvement over the same period last year. The commitment of each and every postal employee is reflected in these service scores. Despite our continued financial struggles, and our declines in mail volume, and despite challenges such as winter weather and staffing realignment, our employees go to work each day with this singular goal in mind – to serve our customers. That commitment is unwavering.

Even as we continue to fulfill our commitment to service, we must address one particular area of concern – our liquidity. I would like to discuss this in more detail, to provide a clear picture of our situation and to give some background, especially for the new committee members. Without changes in applicable laws, at the close of this fiscal year, in seven months, the Postal Service will be insolvent, as we will be unable to meet all of our financial obligations. This liquidity crisis is caused by a combination of factors. With enactment of the *Postal Accountability and Enhancement Act (PAEA)* in 2006, the Postal Service was required, beginning in 2007, to prefund retiree health benefits (RHB) for future retirees. The incredible burden of this annual prepayment of $5.5 billion, due at the end of each fiscal year, is one no other entity, public or private, must bear. In addition to the prefunding, the Postal Service also pays $2.2 billion for annual health benefit premiums for current retirees. Other issues involving legacy costs have contributed to our financial concerns. The Postal Service's Office of Inspector General (OIG) has found overfunding of the two retirement systems within the Postal Service; the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS). The OIG found that the Postal Service has overfunded CSRS by approximately $75 billion and has also overfunded FERS by approximately $7 billion.

The effect of these obligations is startling, when you consider that, in the four years prior to enactment of PAEA, the Postal Service saw a net income in each of those years. In fiscal years 2007 and 2008, the Postal Service would have continued to show a positive cash flow, with significant profits of $3.3 billion and $2.8 billion, respectively, absent the prepayment requirement. Instead, the Postal Service made the required prepayments of $14 billion and had losses of $5.1 billion in 2007 and $2.8 billion in 2008. Protracted losses for the last three fiscal years have had a cumulative effect on both cash flow and on the debt limit. In fiscal years 2008 and 2010, the Postal Service experienced negative cash flow from operations. Fiscal year 2009 would also have been included in that negative cash flow category, except for enactment of Public Law 111-68, which deferred the required payment to the Postal Service Retiree Health Benefits Fund (RHBF) by $4 billion. That change, however, was only a short-term, one-year fix and did not address the larger issues of continued future payment to the RHBF. No such exception was made for the fiscal year 2010 prepayment of $5.5 billion, significantly contributing to a net loss of $8.5 billion for the year.

By statute, the Postal Service is limited to an annual net increase in debt of $3 billion, for a total outstanding debt of $15 billion. At the close of the current fiscal year, the Postal Service will be faced with two substantial cash payments; $5.5 billion for RHB, due on September 30, and another approximately $1.2 billion for the annual payment on workers' compensation liability, due in October 2011. An examination of our current cash balance and the remaining borrowing capacity we have, coupled with projected revenue for FY 2011, shows that the Postal Service will have insufficient cash

available to fund these financial obligations, falling short by $2 to $3 billion. The consequences of a failure to make these payments are not known.

Congress has tried to rectify the fact that we are running out of cash while we have billions of dollars sitting in the Treasury in overfunded retirement accounts. In the 111th Congress, bills were introduced by Representative Lynch and by Senators Carper and Collins. Each sought to find ways to use surpluses to fund the RHB obligation or reduce the Postal Service's total debt. We appreciate the efforts of Congress to find ways to allow the Postal Service to access these overfunded systems. We look forward to continuing our dialogue in the 112th Congress – but let me be clear – these issues must be addressed through legislation this year.

Earlier, I mentioned that today marks one year since the Postal Service introduced a comprehensive Action Plan for the future. That plan had its roots in a careful and thoughtful evaluation of trends in American's use of the mail and what the future might hold for our business. Working with independent consultants, we were able to make projections about what the nation's postal system might look like in 2020. We formulated specific strategies to address areas such as migration to digital means of communication, mail volume declines, and a less profitable mix of mail. We realized that, without significant improvement and changes in a number of areas, the Postal Service could be facing a cumulative $238 billion shortfall in the coming decade. We identified seven key areas of concern and we went to work on those areas.

Since introducing this plan, we have: implemented a strategy to modernize our retail network and increase customer access through retail partnerships, expanded use of kiosks, and improved our online offerings; made strides in establishing a more flexible workforce, in order to better position employees where they are needed; expanded our variety of postal products and services, including building on the success of the Priority Mail Flat Rate Box by introducing additional flat-rate products and offering incentives for Standard Mail; and continued the aggressive pace of cost-cutting, taking out $3 billion in costs in 2010, on top of the $6 billion in savings achieved in 2009. In February, the Postal Regulatory Commission (PRC) approved a price increase for market-dominant products, including First-Class Mail and advertising mail. Prices will increase an average of 1.7 percent and will take effect on April 17.

There are crucial parts of our action plan which are not under our control and that still must be addressed. Specifically, there are statutory and regulatory issues which have not been resolved. We asked Congress to examine both the RHB prefunding requirement and the CSRS overpayment. Although there was legislation introduced to address these issues – efforts we appreciate very much – unfortunately, none of these measures were enacted and these matters, in addition to FERS overfunding, still remain. Our hope is that, in the 112th Congress, both a short-term and a true long-term comprehensive solution can be found to address these issues.

In the meantime, we are actively formulating strategies that will take us into the future. As these complicated legacy cost issues are resolved over time, the best thing the Postal Service can do is continue to aggressively manage costs, become as efficient as possible and, of course, continue to provide the exceptional service that is our hallmark. Shortly after I took over as Postmaster General, I began communicating four simple but effective strategies that are the cornerstone of our efforts going forward. These strategies will shape our future. I have spoken about them time and time again to help reinforce the message that these concepts are the key to our continued success. I appreciate the opportunity to discuss them with you today.

The Postal Service will never stray from its core business function, which is mail and package delivery. What we <u>are</u> doing is revitalizing the way we approach the marketplace. The way people communicate has changed dramatically and we are changing with it. Our employees know it, our customers know it, and our business partners know it. We are finding ways to fit into and complement the new universe of digital communication. And this is how we are getting there.

First, the Postal Service is strengthening the business to consumer channel. We are a major driver of the American economy and mail remains one of the most highly effective ways of promoting and

marketing business. The value of the mail is unsurpassed and market research shows again and again that, compared to other forms of messaging, the Postal Service delivers the highest return on investment. Direct mail is an especially crucial tool for small and medium-size businesses. We are strengthening the business to consumer channel by improving our products, services and features consistent with the changing needs of the market. We are simplifying our requirements and making it easier to do business with the Postal Service. Working with businesses of all sizes, we are helping them to adopt best practices and utilize the mail in conjunction with their current marketing strategies, allowing them to integrate the mail into the way their business works.

Examples of how we have already started to do this can be seen in our Reply Rides Free product, which encourages the inclusion of marketing messages in bill and statement mailings, and payment of bills using the mail. For qualifying customers, a 1.2-ounce piece is charged the 1-ounce price if a reply envelope or card is included in the mailing. In addition, plans are underway for the Postal Service to host 1,000 "eBay Days" throughout the country. Encouraging people to use eBay – one of our most important business partners – to make purchases and to then ship those items using the Postal Service, reaps benefits for both eBay and the Postal Service. We plan to hold 1,000 "Grow Your Business Days", where interaction with businesses of all sizes will drive growth not only in the Postal Service, but in the economy as a whole.

Our second strategy focuses on improving the customer experience. We are striving to ensure that every experience our customers have with us is a positive one. This includes face-to-face interactions at our retail counters, transactions that take place at alternate access locations and on *usps.com*. Keeping things simple, positive, efficient and friendly will ensure customer satisfaction and will keep customers coming back for more. And improving customer experience is not limited to just transactions. We will keep the experience positive by continuing to deliver mail on time and with the personal touch customers expect from their carriers. As I continue to point out, this is all made possible by the continued commitment of our excellent employees. We are expanding access points through use of retail partnerships and kiosk placement and by giving our customers a choice of when, where and how to do business with us. We need to be accessible where the public lives, works and shops and our strategy to improve the customer experience is ensuring that reliability.

The decision to make every First-Class single-piece postage stamp a Forever stamp is one example of improving the customer experience. The comments we have received on this change have been overwhelmingly positive. Only with reliable feedback can we improve our service performance and fulfill our pledge to making sure each transaction is a positive one. Recently, the Postal Service adopted a new measurement system for evaluating customer satisfaction. The Customer Experience Measurement (CEM) gives us timely and useful information on how customers view us and their interactions with us. Very soon, we will be implementing new guidelines, which include enhanced training methods that will ensure all Postal Service employees who come into contact with our customers will be ready to make that experience a positive one. Whether customers contact us at a retail counter, on the phone, or online, we will make that interaction an excellent one.

One change in our retail outlets has already yielded positive results. Earlier this year, we modified existing guidelines governing retail transactions, in order to allow our retail clerks, who know their customers better than anyone – to be able to tailor their interactions with customers based on the individual. This change was a vast improvement, resulting in simpler and more enjoyable transactions for the customer. It also lets our employees know that their expertise is valued. We also recently launched, in partnership with Hallmark, Postage Paid Greetings, a new pre-paid postage greeting card product. This unique offering uses the cutting-edge technology of the Intelligent Mail barcode (IMb) to allow customers to purchase a card and postage at the same time. They can buy it, address it and mail it, all in one trip to their local Hallmark Gold Crown store or at several other participating retail outlets. The simplicity and convenience of these cards is exactly the kind of result we are seeking as we work to improve the customer experience.

Competing for the package business is our third business strategy. With the continued rise in e-commerce, packages represent a major growth area for the Postal Service. Our incredible network and our extended reach – going to every house every day – is an asset upon which we intend to build.

Our goal is to position the Postal Service as the low-cost, high-quality supplier for online purchases and returns, working on our own and with other partners in the shipping industry. A special focus is on product and service innovation with an added emphasis on small businesses, including the "at home" entrepreneur. We continue to work toward a 100 percent visibility network, providing information from acceptance to delivery as packages move through our network.

Examples of our success in the package category are already apparent with our Flat Rate Box campaign. We are building on that success to win new customers and drive revenue growth. In November 2010, the Postal Service marked the sixth year of the Priority Mail Flat Rate Box product. Since debuting in 2004, Priority Mail Flat Rate Boxes have shown an average year-over-year growth rate of 58 percent. Over 350 million of these convenient, simple and versatile boxes have shipped in the last six years, generating revenue in FY 2010 of $1.2 billion. In January of this year, we introduced Priority Mail Regional Rate Boxes. Designed for commercial shippers, these boxes are an affordable solution for package shipments requiring fast delivery over shorter distances. To add to the value, these boxes can be used with Merchandise Return Service parcels to be returned at Priority Mail prices. The possibilities for growth are endless and we will continue to create new ways customers can utilize the Postal Service for their package business needs.

Finally, our fourth strategy is to continue our evolution toward becoming a leaner, faster and smarter organization. To accomplish this, we are redoubling our efforts to streamline the Postal network, in order to properly manage steadily declining mail volumes. We will not sacrifice excellence, however, and will continue to achieve record levels of service, even as we tighten our operational and management structure. The concept of Continuous Improvement drives our efforts to achieve this goal. Using sound management principles, such as Lean Six Sigma (LSS), we constantly evaluate our processes and procedures for mail processing, transportation, delivery, customer transactions, and virtually every aspect of our organization. By making improvements and removing layers of redundant tasks, we are making the Postal Service leaner.

One of the most well-known strategies is the proposal to move to a five-day delivery model. In the last three years, there has been a 20 percent decline in total mail volume. Even with all of the cost-cutting efforts put forward by the Postal Service, there is still more to be done in order to find additional savings. Our analysis shows that the move from the current six-day per week delivery model to a five-day per week schedule would save approximately $3 billion per year. The Postal Service developed a comprehensive plan for a five-day delivery model, one which included consideration of extensive feedback from external stakeholders. If permitted to move to a five-day delivery schedule, the Postal Service would require approximately six months to implement the plan. Currently, six-day delivery language is included in the annual appropriations bill that directs funds to the Postal Service. Removal of existing language would permit the change to five-day delivery. We filed a formal request for an advisory opinion with the Postal Regulatory Commission (PRC) in March 2010. The PRC subsequently held numerous hearings and final briefs were filed by the Postal Service in October 2010. As of today, the PRC has not issued its opinion. Just last month, a new Rasmussen Reports poll found that 52 percent of Americans would rather see mail delivery trimmed back to five days a week than have an increase in the price of stamps. The reality is that there is no longer enough mail volume to support a six-day delivery model. We believe the five-day delivery schedule, as just one component of a comprehensive plan to manage costs and increase efficiencies, will strengthen the Postal Service's future. As we continue to adapt to shifts in customer habits and to an increasingly digital world, five-day delivery is a sound financial and business decision.

We continue to utilize proven processes in order to optimize our network operations, with tools such as Area Mail Processing (AMP) studies and Post Office consolidations. Accelerating our efforts in this area is necessary to respond to changes in mail volume, the mix of mail and to changing customer behavior. Simply put, we must place our resources – employees, machinery, transportation, and facilities – to align with current needs. We know that, particularly in the area of AMPs and Post Office consolidations, your constituents have concerns and you have questions as well. The Postal Service does not take these concerns lightly. We have procedures in place to ensure that our customers receive appropriate information and that public input is received and becomes part of the decision-making process. We are working hard to make sure customers will always have access to postal

products and services, whether through their Post Office, via a Contract Postal Unit (CPU), or online at *usps.com*. Our careful, deliberate and thoughtful decisions in this area illustrate our commitment to our customers.

Becoming faster is part of our overall strategy and we will do that through improving efficiencies with cutting-edge technology. We continue to implement the Flats Sequencing System (FSS) at select sites throughout the nation. FSS gives us the ability to sort flat-sized mailpieces, such as large envelopes and catalogs, to the finest degree possible. This will then allow our carriers to spend the maximum amount of time out on the delivery routes, thus ensuring the mail is delivered promptly and accurately. The Postal Service continues to work closely with the National Association of Letter Carriers (NALC) to evaluate and configure delivery routes to achieve maximum efficiency. This joint effort is also used in our work with the National Rural Letter Carriers' Association (NRLCA) to capture savings and increase efficiencies in rural route delivery operations. The Postal Service and NRLCA have worked together on consolidation of routes and eliminated approximately 1,000 rural routes in the last two years. Since 2009, this collaborative effort between both letter carrier unions and management has resulted in the consolidation of over 12,000 carrier routes, helping drive a 20.1 million work hour reduction in City and Rural delivery operations.

Engaging our employees to find smarter ways to use energy and our natural resources is an integral part of our strategy. The Postal Service has begun to deploy Lean Green Teams throughout the country. More than 80 teams – consisting of postal employees who care about the organization and about the environment – helped the Postal Service reduce energy, water, solid landfill waste and petroleum use in 2010, resulting in savings of more than $6 million. In addition to savings, Postal Service recycling efforts, with more than 222,000 tons of material recycled, generated $13 million in revenue. We are truly at the leading edge of sustainability efforts and were among the first agencies to implement a "buy green" plan more than 12 years ago. By recognizing that we are stewards of the environment, we are constantly looking for ways to optimize the physical footprint of the organization, thus reducing energy use in our facilities and vehicles.

Realigning our workforce and improving workforce flexibility is another key part of our strategy to become a more streamlined and nimble organization. The efficiencies we are pursuing through network modifications have a direct correlation to proper placement of our workforce. We simply need to match where our workers are with where the mail is being processed. The Postal Service historically had enough mail volume to ensure employees had plenty of work. That is no longer the case. We have realized tremendous work hour savings over the last few years. In Quarter 1 of FY 2011 alone, we reduced work hours by 6.4 million hours. Efforts to properly align our workforce are seen in initiatives like Delivery Unit Optimization (DUO), which seeks to move carriers to locations where delivery can be affected in the most efficient way possible. These changes are largely transparent to customers, and mail delivery service is not affected. We follow all collective bargaining agreement requirements when making decisions about our employees and that commitment will not change. By placing our most valuable resources – our employees – where they are most needed, the Postal Service can advance it goal of becoming leaner, faster and smarter.

We began negotiations with two of our labor unions last year; the American Postal Workers Union, AFL-CIO (APWU) and the National Rural Letter Carriers' Association (NRLCA). Our negotiations are ongoing with APWU and, while impasse was declared with the NRLCA on November 20, we continue to have discussions with them. Later this year, we go to the bargaining table with our other two large unions, the National Association of Letter Carriers, AFL-CIO (NALC) and the National Postal Mail Handlers Union, AFL-CIO (NPMHU). In each of these negotiations, we look for a "win-win" situation; one where we can protect workers, but at the same time acknowledge the tough decisions that have to be made, given the current financial situation. We also remain committed to working with the three management associations that represent the interests of Postmasters, supervisors and managers – the National Association of Postmasters of the United States (NAPUS), the National Association of Postal Supervisors (NAPS), and the National League of Postmasters of the United States. Each of these groups is important and we value the input and the consultation we receive from the members and their representatives. Collectively, we are the Postal Service and we all want to achieve the same

result – to see our organization grow and thrive so that we can continue to finance universal service for future generations.

One of the messages we hear most often from various stakeholders is that the Postal Service must be innovative. We agree and we are doing just that, following a long tradition of new ideas and cutting-edge technology to move the mail. The Postal Service has a proven record of innovation. We tested our first electric delivery vehicle in 1899. Concepts like Rural Free Delivery, which became available in 1902, allowed citizens to receive mail delivery no matter where they lived. We used new methods for sorting mail by machine beginning in 1922. In 1963, the ZIP Code was invented to help speed mail delivery. One of our most popular innovations was the introduction of self-adhesive stamps in 1992. Using cutting-edge technology like the Optical Character Reader (OCR), today's mail processing machines sort 40,000 pieces of mail an hour. We have been innovative in developing ways to improve customer access to postal products and services. Use of Contract Postal Units (CPU), Automated Postal Centers (APC), Stamps By Mail, and Stamps on Consignment lets the American public purchase stamps and mail packages wherever and whenever they need to. Our *usps.com* website had 413 million visitors in 2010. Since launching in 2009, the Postal Service iPhone application has consistently been ranked in the top ten free business apps. Looking even further into the future, the Postal Service sees incredible opportunity for growth in areas such as collaborative logistics, electronic bill presentment and payment, and warehousing. We have a long history of finding innovative ways to use the mail and those efforts will never cease.

But one very crucial piece of the innovations puzzle – one the Postal Service cannot control - still needs to be solved. These innovative strategies will require changes in existing law. I discussed earlier how the incredibly onerous burden of RHB prefunding is crippling the Postal Service's finances. Forward-thinking individuals have to collaborate to find a long-term solution to this requirement. Innovative ideas are needed to address the problem of how to resolve overfunding of the CSRS and FERS obligations, and how to arrive at a fair and equitable solution. We need new ways of thinking, in order to remove constraints on a variety of areas, including delivery frequency, workforce flexibility, and facility alignment. These innovations must free the Postal Service to become more nimble and better able to quickly react to shifting customer habits and evolving trends. The innovation necessary to address these issues will not come from the Postal Service alone. We need help – especially from Congress. Fortunately, there has been recognition of the need for these types of solutions and we appreciate that.

Concerns about the health of the Postal Service extend to other branches of the government. In February, the President released his budget proposal for FY 2012 and recognized the importance of the Postal Service to the overall economy as well as steps needed to address our financial challenges. The President's budget contained several items that affect the Postal Service, including: a reduction of the current RHB payment due on September 30, 2011, by $4 billion and adoption of a 40-year amortization schedule; amendments to current law that would allow the Office of Personnel Management (OPM) to assess the Postal Service's FERS obligation, determine if a surplus exists and, if so, transfer annually a portion of the surplus to the Postal Service Fund; and deleting provisions of the Revenue Forgone Reform Act of 1993, which authorizes the Postal Service to receive $29 million annually through 2035 to reimburse the Postal Service for services provided from FY 1991 through FY 1998. The change to RHB prepayment requirements would address our looming insolvency problem, which will occur this September. However, it would not provide a solution for similar liquidity issues that persist for the next several years. We support the principles contained in the President's budget; realigning postal infrastructure, facilities, processing and delivery systems to continuously improve efficiency; promoting an adaptive 21st century postal workforce; and accelerating value creation and enhancing service to the public while respecting fair competition in the marketplace. We look forward to working with the Administration and Congress on these and other legislative initiatives to help put us on a more solid financial footing.

We also appreciate the hard work that is exemplified in the reports and the Congressional testimony of organizations such as the Government Accountability Office (GAO), the Postal Service Office of the Inspector General (OIG) and the Postal Regulatory Commission (PRC). In April 2010, the GAO issued a comprehensive report on strategies and options for ensuring the viability of the Postal

Service. The OIG continues to follow up on a variety of topics, including CSRS, FERS and RHB costs, working hard to prepare reports that explain these complicated topics and helping to facilitate solutions. The PRC put great effort into holding field hearings on five-day delivery and evaluating the proposal. They continually examine a number of Postal Service proposals and remain committed to ensuring the future of the organization. Each of these entities also routinely testifies before Congress and weighs in on crucial Postal issues. We thank them for their commitment to these issues and for providing their valuable input.

It is our plan to continue to simply control what is in our capacity to control. The four core strategies I described in detail here today are our roadmap to the future. We will continue to sustain our organization and the entire mailing industry, which includes millions of jobs, by continuing to make sure businesses know that mail is the highest impact return for the marketing dollar today. By further strengthening the business to consumer channel, we will make the mail work for everybody. We will continue to improve the customer experience by making every interaction a great one. We will continue to simplify the way customers do business with us to keep them coming back again and again. We will continue to compete for the package business segment of the shipping industry. Positioning ourselves for long-term growth, we will continue offering products with a proven track record, such as our Priority Mail Flat Rate Box, as well as creating new products to reinforce the message that we are the best deal in the package market. Finally, we will continue to combine all our efforts to become increasingly leaner, faster and smarter as an organization. Our record of weathering the storm of an ongoing recession, reducing work hours, shrinking the workforce, and streamlining our network, all while still providing levels of service that are second-to-none, speaks for itself and shows how much the Postal Service can accomplish.

We will continue to work with your staffs and with everyone who has a stake in the Postal Service to move forward, to embrace change and to find ways to succeed. This must consist of a combination of efforts; the Postal Service by controlling costs, managing its workforce effectively and finding new and innovative ways to attract customers; our employees by delivering the best service possible; our business partners, by remaining open to new ideas and suggestions; the PRC by continuing to find ways to streamline its oversight of the Postal Service; and Congress by helping the Postal Service solve the far-reaching issues of CSRS and FERS overfunding, RHB prefunding, delivery frequency and by providing the flexibility that the Postal Service needs in order to succeed.

The importance of maintaining a healthy and vibrant Postal Service is crucial to the American economy. This importance is not limited to the Postal Service alone; rather, it includes the thousands of related companies, businesses and organizations that use the mail to reach customers. The mailing industry is a major driver of the economy, employing millions of people and generating over $1 trillion dollars in revenue each year. When we succeed, the nation succeeds. Our ultimate commitment is to our customers, which includes every person in the country. Our employees are the best in the world and I could not be prouder of them. The world is changing around us and we embrace those changes. I am energized by the challenges facing us and I welcome the chance to tackle those challenges together. I truly look on this as a time of great opportunity. I believe that we will look back on this time and say we helped create a stronger organization in a stronger mailing industry. That is not only my responsibility and the responsibility of all of us, but it is our obligation.

I look forward to working with each of you in the coming years as we address these issues head-on and find solutions that will keep the best postal system in the world growing, thriving and serving the public for a long time to come. I will be happy to answer any questions you may have.

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Mr. ROSS. Thank you, Mr. Donahoe.

Ms. Goldway, you are recognized.

STATEMENT OF RUTH GOLDWAY

Ms. GOLDWAY. Thank you Chairman Ross and Ranking Member Lynch and members of the subcommittee. Thank you for inviting me to testify on the record of the PAEA and Postal Service finances. I look forward to your views and your leadership on postal issues.

On the whole, we can say that the PAEA has been a positive force for changing, keeping postage rates low and service at acceptable levels, while providing stakeholders with information and the opportunity to participate in the process. The price cap serves as a powerful incentive for the Postal Service to add efficiency and reduce costs, including $11 billion in the last 3 years.

At the same time, the requirement to measure service and report the results publicly ensured that the Postal Service improved service quality. Seasonal pricing incentives for standard and first class mail, five experimental product market tests, and the expanding use of NSAs, 127 in 2010 and 56 to date in 2011, show that the Service is taking advantage of the law's pricing flexibilities.

Along with some others, I have been concerned that there are some potentially irreconcilable legislative requirements in the law, such as that all products must cover attributable costs, but no class of mail can have rate increases greater than the CPI cap. But, to date, the Commission has been able to justify reasonable exceptions and to encourage the Postal Service to address others.

In the recent exigency case, the Commission carefully reviewed the Postal Service's current financial predicament and found it to be structural, related to the pre-funding of health benefit premiums for future retirees. In the past 4 years, the Postal Service has paid nearly $21 billion into the Retiree Health Benefit Fund, while incurring a cumulative net loss of $20 billion. Bottom line: without the RHBF, the Postal Service would have broken even, despite the impact of the recession and declining mail volume.

Of course, when the PAEA was enacted in 2006, the economy was strong and the Postal Service had record profits. It was in this climate that the Congress mandated the Postal Service to make an ambitious fixed 10-year series of payments at about $5½ billion. But, in retrospect, the RHBF payments have brought the Postal Service deep into debt and close to insolvency. Now, even with a brightening economy and continued cost cutting, the Postal Service cannot surmount its financial crisis without congressional action.

In 2009, at the request of Congress, our expert review of the OPM's computation of the RHBF liability found that a recalculation could lower the Postal Service's liability by nearly $35 billion, still meet the funding goals of the act, and allow the required annual payments to be lowered. This could significantly address the Postal Service's financial shortfall.

Last year, at the request of the Postal Service, we undertook expert actuarial studies to review whether the Postal Service CSRS pension obligations had been properly calculated in relation to wages of employees of the Post Office Department who later retired from the Postal Service. We found that the Postal Service had been

overcharged by an estimated $50 to $55 billion. The surplus, which came from postal revenues, not taxes, should be made available in some fashion for the benefit of the postal ratepayers and customers, perhaps to fund the RHBF.

The Commission believes that given the Postal Service's record of cost cutting over the last decade, and recognizing the price cap restrictions and competition from electronic alternatives, significant cost cuttings will continue. The Commission will serve to guard against any ill-considered cuts, because any reduction in service could be viewed as an equivalent of a defacto rate increase.

Last year, the Commission issued its advisory opinion on Postal Service's proposals to shutter up to 3,200 stations and branches. We affirmed the Postal Service's authority to adjust its retail network, but we made several recommendations to ensure consistency and enhance due process for every citizen.

Over the last year the Commission has conducted an extensive review of another Postal Service proposal, that to go from 6- to 5-day delivery. In my 13 years serving on the Commission, this has been the most difficult and multifaceted issue I have been asked to address. The Postal Service proposal to end Saturday delivery is a serious effort to improve its bottom line, but cutting 17 percent of service in order to save what the Postal Service estimates to be $3 billion must be carefully considered within our obligation to hold prices down, maintain service standards, and ensure efficient postal operations.

We are working overtime to resolve the complex and technical policy aspects of this case, and expect to complete our opinion shortly. We hope the opinion provides the Congress with the information you need to decide whether or not to lift the current 6-day delivery directive.

The Commission is now conducting its first 5-year review of the PAEA, required under Section 701 of the act, to provide recommendations to improve the effectiveness of current postal laws. Certainly, the historic view that the postal system itself is of enduring value to the Nation still stands strong.

We look forward to working with Congress, the Postal Service, and all who depend on the mail to chart a course that keeps the mail affordable, efficient, and relevant for generations to come.

Thank you. That concludes my testimony. I would like to ask that the statement I made with regard to the exigency rate case, which further defines the finances of the Postal Service, be included in the record as well.

Mr. ROSS. Without objection, it is so ordered.

Ms. GOLDWAY. Thank you.

[The prepared statement of Ms. Goldway follows:]

Testimony of Ruth Y. Goldway, Chairman, Postal Regulatory Commission
Before the U.S. House of Representatives Committee on Oversight and Government Reform
Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy

March 2, 2011

Chairman Ross, Ranking Member Lynch and members of the Subcommittee, thank you for inviting me to testify. I appreciate the opportunity to provide the perspective of the Postal Regulatory Commission on the future of the Postal Service and ways to promote its long-term viability and health.

Mr. Chairman, I would also like to welcome you and other new members of the Subcommittee to the important and vital task of overseeing the United States Postal Service. I look forward to your views and leadership on postal issues.

On behalf of the Commission, I pledge our support and our commitment to work with each of you, your committee staff, the Postal Service, and the mailing community to address the current difficulties and to promote a sustainable, affordable universal mail system for the future.

PAEA implementation

The Commission is now in its fifth year of operation under the Postal Accountability and Enhancement Act of 2006 (PAEA). The signing of the PAEA capped more than a decade of hard work by Congress and the postal community.

The PAEA has ensured greater transparency and accountability for the Postal Service. On the whole, the Commission believes the law has been a positive force for change, keeping postage rates low, service at acceptable levels, and providing a broad cross section of stakeholders with information and the opportunity to participate in the process.

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.

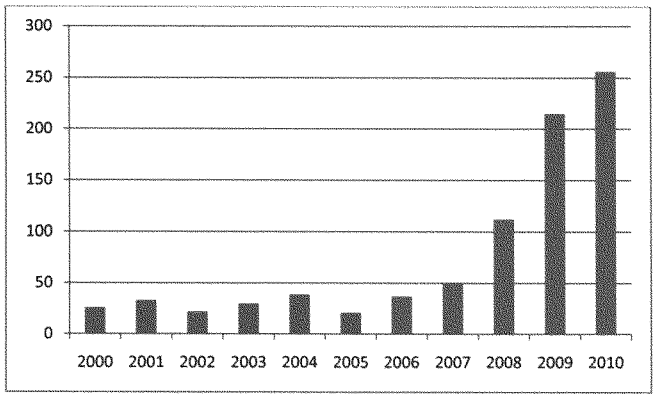
The streamlined rate-setting processes required by the PAEA have performed well, assuring postal customers small, predictable price increases not to exceed the rate of inflation. Since 2008, including the 1.7 percent increase approved this February, postage rates for market dominant products will have increased by a cumulative 8.4 percent, compared to a 16.8 percent increase in the published rates for Postal Service competitive products, which are not capped.

At the same time, the requirement to measure service and report the results publicly helped the Postal Service focus on and improve service quality despite the rapid downsizing of the postal workforce and the mail processing adjustments the Postal Service has undertaken to cut costs.

The Postal Service has recently become more active in developing initiatives to take advantage of the pricing flexibility provided by PAEA. The Commission has approved seasonal pricing incentives for Standard and First-Class Mail, and three experimental product market tests, with two more experimental products 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. The Commission now has approved a new streamlined contracting process which enables the Postal Service to enter into international NSAs without pre-implementation review by the Commission. The new process simplifies the Postal Service ability to enter into new NSAs and improves its ability to compete for such business. We have approved a similar program for domestic Priority mail NSAs. The PAEA has provided the Postal Service with faster decisions and more flexibilities, all within legislative time limits.

While the Postal Service has experienced large deficits in the last four years, the Retiree Health Benefit Fund (RHBF) established by the PAEA now totals more than $42 billion, which includes an initial payment by the Postal Service of $3 billion, the transfer of $17.1 Billion of Civil Service Retirement Fund surplus, four statutorily mandated RHBF payments, and accumulated interest. This is a substantial new postal asset.

The PAEA also expanded the Commission's responsibilities and its workload significantly. The Commission has had to process many more cases, conduct several important special studies and review proposed changes that affect the fundamental universal service charter. While these duties have strained Commission resources, we are well aware that our funding comes from the Postal Service fund, and that we must make every effort to restrain expenditures. A chart of our case workload for the last decade is attached.



Orders Issued by the Commission 2000-2010

I am personally concerned that there are some potentially irreconcilable legislative requirements such as all products must cover attributable costs but no class of mail can have rate increases greater than the CPI cap. To date, the Commission has been able to justify reasonable exceptions and encourage the Postal Service to address others. On the whole, the PAEA was an important step forward. It provides a solid foundation for the future and as I mention later, for developing further refinements to the postal model.

The solvency challenge

A majority of the Commission believes the Postal Service's current financial predicament is rooted in the PAEA mandate to rapidly prefund health benefit premiums for future retirees.

In the past four years, the Postal Service has paid nearly $21 billion into the RHBF. During that time, it incurred a cumulative net loss of $20.25 billion. Without the RHBF requirement, the Postal Service would have broken even financially despite the large mail volume declines that occurred during that time and without use of its borrowing authority.

When the PAEA was enacted in 2006, the economy was strong and the Postal Service was concluding one of the most prolific four-year periods in its history. Driven by the booming financial and housing sectors, overall mail volume increased by nearly 11 billion pieces from 2003-2006, reaching a record volume of 213 billion pieces in 2006. During that period, the Postal Service was exceedingly profitable, earning more than $9 billion in net income. At the close of FY 2006, the Postal Service appeared to be in good financial health.

It was in this climate that Congress mandated the Postal Service to make an ambitious ten-year series of payments averaging about $5.5 billion per year to address its growing unfunded liability for future postal retiree health benefits. At the time, the Postal Service viewed the payment schedule as demanding, but achievable. In the difficult economy that ensued, and with record mail volume declines, RHBF payments have brought the Postal Service deeper into debt and closer to insolvency.

Even with a brightening economy and continued cost cutting, the Postal Service cannot surmount its financial crisis without Congressional action.

Congressional options

There are a number of options available to Congress to address the immediate postal liquidity problem. Commission studies authorized by the PAEA suggest alternatives that would provide substantial leverage for Congressional action.

Last year, at the request of the Postal Service, the Commission initiated actuarial studies prescribed by the PAEA to review whether the Postal Service's pension obligation had been properly calculated in relation to service performed by employees of the Post Office Department who continued to serve after postal reorganization in 1971 and later retired from the Postal Service. It was determined, applying current generally accepted accounting principles and the best practices from the public and private sector, that the Postal Service had

been overcharged. The amount due the Postal Service under a current calculation was estimated between $50-55 billion. These funds were paid into the fund from postal revenues. The surplus should be made available in some fashion for the benefit of postal ratepayers and customers.

In 2009, then-Chairman Lynch asked the Commission to look at OPM's computation of the RHBF liability. 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 allow the required annual payments to be lowered by more than $2 billion while meeting the original funding goals of the PAEA. Such an adjustment could ameliorate the Postal Service's ongoing financial shortfall.

Future cost control

The last decade demonstrates that the Postal Service is determined to cut costs. Relief from current financial solvency pressures will not deter it or slow it down. As noted earlier, the statutory cap on market-dominant price increases provides a strong and permanent incentive for continued cost control efforts. The Postal Service also has proven its ability and will to lower costs and reduce its workforce in both good times and bad. From 2002 to 2006 for example, when mail volume was rising to a record 213 billion pieces and the Postal Service had a cumulative $9.5 billion net income, it reduced its career employee rolls by over 56 thousand – or eight percent.

During the past three years, as mail volume declined significantly, the Postal Service reduced work hours to match the workload and eliminated $11 billion in costs. As it enters the second quarter of FY 2011, the Postal Service continues to make work hour and complement reductions, even as current figures reported to the Commission show that overall mail volume is increasing. This trend appears likely to continue under Postmaster General Donahoe, who has announced plans to cut 7,500 administrative positions and make other complement reductions.

Overall, postal career ranks have been reduced 27 percent from their peak of 798,000 in

alternatives to the mail and the discipline imposed by the statutory price cap, the Postal Service has substantial incentive to control costs.

Universal service – post offices and delivery

While the Commission appreciates the Postal Service's difficult cost cutting measures, at the same time it is our responsibility to guard against the possibility that the Postal Service may implement ill-considered cuts that adversely affect postal customers. Any reduction in service could be viewed as the equivalent of a de facto rate increase.

Last year, the Commission deliberated on two Postal Service proposals for nationwide changes in service: one for potentially closing thousands of station and branch retail outlets, and the second to eliminate Saturday mail delivery service. In such circumstances, the law requires the Postal Service to submit their plans to the Commission for an Advisory Opinion.

The Advisory Opinion process is an important protection that 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 public interest may participate. Advisory Opinions embody the intent of Congress that 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. The law presumes that the substantial evidentiary record, public input and objective analysis contained in the Opinion will have a beneficial impact on Postal Service decision making and the outcome of proposed changes.

Early last 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 decreased 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 Postal Service decision-making will be improved if it established a notice and comment period that provides an adequate opportunity for public input before an initial decision to close a facility is made. Further, inconsistent financial and operational analyses impaired evaluations of facility closures and consolidations. The Commission 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.

Postal Service nomenclature – and procedure – differentiates among stations, branches and post offices. But to customers each of these postal retail facilities is a post office, a view that is consistent with the Commission's long-standing position.

Since 1976, the Postal Service has been required by statute to give 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 a post office.

Citizens expect and deserve the same public notice, opportunity for comment and right of appeal if and when the 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. These protections grant the public the right to participate in the process and to raise concerns that may have been neglected. These basic rights should be accorded to all postal customers.

The second Advisory Opinion involves a proposal to end Saturday mail delivery service. The Commission recently concluded an extensive review of this initiative that included seven regional public hearing and extensive testimony from the Postal Service, postal employees, mailers, public officials, and other stakeholders.

In my 13 years serving on the Commission, this has been the most difficult and multifaceted issue I have been asked to address. And this inquiry did not arise in a vacuum. Last summer, the Commission evaluated a Postal Service request for emergency rate relief. Ultimately, the Commission rejected the request for a 5.5 percent rate increase. The Commission recognized that the PAEA required the Postal Service to operate under the price cap and that the structural financial concerns of the Postal Service did not meet the statutory requirements for emergency rate relief. The Postal Service's proposal to reduce its expenses by

cutting service in order to save what the Postal Service estimates to be three billion dollars must be carefully considered within the construct of its requirement to hold prices down and maintain service standards.

The Commission is working overtime to resolve both the complex technical and policy aspects of this case and we expect to produce our Opinion shortly.

The product of our proceeding will be an Advisory Opinion to Congress and the Postal Service, offering not only our expert opinion, but also reflecting the extensive participation of stakeholders and citizens. Ultimately, it will be up to Congress to decide whether to lift current legislative restrictions that require the Postal Service to provide six-day delivery, to declare whether five days is an acceptable standard to leave that decision to eh Postal Service and/or the Commission.

Looking to the future

This Congress has several options on how best to deal with the underlying circumstances of the Postal Service's present financial difficulty. The Commission hopes that you can address some of them this year. Thoughtful reform proposals have been put forward by Senator Carper, who introduced legislation last year, and by Senator Collins who introduced a bill in this Congress.

It can be said with great assurance that there is a sizeable part of the U.S. population that depends on the mail to manage their lives and stay connected with their government. A Commerce Department study issued last November reported that as of 2009, 31 percent of U.S. households did not have Internet access at home, and nearly one-fourth of households did not even use the Internet. Statistically, they are disproportionately poor, less educated, and under-employed. But in a universal mail service network, they are served. They are connected.

In the future, with greater broadband penetration the needs of the Nation may change. The Postal Service will need to find greater efficiencies and cost controls. Whether it will be possible to redefine universal service and to differentiate among users of the mail according to their willingness to pay is a question to be addressed several years from now. Certainly, the historic view that the postal system itself is of enduring value to the Nation still stands.

The Commission now is conducting its first five-year review of the PAEA. Section 701 of the Act requires the Commission, at least every five years, to submit a report to the President and Congress on the operation of the PAEA, and to provide any recommendations for legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States. We will have our report to you before the end of the year.

The need for collaboration, innovation and enlightened management of this essential but challenged institution has never been greater. Although the Commission is small – just 70 people including the five Commissioners – it brings considerable expertise and more than 40 years of postal regulatory experience to the table. We look forward to working with Congress, the Postal Service and all who depend on the mail to chart a course that keeps the mail affordable, efficient and relevant for generations to come.

Thank you, that concludes my testimony.

# # # #

Mr. ROSS. Thank you, Ms. Goldway.
Mr. Herr, you are recognized.

STATEMENT OF PHIL HERR

Mr. HERR. Thank you. Chairman Ross, Chairman Issa, Ranking Member Lynch, and members of the committee, I am pleased to be here today to participate in this hearing. Today I will discuss the Postal Service's financial condition and outlook, and the actions needed to modernize and restructure it.

The Postal Service's financial condition has declined significantly since fiscal year 2006 and it remains on GAO's high risk list. As discussed, the challenges facing the Postal Service are linked to decreases in mail volumes as customers have shifted to electronic communications and payment alternatives. More specifically, profitable first class mail has been declining relatively quickly.

While mail use has been declining, the Postal Service has large fixed costs associated with delivering to 150 million addresses. It also has a large physical network spanning over 500 mail processing facilities and more than 32,000 post offices. It has 670,000 employees, about 80 percent of whom work full-time. And compensation benefits, as you noted, comprise 80 percent of its costs. The Postal Service expects to reach its $15 billion statutory debt limit this year, while still facing a cash shortfall. Unfunded obligations and liabilities, detailed in a table in my statement, for such things as worker's compensation and expenses in retiree health care are now estimated to total $105 billion.

These figures strongly suggest the Postal Service's financial condition has reached a tipping point, and key stakeholders need to reach agreement on actions to address its structural problems. We believe that action is needed in five areas.

First, realign service with customers' changing use of the mail. The Postal Service has sought to reduce delivery by 1 day and provide retail services outside of post offices. It estimates that dropping a day of delivery could reduce its costs by about $3 billion annually. This raises questions about what aspects of universal's Postal Service are appropriate given declines in mail use.

Second, postal operations, networks, and its work force need to be realigned to reduce excess capacity. Key questions include: How quickly can these networks be realigned? The pace of change has simply been too slow. And should some post offices move to alternate locations to better serve customers and reduce costs?

Third, compensation and benefit costs need to be addressed. Wages and benefits represent 80 percent of postal costs, about $60 billion in fiscal year 2010. Congress may wish to consider revisiting the statutory framework for collective bargaining to ensure that binding arbitration takes the Postal Service's financial condition into account. Other options include implementing a two-tier pay system, outsourcing if it results in cost savings, or revising employees' share of health and life insurance premiums.

Fourth, generating revenue through new or enhanced products and services. The Postal Service has asked Congress to allow it to diversity into non-postal areas and sought additional pricing flexibility. Questions about this include: Are there opportunities to introduce profitable new postal products and enhance existing ones?

Should it be allowed to enter non-postal areas to compete with private sector providers?

Finally, the funding structure for postal retiree health benefits needs to be addressed. The roughly $5 billion-plus payments through 2016 are steep, and we believe that Congress should consider modifying them in a fiscally responsible manner. However, we also believe the Postal Service should pre-fund these obligations to the maximum extent its finances permit because thousands of individuals rely on and expect this benefit.

Making changes to the Postal Service will not be easy. In a recent report requested by Ranking Member Lynch, we discussed how foreign posts have modernized their operations. Key aspects of these changes included strategic outreach and coordination with stakeholders about the nature, scope, and need for changes. An employee transition strategy was also crucial. Foreign posts experience suggests the Postal Service needs to clarify its modernization plans, including over what period it will implement them, and explain improvements in customer service and cost savings it expects, while ensuring that alternatives are available.

In conclusion, Mr. Chairman, modernizing and restructuring the Postal Service so that it can be viable is imperative given its financial condition. This will not be easy and changes, some difficult, are needed to ensure that postal services remain available.

I am pleased to answer any questions. Thank you.

[The prepared statement of Mr. Herr follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, Committee on Oversight and Government Reform, House of Representatives

For Release on Delivery
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U.S. POSTAL SERVICE

Modernization and Restructuring Needed to Address Financial Challenges

Statement of Phillip Herr, Director
Physical Infrastructure Issues

GAO-11-428T

March 2, 2011

GAO
Accountability • Integrity • Reliability
Highlights

Highlights of GAO-11-428T, a testimony before the Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy, Committee on Oversight and Government Reform, House of Representatives

U.S. POSTAL SERVICE

Modernization and Restructuring Needed to Address Financial Challenges

Why GAO Did This Study

The U.S. Postal Service's (USPS) financial condition and outlook are deteriorating because revenues are not sufficient to cover its expenses and financial obligations. These challenges continue to threaten USPS's financial viability and GAO has therefore retained USPS on its high risk list issued in February 2011. USPS also faces cost pressures from maintaining a national network of processing, retail, and delivery operations.

This testimony discusses (1) updated information on USPS's financial condition and outlook and (2) actions needed to modernize and restructure USPS. It is based primarily on GAO's past and ongoing work, as well as GAO's review of USPS's recent financial results and the President's proposed budget for fiscal year 2012.

What GAO Recommends

While this testimony contains no new recommendations, GAO has reported that Congress, the administration, and USPS urgently need to reach agreement on a package of actions to restore USPS's financial viability by modernizing its operations, networks, and workforce. GAO has also recommended that Congress consider providing USPS with financial relief, and in doing so, consider all options available to reduce costs. In commenting on this statement, USPS generally agreed with its accuracy and provided technical comments that were incorporated as appropriate.

View GAO-11-428T or key components. For more information, contact Phillip Herr at (202) 512-2834 or herrp@gao.gov.

What GAO Found

USPS experienced a net loss of $329 million in the first quarter of fiscal year 2011 and is projecting a $6.4 billion total net loss for fiscal year 2011. Mail volumes, USPS's main revenue source, have generally been decreasing as customers have shifted to electronic alternatives. This trend exposes weaknesses in USPS's business model, which has relied on mail volume growth to help cover costs. While USPS continues to reduce employees' work hours, its cost reduction efforts have not been sufficient to offset lost revenue. Since fiscal year 2006, USPS has relied on debt to help cover its obligations. If it borrows $3 billion in fiscal year 2011 as its plans indicate, USPS will reach its $15 billion statutory debt limit. The President's Fiscal Year 2012 Budget Request proposes providing USPS with over $4.5 billion in short-term financial relief in fiscal year 2011 by reducing its retiree health benefit payment by $4 billion and reimbursing it for approximately $550 million in Federal Employee Retirement System payments. While useful, these actions would not sufficiently address USPS's structural problems.

Postal Service Financial Results and Projections, Fiscal Years 2006 through 2011
Dollars in billions

Fiscal year	Net income (loss)	Total revenues	Total expenses	Outstanding debt
2006	$0.9	$72.8	$71.9	$2.1
2007	(5.1)	75.0	80.1	4.2
2008	(2.8)	75.0	77.8	7.2
2009	(3.8)	68.1	71.9	10.2
2010	(8.5)	67.1	75.6	12.0
2011 (projected)	(6.4)	67.7	74.1	15.0

Source: USPS.

As seen in the table, USPS's financial condition has reached a tipping point. Given USPS's role in facilitating key aspects of the U.S. economy, Congress, the administration, USPS, and stakeholders need to reach agreement on a package of actions to restore USPS's financial viability, facilitate progress toward modernizing its services to meet changing customer needs, and remove barriers restricting USPS actions. This would allow USPS to optimize its networks and workforce so that it can become more efficient and reduce costs. GAO recently reported on lessons learned from foreign posts' modernization efforts, including using outreach and communication strategies to inform public officials and customers of increased access to products and services to help gain acceptance for retail network changes. Some posts also developed labor transition strategies that included training, relocation, job search services, and financial incentives to support employees who were negatively affected. While USPS has taken steps to generate ideas for modernizing its retail and delivery networks, the experiences of foreign posts suggest that it will be critically important for USPS to fully develop and implement similar outreach, communication, and labor transition strategies.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to participate in this hearing on the U.S. Postal Service's (USPS) financial condition, a topic we have addressed in recent reports and testimonies. My statement will discuss (1) updated information on USPS's financial condition and outlook and (2) actions needed to modernize and restructure USPS.

This statement is based primarily on our past and ongoing work, and updated financial information, including our reviews of USPS's business model, financial condition, networks, service, and postal reform issues.[1] To perform our work, we reviewed USPS's financial statements for the fiscal year that ended September 30, 2010, and for the first quarter of fiscal year 2011 that ended December 31, 2010; USPS's Fiscal Year 2011 Integrated Financial Plan; the President's Fiscal Year 2012 Budget Request; and other reports, testimonies, and documentation on USPS's financial condition, operations, and outlook. In addition, we interviewed senior USPS officials. We conducted this performance audit in February 2011 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives.

[1]A list of GAO's recent work on USPS-related issues is provided at the end of this testimony. We conducted our work for these reports in accordance with generally accepted government auditing standards or in accordance with our quality assurance framework. A more detailed discussion of our scope and methodology is available in each of the reports cited in the GAO Related Products list.

USPS's Financial Condition Continues to Deteriorate, and USPS May Face a Cash Shortfall This Fiscal Year

USPS's financial condition has deteriorated significantly since fiscal year 2006, and its financial outlook is grim in both the short- and long-term. In July 2009, we added USPS's financial condition and outlook to our high-risk list because USPS was incurring billion-dollar deficits and its debt was increasing as mail volumes and revenues declined and costs rose. USPS experienced a net loss of $329 million in the first quarter of fiscal year 2011 and is projecting a $6.4 billion total net loss for fiscal year 2011. In February 2011, we retained USPS on our updated high-risk list and reported that USPS finds itself without sufficient revenues to cover its expenses and financial obligations (see table 1).[2]

Table 1: Postal Service Financial Results and Projections, Fiscal Years 2006 through 2011

Dollars in billions

Fiscal year	Net income (loss)	Total revenues	Total expenses	Outstanding debt
2006	$0.9	$72.8	$71.9	$2.1
2007	(5.1)	75.0	80.1	4.2
2008	(2.8)	75.0	77.8	7.2
2009	(3.8)	68.1	71.9	10.2
2010	(8.5)	67.1	75.6	12.0
2011 (projected)	(6.4)	67.7	74.1	15.0

Source: USPS.

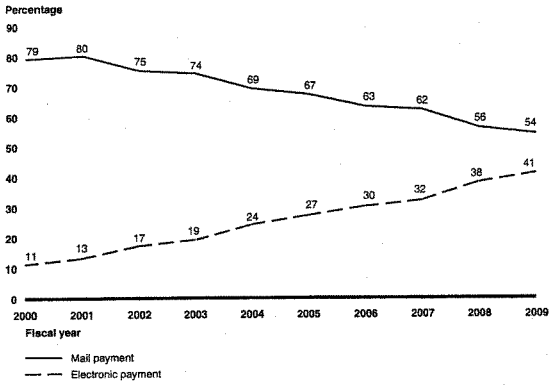
Mail volumes have generally been decreasing as customers have increasingly shifted to electronic communications and payment alternatives (see fig. 1), a trend that is expected to continue. USPS's two major products are First-Class Mail and Standard Mail.[3] These accounted for nearly 94 percent of all mail volume and 77 percent of USPS revenues in fiscal year 2010. One piece of First-Class Mail generated about three times the profitability of the average piece of Standard Mail. USPS expects First-Class Mail volumes to continue declining in both the short- and long-term, as customers increasingly rely on electronic alternatives. In the first quarter of fiscal year 2011, First-Class Mail decreased by about 6 percent

[2]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

[3]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.

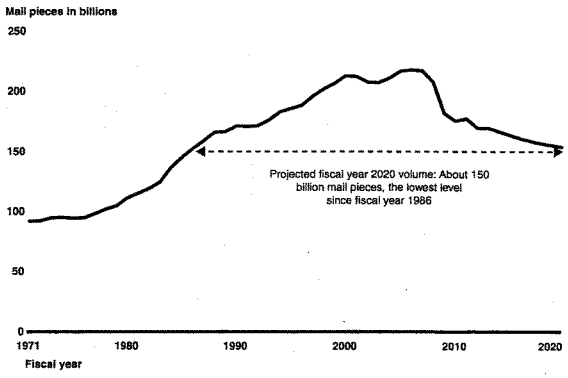
compared to the same period last year, while Standard Mail volumes grew by about 9 percent. Figure 2 depicts actual and projected mail volume trends—which show that by fiscal year 2020 mail volume is projected to decline to a level not seen since fiscal year 1986. Additionally, USPS expects the gap between First-Class and Standard Mail to expand—Standard Mail volumes first exceeded those in First-Class Mail in fiscal year 2005.

Figure 1: Percentage of Household Bill Payments Made by Mail and Electronically, Fiscal Years 2000 through 2009



Source: USPS.

Figure 2: Actual and Projected Total Mail Volume, Fiscal Years 1971 through 2020



Source: USPS.

In 2010, USPS delivered mail to over 150 million addresses nationwide. USPS has about 670,000 full-and part-time employees, and reports that, when benchmarked against other large posts, it has the highest percentage of full-time employees—about 79 percent. USPS has reported achieving cost savings close to $13 billion in the last 5 years. For example, USPS eliminated 125,000 full- and part-time positions (about 16 percent). Despite these achievements, USPS has had difficulty significantly reducing its compensation and benefits costs and has struggled to optimize its workforce and retail, mail processing, and delivery networks. For example, during the first quarter of fiscal year 2011 despite a reduction of 6.4 million work hours when compared with the same period last year, savings from this reduction were partially offset by wage increases and increase in total retirement and health benefits expenses. Further, some USPS savings during these years came as a result of congressional action—Congress deferred $4 billion of USPS's $5.4 billion scheduled payment to its retiree health benefit fund that was due at the end of fiscal

year 2009.[4] Table 2 provides an overview of key components of USPS's operational network.

Table 2: Key Aspects of USPS's Operational Network, Fiscal Year 2010

• Delivered to over 150 million business and residential addresses	• Processed about 563 million pieces, on average, of mail each day
• Nearly 740,000 new additional delivery points	• Over 670,000 full- and part-time employees
• 6-day mail delivery to most addresses	• $60 billion in compensation and benefits expense (80 percent of total expenses)
• Over 32,500 post offices and other retail and delivery facilities	• 528 mail processing facilities
• Over 215,000 vehicles, 193,000 of which are delivery vehicles	• Nearly 1.2 billion staff work hours
• 4.1 million miles driven in an average day by letter carriers and truck drivers	• $5.9 billion in transportation expense, primarily for highway and air transportation

Source: USPS.

USPS has relied increasingly on debt to fund its operations and has increased its net borrowing by nearly $12 billion over the last 5 years. USPS also ended fiscal year 2010 with about $1.2 billion in cash and unfunded obligations and liabilities of roughly $105 billion (see table 3). For fiscal year 2011, USPS has not updated its financial projections based on its first quarter results and it still plans to borrow an additional $3 billion—an increase that would place USPS at its $15 billion statutory limit and prevent it from further borrowing in fiscal year 2012 absent congressional action. USPS also projects a $2.7 billion cash shortfall at the end of fiscal year 2011.

[4]USPS made its scheduled $5.5 billion payment into the Postal Service Retiree Health Benefit Fund that was due at the end of fiscal year 2010.

Table 3: USPS Financial Liabilities and Unfunded Obligations, Fiscal Years 2007 through 2010

Dollars in billions

	Liabilities				Obligations			
Fiscal year	Outstanding debt	Workers' compensation liabilities	Other liabilities[a]	Total liabilities	Unfunded obligations for retiree health benefits	Unfunded obligations (surplus) for pension benefits	Total unfunded obligations	Total liabilities and obligations
2007	$4.2	$7.8	$12.7	$24.7	$55.0	$(5.3)	$49.7	$74.4
2008	7.2	8.0	12.5	27.7	53.5	2.5	56.0	83.7
2009	10.2	10.1	13.2	33.5	52.0	16.7[b]	68.7	102.2
2010	12.0	12.6	13.6	38.2	48.6	17.9[b]	66.5	104.7

Source: USPS.

Note: Data may not add exactly to totals due to rounding; workers' compensation liabilities include the current and non current portion of this liability.

[a]Other liabilities include many items, such as operating expenses that USPS committed to in fiscal year 2009 but has not yet paid, the value of postage purchased by customers but has not yet been used, and the value of employees' accumulated leave.

[b]Pension obligations for 2009 and 2010 reflect the adoption of new accounting principles by the plan administrator in the Office of Personnel Management (OPM). In fiscal year 2010, OPM adopted the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standard No. 33: Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Date.

The President's Fiscal Year 2012 Budget Request also proposes changes that, if enacted, would provide USPS with over $4.5 billion in short-term financial relief for fiscal year 2011. The majority of this relief—$4 billion—would come as a result of USPS paying $1.5 billion into the Postal Service Retiree Health Benefit Fund instead of the $5.5 billion required under current law. The remaining relief would come from reducing USPS's obligation for future funding of retirement payments to the Federal Employees Retirement System (FERS).[5] This relief, however, would be somewhat offset by terminating $29 million in annual appropriations in

[5]The proposal would reduce USPS's obligation for future funding of retirement payments to FERS—a change that would result in a reduction of this obligation totaling approximately $6.9 billion, payable over 30 years with an estimated impact of $550 million in fiscal year 2011.

fiscal year 2012, that reimburses USPS for revenue foregone from reduced rate mail.[6]

USPS's financial problems will not be fixed easily or quickly. USPS projects future mail volume declines, stagnant revenues, large financial losses and continued significant financial obligations.

Actions Are Urgently Needed to Modernize and Restructure USPS to Achieve Financial Viability

Considering USPS's important role, action is urgently needed to facilitate its financial viability as USPS cannot support its current level of service and operations. Congress, USPS, the administration, and stakeholders need to reach agreement on a package of actions to restore USPS's financial viability and take steps to modernize and restructure it. USPS needs to become a leaner, more flexible organization so that it can operate more efficiently, control costs, keep rates affordable, and meet customers' changing needs. In considering proposed legislation, incentives and oversight mechanisms would help to ensure an appropriate balance between providing USPS with more flexibility and assuring sufficient transparency, oversight, and accountability.

We have previously identified five key areas where action is needed to facilitate progress toward meeting USPS's growing fiscal challenges:

- *Realign postal service with customers' changing use of mail:* As mail use by businesses and consumers continues to change, USPS has stated that it cannot afford to sustain its current level of delivery and retail services. For example, it has estimated that it could reduce its costs by about $3 billion annually if it reduced delivery frequency from 6 days to 5 days per week, but congressional action would be needed for this change. USPS filed its proposal to eliminate Saturday delivery with the Postal Regulatory Commission (PRC) on March 30, 2010, and the PRC's advisory opinion is expected to be released in 2011.[7] Key questions to consider when evaluating this proposal include:

[6]Under this appropriation, USPS receives reimbursement for previously provided services—free mail service for the blind and overseas voting. See e.g., Pub. L. No. 111-117, div. C, tit. V, 123 Stat. 3200 (Dec. 16, 2009).

[7]We also expect to issue a report on 5-Day delivery this spring.

- What aspects of universal postal service, including 6-day delivery, are appropriate in light of fundamental changes in customers' use of the mail?
- What, if any, changes are needed to other elements of universal service (e.g., delivery standards)? How can USPS improve customers' access to postal services while modernizing its retail network to maximize costs savings?
- Should USPS implement its proposal to reduce delivery frequency to 5 days a week? How would such a change affect its operations, costs, workforce mix, employees, service, competition, value of mail, mail volume, and revenue? How would shifting to 5-day delivery affect business mailers and the public?

- *Realign operations, networks, and workforce*: USPS's operations, networks, and workforce need to be realigned with the changes in mail usage and customer behavior, as USPS now has costly excess capacity. Key questions to consider when evaluating proposed actions in this area include:
  - How should USPS optimize its operations, networks, and workforce to support changes in services? How quickly can this happen? How can it work with its employees and customers to minimize potential disruptions?
  - Should USPS have greater flexibility to realign its retail networks and workforce, which may involve closing post offices and moving retail services to alternative commercial locations that are often open 7 days a week and keep longer hours than postal facilities?
  - What process is appropriate to assure sufficient transparency, oversight, and accountability?
- *Reduce compensation and benefit costs:* Wages and benefits represent 80 percent of USPS's costs (about $60 billion in fiscal year 2010). One of the most difficult yet critical challenges is making changes to USPS's compensation systems. These systems have been set in law and also negotiated during collective bargaining with its four largest employee unions. USPS also consulted with its three management associations. We suggested that Congress should consider revisiting the statutory

framework for USPS's collective bargaining to ensure that binding arbitration takes USPS's financial condition into account.[8] We also reported other possible options for reducing compensation and benefit costs, including implementing a two-tier pay system, outsourcing if it results in cost savings, or revising employees' share of health and life insurance premiums. Key questions to consider when evaluating proposals in this area include:

- What changes, if any, should be made to USPS's compensation and benefits?
- Is it appropriate that USPS pays a larger share of its employees' health and life insurance premiums than do most other federal agencies? What impact would changes to these premiums have on USPS and its employees?

- *Generating revenue through new or enhanced products and services*: A key issue is whether USPS can generate sufficient new revenues using the pricing and product flexibility provided in the Postal Accountability and Enhancement Act of 2006[9] or if changes are needed. In 2009, USPS asked Congress to change the law to permit it to diversify into nonpostal areas to find new opportunities for revenue growth. USPS also asked for additional pricing flexibility in a 2010 action plan.[10] However, it is unclear what the potential impact of such changes would be and what statutory or regulatory changes would be needed. Key questions to consider when evaluating proposals in this area include:
  - New products and services: What opportunities are there to introduce profitable new postal products and enhancements to existing ones?
  - Should USPS engage in nonpostal areas where there are private sector providers? If so, under what terms?

[8]About 77 percent of USPS employees are covered by collective bargaining agreements, and if the current collective bargaining process reaches binding arbitration, there is no statutory requirement to consider USPS's financial condition when determining pay or other compensation.

[9]Pub. L. No. 109-435 (Dec. 20, 2006).

[10]United States Postal Service, *Ensuring a Viable Postal Service for America: An Action Plan for the Future* (Washington, D.C. March 2010).

- *Funding postal retiree health benefits*: USPS has said that it cannot afford its required annual prefunding payments ($5.5 billion in fiscal year 2011 and gradually increasing to $5.8 billion by 2016), and it has requested that Congress reduce these payments.[11] Several proposals have been put forth to revise the current statutory requirements and reduce or defer some of these costs, thereby providing USPS with financial relief.[12] Changes to this structure, however, could affect the federal budget, and the Congressional Budget Office has raised concerns about how aggressive USPS's cost-cutting measures would be if these payments were reduced.[13] As we reported in 2010, Congress should consider modifying USPS's retiree health benefit payments in a fiscally responsible manner. However, we also believe that it is important that USPS fund its retiree health benefit financial obligations—including prefunding these obligations—to the maximum extent that its finances permit. Key questions to consider when evaluating proposals in this area include:

  - 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?

The President's Fiscal Year 2012 Budget Request proposed specific short-term financial relief measures, that it stated are grounded in principles of fiscal responsibility and sound financial management. The budget request states that these steps are to provide USPS with the "breathing room" necessary to continue restructuring its operations without severe disruptions and notes that they must be coupled with meaningful business model reforms to make USPS viable for the medium- and long-term. To that end, the budget request outlines three principles to guide these reforms: (1) realigning postal infrastructure, including processing and delivery facilities; (2) adapting the postal workforce to the 21st century; and (3) enhancing service and accelerating the value of USPS services

[11]The Postal Accountability and Enhancement Act of 2006 required USPS to prefund its retiree health benefit obligations with annual payments through 2016 to the Postal Service Retiree Health Benefits Fund.

[12]See GAO, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455 (Washington, D.C.: Apr. 12, 2010) for a discussion of different approaches for funding USPS's retiree health benefit obligations.

[13]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).

while respecting fair competition in the marketplace. However, while promoting realignment and modernization, the budget request would also continue to restrict USPS from reducing delivery from 6 days a week and closing small rural and other small post offices.

Much attention has been focused on ways postal services may be reduced—such as USPS's proposals to move to 5-day-a week delivery or to close post offices. Less attention has been given to more positive aspects of USPS's plans to modernize its retail services, which it believes will improve customer access and convenience while reducing costs and improving efficiency. In a recently issued report on strategies and initiatives foreign posts have used to modernize their delivery and retail networks, we discussed some lessons learned that could inform USPS's modernization efforts.[14]

Although the foreign posts we reviewed reported that changing how postal services were provided was challenging, they also found that outreach and communication strategies helped to inform public officials and customers of increased access to products and services and to gain acceptance for retail network changes. For example, when realigning their respective retail networks, Australia Post developed a labor outreach strategy, and the Swedish postal operator, Posten AB, created a communications strategy to inform customers of its retail network transformation. Additionally, foreign posts modernized their retail networks by forming partnerships with private sector businesses such as grocery stores to sell postal services. According to the foreign posts we reviewed, retail modernization improved customer service, in some cases because the private sector partners stayed open longer, reduced operating and labor costs through closures of post-owned and -operated facilities, or both.

When modernizing, foreign posts also transitioned their workforce to have a greater percentage of part-time employees, which they reported afforded flexibility to adjust work to decreased mail volumes. A few foreign posts developed labor transition plans or strategies under which they provided training, relocation and job search services, and financial incentives to support employees who were negatively affected by the modernizations.

[14]GAO, *U.S. Postal Service: Foreign Posts' Strategies Could Inform U.S. Postal Service's Efforts to Modernize*, GAO-11-282 (Washington, D.C.: Feb. 16, 2011).

The foreign posts we reviewed did not plan or implement changes or realize improvements to their networks overnight. Modernization took several posts 10 to 20 years to implement and was often met with stakeholder resistance. Among the key principles that foreign posts used to help modernize and restructure their organizations are the following:

- Strategic outreach and coordination with governments, the public, mailers, small businesses, and retail customers can address political resistance. For example, foreign posts communicated with and reached out to customers to increase acceptance of changes and to better meet customers' needs, including providing alternatives before implementing major retail network changes.
- A labor relations strategy can assist employees in making the necessary transition to modernization changes. For example, a few foreign posts provided training, relocation and job search services, and financial incentives to support employees who were negatively affected by the modernizations.

The lesson from these experiences is that USPS needs to clarify what its modernization plans are, how and over what period it will implement them, and what improvements in customer service and cost savings it expects to achieve. In its efforts to modernize its retail network, USPS needs to assure customers that they will have alternative access to postal services, such as through self-service retail kiosks or retail partners. While USPS has taken steps in the past year to generate ideas for modernizing its retail and delivery networks, the experiences of foreign posts suggest that it will be critically important for USPS to fully develop and implement similar outreach, communication, and labor transition strategies.

In summary, modernizing and restructuring USPS so that it can be viable in the future is imperative given its financial condition. While we recognize that this will not be easy, changes—some difficult—are needed to ensure that postal services remain available to all U.S. residents and businesses. Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

Mr. ROSS. Thank you, Mr. Herr.

We will now move into the questions and I will recognize myself for 5 minutes.

I want to jump right into what I think is really the heart of the first issue that we are facing, and that is the PAEA and its aftermath today.

Ms. Goldway, I know you have acknowledged that the Commission is doing a study on that. Specifically, at the time the PAEA was passed in 2006, we had certain assumptions that I think may have been taken into consideration to go ad infinitum. For example, 800,000 employees at the time. Now we are down to 575,000. A decline in first class mail.

My question, and I will go to Mr. Donahoe first, is with this prefunding of the pension benefit, are there not assumptions that today may not exist, or have changed dramatically, that in and of itself, if actuarially identified, could reduce the obligation of the Postal Service that is being imposed by the PAEA?

Mr. DONAHOE. We believe so, Mr. Chairman. We think that if you take a look at the intentions behind the law that was passed in 2006, they were very good intentions. The expectation was that the Postal Service, having a base volume of 213 billion pieces of mail, along with no debt at the time, could carry that burden of the health benefits going forward. It was a responsible idea. We still think it is a responsible idea to account for our retiring health benefits going forward, but we think there are a number of things we have to take into consideration.

No. 1, we have had a substantial drop in volume. That has to be considered. No. 2, to your point, we have reduced headcount. I think back in 2006, when the law was passed, it was based on the assumption of 757,000 employees. Today we have about 570,000 employees, and we think that, moving forward, we will eventually break into the 400,000 range. We know, going forward, we will not have those same burdens, so we would ask that Congress take a look, ask the GAO to examine what the actual liability is going forward.

We also think there are some solutions as far as how to fund that. We think that the funds that are existing in the Civil Service Retirement funds that we have overpaid, by our estimates, $75 billion, the Postal Regulatory Commission's estimate is $55 billion, could be used to make that payment.

If that is not available, we think that we can also look at some other options. Our own IG has suggested that we take a look forward around the option of taking a private sector model or you fund at 30 percent versus the 100 percent that we are required to now. So there are many options on the table, and we would be more than happy to explore any of those with you.

Mr. ROSS. Thank you.

Ms. Goldway, would you have any estimate based on new assumptions as to what the reduction could be or potentially be?

Ms. GOLDWAY. What we did in 2009, working with consultants, the Mercer and the Hay Group, is to look at the OPM projections and factor in lower levels of employees and to adjust the expectations of health care cost increases that the OPM had in their formula, and we estimated that in order to fund 100 percent of what

would be the health care retiree benefit problem, you could do it with $35 billion less money than the OPM had estimated in 2006. I would suspect that number might even be lower today than it was in 2009 when we did it and that, therefore, the target for what the Postal Service needs to pay into a health care retiree benefit fund is lower and the annual payments that they make into it could be adjusted downward and reduce their burden.

Mr. ROSS. Any idea how much?

Ms. GOLDWAY. Well, we have estimated about $2 billion a year.

Mr. ROSS. Reduction?

Ms. GOLDWAY. Reduction.

Mr. ROSS. OK.

Ms. GOLDWAY. So instead of $5 billion, it would be $2 billion. But that was an estimate and, again, it would need the assistance of OPM and perhaps GAO to clarify those numbers.

Mr. ROSS. Thank you.

Mr. Donahoe, of course, one side of the issue is the ongoing liability for the pre-funding. But the other side is a systemic change. And what we have to do, and this is what I would ask your opinion on, is how do we go about competing in the 21st century? How do we go about now adapting to the digital age? And I think that if we are able to do something and empower the Postal Service to take care of the immediate need, but how does it go on from hereafter so that it is existing for another 235 years without any subsidies?

Mr. DONAHOE. Well, first of all, Mr. Chairman, we think that there is a tremendous upside on the top line on our revenue in the Postal Service and the entire industry. We think there is plenty of growth available in the area of standard mail. Standard mail is the most direct way to get in front of a customer's eyes; better than the Internet, better than TV, better than radio. So we know there is growth there.

We also know there is growth in the package market, and we have been exploring that. We have been working with a number of new products. You have seen our flat rate products come out. We have introduced a number of others coming forward. Matter of fact, Ms. Goldway showed me, we brought along a copy of our free sample box they have just approved over at the Regulatory Commission. We think there is a ton of value in that. We think that this is an opportunity on a monthly basis for people to get in to the sample business in a very affordable way. So we know there is an upside.

Now, on the first class mail, as you mentioned, it is declining, but we think that by using NSAs contracts with many of our customers, we can actually slow down the pace of change with the drop-off in first class.

Congressman Lynch mentioned some opportunities in digital, and we are exploring that too. We have had some really good ideas come back from an innovation summit, along with a number of other ideas that we have been exploring with partners; digital to hard copy, hard copy to digital, and even digital to digital. We know that the Postal Service provides tremendous opportunities and security in that entire market, and we think there is plenty of opportunity for growth there too.

Mr. ROSS. Thank you, Mr. Donahoe. My time is up.

I now recognize the distinguished gentleman—are we going in for a vote? Have they called us? If no objection, the ranking member, Mr. Lynch, for questions.

Mr. LYNCH. Thank you, Mr. Chairman.

I want to thank the witnesses for your help.

Mr. Donahoe, let me push back on that a little bit. I know I have spoken with Pitney Bowes and a number of other firms that operate in Europe as well, and they have some systems where you can actually pull up on your laptop or on your iPad and actually click on your mail before it is delivered, and you can click off the stuff that you don't want to have delivered and click on the stuff you would like to have delivered. But that tells me that, with technology, there will be a further reduction in volume as people are given that option. So I am not so sure I buy into the idea that we are actually going to be able to increase volume.

But that much being said, let's go back to where the chairman was considering PAEA. What does it look like right now? And, Mr. Herr, you might be able to jump; actually, Ms. Goldway as well. If we are overfunding future retiree health benefits, what is the measurement of that overpayment? Do we have a sense of that? I know they are making you full fund it in advance, and no one else is required to operate under that standard, but I am just wondering what the overpayment is in there right now.

Ms. GOLDWAY. Well, I don't think there is—there is no overpayment in the health care retiree benefit fund at the moment; there is about $42 billion——

Mr. LYNCH. But it is pre-funded. I mean if—what I am trying to——

Ms. GOLDWAY. In the Civil Service Retirement Benefit Fund, there is. In the Civil Service Retirement Fund——

Mr. LYNCH. No, no, I know that. I know that. OK, look, you have ordinary health benefit plans——

Ms. GOLDWAY. Right.

Mr. LYNCH [continuing]. That are required to pay in annually. They are not required to pre-fund, OK?

Ms. GOLDWAY. Right.

Mr. LYNCH. So if you compare the pre-funding requirement to a "normal" health care benefit requirement, what excess do we have in there that if we were required to meet normal health care fund obligations, what would be in there that would not be required under a standard system?

Ms. GOLDWAY. I am not sure I understand, but I think what you are talking about is that the Postal Service currently pays out of its existing revenues the money it needs to pay for retirees' health care benefits, and that is about $2½ billion a year. And there are $42 billion in a fund. So one could either take some of that money to pay the existing health care retiree benefit retirees' funds or at least take some income from that to help pay that off. I think that is what you are referring to.

Mr. DONAHOE. Another way to look at it is potentially, Congressman, the estimate for the prepayment that was needed back in 2006 was $90 billion. Our IG has done a study looking at regular businesses, private firms and what their requirements are to pay.

The average prepays is at about 30 percent. So their recommendation has been you would owe somewhere around $30 billion. We have paid $42 billion to it already, so theoretically we are overfunded at that rate.

Mr. LYNCH. OK. That probably answers the question.

Mr. HERR. Mr. Lynch, if I may?

Mr. LYNCH. Yes, Mr. Herr, go ahead.

Mr. HERR. In my statement we actually report the data that the Postal Service had in its annual financial report, and there is, as was stated, there is about $42 billion in that fund. But the unfunded liability is $48.6 billion, as calculated by OPM using Postal Service numbers, and as reported in the annual financial report.

Ms. GOLDWAY. And that is the part that our consultants thought could be lowered.

Mr. LYNCH. And that is for all future employees who are not necessarily going to tap into the fund in 1 year, right?

Mr. HERR. Correct.

Ms. GOLDWAY. At some point.

Mr. LYNCH. Let me ask you this, then. I know you are running out of money, Mr. Donahoe, this year. With the obligations you have for the health benefit and other obligations, you have a workmen's compensation payment for $1.3 billion, I think. When does that happen and what do you do when you run out of money?

Mr. DONAHOE. Here is the thing. September 30th we finish the fiscal year. I will owe the Federal Government $5½ billion for the pre-funding. In November I will owe another $1.3 billion for worker's comp. At the end of the fiscal year I am out of cash.

Mr. LYNCH. You are also up against your debt limit.

Mr. DONAHOE. I am up against the debt limit, so there is no breathing room. We will deliver mail. We will pay the employees and deliver mail. We will make sure that we pay our suppliers. They are providing contract transportation, etc. The thing we will not do is be able to pay the Federal Government. That will have to be negotiated. We will talk with the Board of Governors, come back to the Treasury and figure out what we will have to do. That is why it is so important that we address this.

Mr. LYNCH. OK. Thank you. My time has expired. I yield back.

Mr. ROSS. Thank you, Mr. Lynch.

The subcommittee will now stand in recess until probably 5 minutes after the last vote. I expect it will probably be about 30 minutes. Thank you.

[Recess.]

Mr. ROSS. Good afternoon. I will call the subcommittee back to order and will recognize the gentleman from Florida, Mr. Mack, for questions.

Mr. MACK. Thank you, Mr. Chairman. Before I begin, I want to congratulate you for being the chair of this subcommittee and for being here in Washington.

Mr. ROSS. Thank you.

Mr. MACK. For people who don't know, we served in the legislature together in Florida, and he is a great friend and the committee is lucky to have you as the chair, so thank you.

Mr. ROSS. Thank you.

Mr. MACK. Before we left, something kind of struck me. We keep asking, well, how can we kind of help get the Postal Service in the right direction, and part of me is thinking government just doesn't know how to run a business. So, first of all, the idea that the government is going to fix a business model I think has been proven over and over and over again it can't do it.

So I think what we are really talking about here is time. At some point some drastic changes are going to have to be made to the Postal Service. If this committee is going to—and no disrespect to anybody on this committee, but the idea that somehow government is going to fix this, I am not sure that government has a great track record when it comes to business. So I just thought I would put that out there.

The Office of the Inspector General recently released a study in which it looked at shifting costs from ratepayers to taxpayers, and I think the study was pretty clear about that may be a way that it has to go to be solvent. Mr. Donahoe, are you ready to admit that the only way to stay afloat is through a bailout by the taxpayers?

Mr. DONAHOE. Thank you, Congressman. First of all, I think I would take umbrage with the fact that we can't get our finances together and right the ship in the Postal Service. We, as a government entity providing universal service to the American public, have done a pretty good job especially over the last 10 years, from a standpoint of cost improvement, service improvement. Granted, we have some constraints around some of the revenue generation that we see, but we also think we have a good plan going forward, and with a little freedom and flexibility we think we can get there. The major issue that we've got, again, is the issue with the prepayment of the retiree health benefits.

Mr. MACK. I understand.

Mr. DONAHOE. And I think there is an opportunity to resolve that.

Now, I have to ask you a question On your statement, is that from our IG or is that from a different IG? I am not 100 percent sure.

Mr. MACK. It is a recent released study from the Office of Inspector General.

Mr. DONAHOE. That is probably the OPM. That is the OPM's IG.

Mr. MACK. OK, you are right. But let me just ask you this.

Mr. DONAHOE. OK.

Mr. MACK. OK? Forget about the study.

Mr. DONAHOE. OK.

Mr. MACK. I mean, you have already admitted that there are big problems, right?

Mr. DONAHOE. Absolutely.

Mr. MACK. So are you prepared to admit that you are going to need a bailout to stay afloat?

Mr. DONAHOE. We will not need a bailout. Here is the way we look at this. There are a couple solutions. No. 1, we have an overpayment into the retirement systems, whether the Civil Service or——

Mr. MACK. OK, I only have a few minutes, so——

Mr. DONAHOE. OK.

Mr. MACK. So the answer is, you think, no.

Mr. DONAHOE. I think no.

Mr. MACK. Are there any modifications to a postal employee's pay or benefit schedule that would help insolvency?

Mr. DONAHOE. Absolutely. We are working with our unions right now. We have a union contract discussion going on with the American Postal Workers Union Rural Carriers. We are having some very good discussions about flexibility.

Mr. MACK. And what are they offering right now?

Mr. DONAHOE. We are talking about changes in flexibility and compensation going forward.

Mr. MACK. Now, is there talk about coming down to the rest of the Federal work force, the pay schedule and benefits?

Mr. DONAHOE. The only pay that the Postal Service has that is in excess of the rest of the Federal Government is in terms of the health care contribution. That is a very small portion of what we pay our people. We are, through negotiations, working to come to the same level. That is minimal. The big opportunities are work——

Mr. MACK. Do you think that can be achieved? Do you think the unions will agree to come to——

Mr. DONAHOE. Absolutely.

Mr. MACK [continuing]. The rest of the Federal work force?

Mr. DONAHOE. The unions are already coming to that level. We have seen progress in the last contract. We have moved 1 percent per year in the last contract, and what is being discussed right now will get us to that level in the next 4 years.

Mr. MACK. In the next 4 years.

Mr. DONAHOE. Yes.

Mr. MACK. So of the rest of the Federal work force.

Mr. DONAHOE. That is a small——

Mr. MACK. The pay and the benefit?

Mr. DONAHOE. No, no, no, no. That is a small portion. That is the compensation that we give our people in terms of health benefit contribution. Our people pay, right now, about 81 percent toward their—we pay 81 percent toward their health benefits.

Mr. MACK. I have 25 seconds, so let me just ask one more question.

Mr. DONAHOE. OK.

Mr. MACK. Do you believe the U.S. Postal Service is too big to fail?

Mr. DONAHOE. We are too big to fail. We are an important part of the American economy, important part of American society. We will deliver 171 billion pieces of mail this year.

Mr. MACK. And you are going to do that without a bailout?

Mr. DONAHOE. We are not going to have a bailout. There is a solution to this. There are a number of things that we can do working with Congress to get a resolution, and it is not a bailout.

Mr. MACK. Thank you, Mr. Chairman.

Mr. DONAHOE. Thank you.

Mr. ROSS. Thank you, Mr. Mack.

I now recognize the gentlewoman from the District of Columbia, Ms. Norton, for 5 minutes.

Ms. NORTON. Thank you very much, Mr. Chairman.

I want to thank you again, Mr. Postmaster, for the improvements in delivery that you have personally made in this region some years ago. I love that. You did something good then and look where you are now.

Mr. DONAHOE. Thank you, ma'am.

Ms. NORTON. I would like to know where we are headed. We have been talking about the Postal Service model for some time, yet we have seen no alteration in the model, and many of us, I think on both sides, can't believe that this model is meant for all time. If you look at the assumptions of the statute when the U.S. Congress set up the Postal Service, essentially it was that you would be a profit-making business, is that not true?

Mr. DONAHOE. At least to break even.

Ms. NORTON. So a profitable business at least.

Mr. DONAHOE. Yes, ma'am.

Ms. NORTON. On page 1 of your testimony you say "Our core business will always be delivery. There is one customer need that will not change and it is the very essence of what we do, day in and day out."

Now, I must ask you if we make the kinds of assumptions that we are making at this hearing, that perhaps you will pay, but not overpay, into the trust fund; and you have calculated that to be 55 or 75 million, give or take however millions you want to. Let's say you pay or not overpay. Let's assume that you are delivering mail 5 days a week.

Can you say to us this afternoon that this model, which requires you to be a profitable enterprise, delivering the mail as you are delivering it now, is a model, the model in the statute is a model, the model of a profitable enterprise, is a model we can expect to survive; that you will be a profitable enterprise under the assumptions of the statute that you are now held to now? And remember I am saying you would not overpay into the trust fund.

Mr. DONAHOE. Yes, ma'am. I think that we can be profitable. I think that there are a number of things that have to happen. No. 1, the Postal Service has undertaken a number of issues, revenue generation, cost reductions on our own that we feel responsible toward and will work toward that point. As I mentioned before, we are also working with the unions going forward. We have very responsible leadership there; they understand what we have to do for a strong Postal Service. So we will take care of what we need to take care of.

The key for us is this: we are being required to prepay a health benefit rate $5½ billion. This year we will lose $6.4 billion.

Ms. NORTON. And that is why I say if we assume that is no longer a problem——

Mr. DONAHOE. Yes.

Ms. NORTON [continuing]. Then we will be back to a profitable enterprise under the assumptions of the statute in 1970.

Mr. DONAHOE. This year, if we were not required to make that payment, we would break even, and that is with a volume loss——

Ms. NORTON. If you were required not to overpay.

Mr. DONAHOE. Right. And that is with a volume loss of 22 percent. So our people have done a great job taking substantial cost——

Ms. NORTON. Well, that is very important to know, if you say that but for this overpayment. Normally if you overpay something, you are due a refund, so I am hearing you.

I would like to ask one more question, and I don't want false hopes here, but I noted on page 2 of your testimony something I have not heard before in a very long time. I don't think I have heard it before, period. The first quarter showed a modest increase of 1½ percent. Is that because people quit writing their tax forms? To what do you attribute an increase? In your testimony you say that the Christmas season was not very good. Why is this first quarter showing a modest increase in first class mail?

Mr. DONAHOE. Well, the increase is total volume, and we have seen a 9.6 percent increase in standard mail, advertising mail; an increase in our package business. But we have had a decrease of 5.9 percent in first class. First class pays the freight, and that is why we have been asking, also, for the consideration before Congress to go from 6 to 5 days.

Ms. NORTON. And you think that, then, would have what effect?

Mr. DONAHOE. I will tell you this. If we can get a resolution around the health benefits, if we can get a resolution around the first payment—the President has made that recommendation in his budget—if we can get a resolution around the 6 to 5 day—these are things that are not in our control—I know that we can get this organization profitable and strong going into the future.

Ms. NORTON. We are marking that down, Mr. Postmaster.

Mr. DONAHOE. Yes, ma'am, you can. Thank you.

Ms. NORTON. Thank you, Mr. Chairman.

Mr. ROSS. Thank you.

I would now like to recognize the gentleman from Michigan and our subcommittee vice chairman, Mr. Amash, for 5 minutes.

Mr. AMASH. Thank you, Mr. Chair, and thank you to the panel for being here.

Mr. Donahoe, I really enjoyed meeting you the other day and chatting with you.

Mr. DONAHOE. Thank you.

Mr. AMASH. You just said, I think, that you guys would break even if you didn't have to make the pre-funding.

Mr. DONAHOE. This year, yes.

Mr. AMASH. But I think your own plans shows that you would have an operating income loss.

Mr. DONAHOE. Our plan shows an operating income loss of about $900 million, but we will continue to cut. We have a plan in place right now where we are addressing administrative cost reductions, $750 million. We will get some of that this year. We have some other changes going. Our goal would be to make $100 million this year if we were able to be forgiven from the prepayment plan this year.

Mr. AMASH. OK. I have a copy of the letter from the Office of Personnel Management to former Postmaster General John Potter. It is from September 2004 and it rejects the claim that USPS has overpaid the Civil Service Retirement System. OPM explains that the Postal Service's request for a return of $75 billion in overpayment to the CSRS is unfounded and should not be granted by the Congress. Furthermore, the letter includes a statement from the

CSRS Board of Actuaries, in which it declares that OPM has appropriately and accurately determined the financial obligations for the Postal Service.

Mr. Chair, I ask unanimous consent to submit this letter for the record.

Mr. Donahoe, what is your response to the letter?

Mr. DONAHOE. Here is my response: we have differing opinions here. Our IG in the Postal Service has estimated with external actuaries that we have overpaid $75 billion. The Postal Regulatory Commission has looked at the same information and their outside actuaries have estimated that we have paid somewhere between 50 and 55. So there is a meeting of the minds necessary to sit down and get this resolved once and for all.

Mr. AMASH. So you do disagree with the letter.

Mr. DONAHOE. I disagree with the letter.

Ms. GOLDWAY. If I could add that the PAEA actually has a provision so that the Postal Service can ask us to review the OPM analysis, and the Postal Regulatory Commission did what we believe is an objective analysis, bringing in a highly respected third-party expert to review the situation. So one could say you have the self-interest of the Postal Service and the self-interest of the Office of Personnel Management, each one wanting to protect its funds, but I want to assure you that the Postal Regulatory Commission had no preconceptions, gave this study no prior directions, and we came up with what we believe is a fair and objective assessment that there is in fact a $50 billion overpayment there.

Mr. ROSS. And, without objection, the letter so referenced is entered into the record.

[The information referred to follows:]

United States
Office of
Personnel Management

Washington, DC 20415-0001

In Reply Refer To:

Your Reference:

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OFFICE OF PMG
CORRESPONDENCE # 119426

SEP 16 2004

The Honorable John E. Potter
Postmaster General, CEO
United States Postal Service
475 L'Enfant Plaza, SW.
Washington DC 20260-0010

Dear Mr. Postmaster General:

This is in regard to your letter of January 26, 2004, addressed to the Board of Actuaries of the Civil Service Retirement System (Board of Actuaries), in care of the undersigned. In your letter, you requested that the Board of Actuaries reconsider the "Postal supplemental liability" and the methodology and computations for determining the amount of Postal Service obligations to the Civil Service Retirement System (CSRS) and the amount of Postal Service over funding of the Civil Service Retirement and Disability Fund (CSRDF) that resulted from computations in effect under prior law and which now, under the Act, are to be realized by the Postal Service as "savings." The "Act" refers to the Postal Civil Service Retirement Funding Reform Act of 2003, Public Law (P.L.) 108-18 (April 23, 2003).

In your letter, you maintain that the Office of Personnel Management's (OPM's) methodology understates the Federal share of the liabilities for pre-July 1, 1971, employees and proposed that a "service ratio" method should be used instead. Under your proposal, the Treasury would be allocated a share of the cost of retirement benefits attributable to salary increases granted by the Postal Service since June 30, 1971, while under the OPM methodology, the Postal Service would be responsible for these costs.

Your request for reconsideration fails to recognize the existence of P.L. 93-349 (July 12, 1974). Under this law the Postal Service was required to finance, through 30-year amortization payments, all increases in retirement liabilities that are attributable to salary increases granted by the Postal Service. The increases in liabilities were determined without regard to the amount of service the employees may have had before or after the Postal Service became independent on July 1, 1971.

House Report 93-120 (April 11, 1973), issued by the House Committee on Post Office and Civil Service, entitled "Postal Service Payments to Retirement Fund," on the legislation ultimately enacted as P.L. 93-349 states, at page 2, that "The purpose of this legislation is to clearly establish the responsibility of the U.S. Postal Service to finance increases in the liability of the Civil Service Retirement and Disability Fund, caused by administrative action of the Postal Service, as apart from increases in unfunded liabilities which are incurred by act of Congress." The Report continues by stating, at

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page 4: *"The situation with respect to the Postal Service is quite unique and results from passage of the Postal Reorganization Act. The Congress now has no control – no oversight whatsoever – with respect to the pay machinery in the Postal Service. Since each future pay raise, negotiated or otherwise granted to employees in the Postal Service, will result in a specific unfunded liability and a new drain on the Retirement Fund, the cost of this liability should properly and equitably be borne by the Postal Service."*

Under the static funding method used in the law in effect prior to the enactment of P.L. 108-18, not only was the Postal service required to finance the cost of increases in retirement liabilities attributable to the salary increases that it granted, but it was also required to finance the cost of COLAs for retired Postal employees. The financing of COLAs was established through a series of Omnibus Budget Reconciliation Statutes passed in the early 1990's. Unlike the method for determining the Postal Service liability for salary increases under P.L. 93-349, the pro-rata approach was used to determine the Postal service liability for COLAs.

The approach recommended in your appeal would determine the Postal Service's liability for salary increases for pre-1971 hires based on the pro-rata approach that had been used for determining the Postal Service liability for COLAs. However, we believe that it is inappropriate to apply the methodology that had been used for allotting the funding of COLAs, which are controlled by a formula which is a part of CSRS, for the purposes of determining the Postal Service's liability for salary increases that were exclusively under the control of the Postal Service. Under the provisions in effect prior to the enactment of P.L. 108-18, the question of how to determine the Postal Service liability for salary increases is specifically addressed in P.L. 93-349, and Congress chose not to apply a pro-rata approach with regard to salary increases.

You have asked that we submit your appeal of OPM's methodology to the Board of Actuaries, and we have done so, although OPM takes the position that the Board lacks specific jurisdiction to review the methodology developed by OPM under section 3(b) of the Act for computing the amount of any annual savings realized by the Postal Service. At best, the allowable review goes to the computations derived from the OPM methodology. However, we also conclude that the Act does not forbid the Board of Actuaries from again analyzing the methodology in conjunction with our response to your appeal.

The Board of Actuaries has undertaken such analysis, and their conclusions are set forth in the enclosed letter to the undersigned. As you can see from that correspondence, the Board of Actuaries again considered OPM's methodology and approved that methodology, as well as the computation of the resulting Postal supplemental liability. The Board clearly concluded that the methodology OPM used this year is valid and follows the intent of the Act. We believe the Board of Actuaries' conclusion and OPM's

concurrence with that conclusion resolves all substantive issues between our different approaches both for fiscal year 2003 as well as for future years.

Although you addressed your January 26, 2004, letter to the Board of Actuaries, I am responding, on behalf of the Director of OPM, in order to avoid any possibility that a constitutionally suspect action be taken by the Board of Actuaries. As the President noted in his statement issued upon signing P.L. 108-18, the Supreme Court stated in Edmond v. United States, 520 U.S. 651 (1997) that final decision-making authority for the United States must be vested in, or be subject to the control of, a principal officer of the United States, i.e., one who is appointed by the President subject to confirmation by the Senate. Because the Board of Actuaries is not composed of principal officers, a decision on a appeal under 5 U.S.C. § 8348(h)(4) and/or § 3 (b) of the Act must be subject to review by the Director of OPM or her designee under 5 U.S.C. § 1103(a).

We trust that this determination by OPM concerning the methodology and computations of the Postal Service obligations, clearly consistent with the conclusions of the Board of Actuaries, will be accepted by the Postal Service at this time. If you or your staff have any additional questions or concerns, my staff and I would be pleased to further discuss this matter.

Sincerely,

Ronald P. Sanders
Associate Director
for Strategic Human Resources Policy

Enclosure

BOARD OF ACTUARIES
United States Civil Service Retirement System
U.S. Office of Personnel Management
Washington, DC 20415-0001

Douglas C. Borton, FSA, Chairman
A. Norman Crowder III, FSA
Mary S. Riebold, FSA

August 18, 2004

Dr. Ronald P. Sanders,
Associate Director for Strategic Human Resources Policy
U.S. Office of Personnel Management
1900 E Street NW, Room 6566
Washington, DC 20415

Dear Dr. Sanders:

The Board of Actuaries has reconsidered in detail the methodology used by the U.S. Office of Personnel Management to determine the obligations of the United States Postal Service under the United States Civil Service Retirement System. When private sector plans are transferring participants to a new employer, it is a common practice to allocate liabilities by using a method which reflects the fact that all obligations arising from future salary increases are the responsibility of the new employer. We find this approach to be the most appropriate way to determine the obligations of the Postal Service and further confirm our prior finding that this method clearly follows the intent of Congress in Public Law 93-349.

The OPM methodology was reviewed and described by the General Accounting Office in its report of January 31, 2003. This report was distributed to the Postal Service and members of Congress. Although the GAO suggested some adjustments to the OPM's calculations, it did not question the OPM methodology.

Sincerely yours,

Douglas C. Borton

Douglas C. Borton
Chairman, Board of Actuaries

cc: A. Norman Crowder, III
Mary S. Riebold
Michael R.Virga

Mr. AMASH. I have a question for Mr. Herr as well. In your testimony you recognize that a significant financial issue for the Postal Service is the fact that 80 percent of its costs go toward employees' salaries and benefits. Do you believe that the USPS should be able to renegotiate collective bargaining agreements?

Mr. HERR. One area that we suggested the Congress reconsider is whether contracts that go to binding arbitration, if there is an impasse, that there be a consideration given to the Postal Service's ability to pay, given its financial situation. So that is an area that we have highlighted in prior work and I highlighted again today in my statement.

Mr. AMASH. And the President has suggested giving USPS some breathing room. Will that actually make the problem worse by delaying it?

Mr. HERR. I would say that one of the things that we have been on the record as saying the Postal Service needed some short-term relief for this retiree health care benefit payment. We have been saying that for 2 years; this would be a third year. I think this is really the time, we are the statutory debt limit, to make some hard decisions about what this organization is going to look like going forward. The overall liabilities and obligations outlined in my statement are over $100 billion now, so it is time to take into consideration the changing use of the mail, what kind of footprint the Postal Service needs, and to really think about how that is all going to be paid for, including retiree benefits, which employees are expecting too.

Mr. AMASH. Thank you all for your testimony. I yield back.

Mr. ROSS. Thank you.

The distinguished gentleman from Virginia, Mr. Connolly, you are recognized for 5 minutes.

Mr. CONNOLLY. Thank you again, Mr. Chairman, and, again, congratulations on your elevation as chairman of the subcommittee. And I thank my good friend and colleague, Mr. Lynch, for his leadership in the past on these issues and some very thoughtful and groundbreaking hearings we have had in the past, this being another contribution. And welcome to the panelists.

Mr. Herr, let's start with that last point, the issue of whether the President brought some breathing room. I believe in his budget he recommended, was it, $4 billion of relief?

Mr. HERR. That is my understanding, yes, sir.

Mr. CONNOLLY. And that $4 billion, is it not predicated on the same assumption Ms. Goldway makes and, for that matter, the postmaster general makes, that in fact there have been overpayments?

Mr. HERR. I think that is actually predicated on the fact that there would be other efforts underway to restructure as well.

Mr. CONNOLLY. Right.

Mr. HERR. This would be a deferment, it is not a—my understanding of the proposal the President made——

Mr. CONNOLLY. I understand that, Mr. Herr, but is it not, by implication, a recognition that in fact this is an issue, that there have been overpayments in the past?

Mr. HERR. I guess you would have to—I would have to look at the fine print.

Mr. CONNOLLY. All right. Well, certainly the President, hopefully, in his budget wasn't trying to add to the postmaster's woes fiscally. He wasn't trying to add to that debt.

Mr. HERR. Well——

Mr. CONNOLLY. He was trying to provide relief.

Mr. HERR. Right. It is a short-term relief——

Mr. CONNOLLY. Does the GAO have an opinion about this issue of whether there is $50 to $75 billion of overpayments?

Mr. HERR. We have not looked at——

Mr. CONNOLLY. You have not looked at it.

Mr. HERR. I can assure you we have read the reports, though.

Mr. CONNOLLY. You would agree, however, that if anywhere between $50 and $75 billion were verified, that alone, amortized over some period of time, could provide significant relief to what is currently a significant imbalance in the operational revenues of the Postal Service?

Mr. HERR. Given the numbers that are being discussed, yes, that would be a significant——

Mr. CONNOLLY. You would agree. OK, as the GAO, do you have any plans to look at this?

Mr. HERR. If requested by Congress, we would certainly—both today——

Mr. CONNOLLY. Well, Mr. Chairman, I would hope that this subcommittee would in fact make such a request. That is not a trivial number. And if we are going to talk about dire futures for the Postal Service, surely we want to look into a $50 to $75 billion item that could provide relief fairly quickly over an amortized basis. And I know, Mr. Chairman, you share my concern about the options in front of us, and I would urge the subcommittee to consider making a formal request to GAO for just such a study.

Let me ask you another question, Mr. Herr, and maybe Ms. Goldway or Mr. Postmaster General Donahoe, you as well. Between 1990 and 2007, did overall mail volume for the Postal Service go up or down?

Ms. GOLDWAY. It went up.

Mr. CONNOLLY. It went up. At precisely the time the Internet was coming in full play in the United States, is that correct?

Ms. GOLDWAY. Yes.

Mr. CONNOLLY. So the relationship between the Internet and mail volume is not necessarily always inevitably a negative one. Might one conclude that, given that statistic, Ms. Goldway?

Ms. GOLDWAY. Oh, I think—my theory is that human beings have an insatiable appetite for communication and everything will grow, but it grows in different stages, just like radio has adjusted——

Mr. CONNOLLY. My time is limited, but——

Ms. GOLDWAY. Oh.

Mr. CONNOLLY. That is all right.

Ms. GOLDWAY. But I do think that——

Mr. CONNOLLY. But it went up?

Ms. GOLDWAY. It went up.

Mr. CONNOLLY. Did it go up last year? Did mail volume go up or down last year?

Mr. DONAHOE. Mail volume went down.

Mr. CONNOLLY. It went down over the previous year?

Mr. DONAHOE. Yes. Slightly.

Mr. CONNOLLY. Slightly. When we look at—because you talked a little bit, I think you made reference, Mr. Donahoe, to the impact of the Internet on your business. But the Internet can also generate business, can it not? For example, if I order a book from Amazon, not only is that business for the Postal Service, but it is actually lucrative business for the Postal Service, is that not correct?

Mr. DONAHOE. Absolutely.

Mr. CONNOLLY. Ms. Goldway, because my time is limited, have you had a chance to look at the draft legislation we have been working on and do you, by and large, find that it is consistent with many of the findings the Postal Regulatory Commission has brought before this subcommittee over the years?

Ms. GOLDWAY. I certainly think that many of the suggestions that have been discussed by other legislators to address the financial issues are included, and I am very pleased. In addition, there are some specific items that you and I have addressed that we think will really improve the revenues for the Postal Service in the future and position it as a more modern agency with the rest of the government. So I certainly appreciate your efforts there and I am sure it will be a valuable contribution to the conversations for legislation.

Mr. CONNOLLY. We can only hope. And I am going to run out of time; I have 20 seconds. But real quickly, don't we have a problem, on top of everything else, with the aging and costly vehicular fleet of the Postal Service?

Mr. DONAHOE. I will take that one. Yes, we do. We have a fleet of 185,000 delivery vehicles that are about 22 years old, on average.

Mr. CONNOLLY. Mr. Chairman, I have run out of time, but if I had a lot of time we would talk about this issue, because I think it is another burden they have to face. Thank you very much.

Mr. ROSS. Thank you. And just for the record, as part of that conversation, we did invite the Office of Management and Budget to attend here that I think could have addressed some of these questions; they declined the invitation, but I think it would have been healthy to have them here as well.

I would now like to recognize the distinguished gentleman from Illinois, Mr. Davis, for 5 minutes.

Mr. DAVIS. Thank you very much, Mr. Chairman, and let me congratulate you on your elevation. As a matter of fact, we had a young fellow here yesterday testifying, and he mentioned the colleges that he wanted to attend, and he railed off about 10, and all of them were in Florida, so there must be something good about Florida.

Mr. ROSS. Well, as an Auburn graduate, I have to take some difference with that.

Mr. DAVIS. Let me welcome the witnesses. It is a pleasure to see you and to have you here with us, Mr. Donahoe.

Mr. DONAHOE. Thank you.

Mr. DAVIS. Ms. Goldway, Mr. Herr, it is good to see you again.

I have listened to the testimony and I have listened to the questioning, and, of course, I am not one of these individuals who believe that government cannot get it right. I don't subscribe to that school of thought. I think that government can in fact get it right. And I guess as one of the persons who helped put together the Postal Enhancement and Accountability Act, we thought we were getting it right, or at least moving in the direction of getting it right. We thought that we were providing the kind of flexibilities that the Postal Service needed; we thought we were providing opportunities for new products and new approaches; and we thought we were providing opportunity to make use of all the resources that the Postal Service should have at its disposal.

You attempted a moment ago to talk about your vision in terms of how we can get it right and how we can have the Postal Service be self-sufficient; how we can make sure that we interact a certain way with our stakeholders and our unions. Could you share that direction for us again?

Mr. DONAHOE. Sure. Thank you very much. I do believe the Postal Service is and will be a very viable part of the American economy and American society. There are definitely changes going on, but we do provide that kind of contact that people are looking for. If you look at what we offer from a standpoint of the ability of a person to get in front of a customer's eyes, we are the most direct way, the most direct; and there is plenty of opportunity there. You talk about the Internet. There are oftentimes no way you will find a Web site unless you get a postcard in the mail that says come to my Web site; and we know we provide value there.

We know we provide value for small business in the package shipping business. When they can go down to the local post office and put three or four or five packages in at a flat rate of a fish and chips with guaranteed delivery within 2 to 3 days, there is tremendous value there. And we know that people will continue to mail packages. We know we have some very valuable partnerships; UPS and FedEx. We deliver the last mile for a lot of their packages. This holiday season we delivered 16 percent more than we did last year, so we know there is definitely opportunity in that area.

We also realize that there are costs that we need to address. I think, as I said before, we have very responsible leadership from our unions. They understand this. They can hear the waterfall. They understand that we have to make some changes. We are having very good discussions with the APWU. The Rural Carriers have kept the contracts open, so we think there are some opportunities to move in the right direction there.

With our management associations we have seen progress in a lot of the changes we have made there. They have been very supportive in big changes that we have had to make within the administrative staff to reduce costs due to the mail volume drop.

Congressman, I am 100 percent positive that there is a ton of value in the Postal Service. I think from a government perspective the Postal Service is pretty proud of the fact that we do a good job. Excellent service. We have taken more costs out of this organization than any private firm, and we know we can continue to do that in the future. We need the aid of Congress on a couple issues.

Mr. DAVIS. Let me just ask you. I know that we have been talking about loss projections, and we hear $900 million. Have we ever had any projections that were higher than that?

Mr. DONAHOE. Higher in terms of losses?

Mr. DAVIS. Yes.

Mr. DONAHOE. Oh yes, absolutely.

Mr. DAVIS. So that means that we are actually making some progress.

Mr. DONAHOE. Sure. If we can get some resolution on a couple of these fixed costs, we definitely can. And the other thing that is important is with the uncertainty of all this discussion about year after year the Postal Service loses money, that starts to make customers fearful of doing business with us. We need to get that behind us. We are the lynchpin of a $1 trillion industry. That needs to be resolved.

Mr. DAVIS. Well, I was always told that wherever there was a will, there was a way.

Mr. DONAHOE. That is right.

Mr. DAVIS. It seems to me that you have both the will and you are searching for the way, and I think you are refreshing, and I look forward to working with you.

Mr. DONAHOE. Thank you, sir.

Mr. ROSS. Thank you, Mr. Davis.

At this time I want to thank our panel for taking the time and now take just a brief recess while we get ready for our second panel. We are probably going to have another vote series a little bit after 4, so hopefully we can accomplish all we need to accomplish before that vote series.

Again, thank you all for being here and we will let the clerk set up for the next panel.

[Recess.]

Mr. ROSS. We will call the subcommittee back to order.

I now recognize our second panel. Mr. Sampey, seated to my left, is the executive vice president and chief operating officer of Valpak; Mr. Sackler is the coordinator of the Coalition for a 21st Century Postal Service; and Mr. Frederick Rolando is the president of the National Association of Letter Carriers.

Gentlemen, I will ask you to stand to be sworn in. Please raise your right hands.

[Witnesses sworn.]

Mr. ROSS. Let the record reflect that all witnesses answered in the affirmative.

Please be seated.

Again, in order to allow time for discussion and questions, please limit your testimony to 5 minutes. Of course, your written testimony has been submitted and entered into the record.

With that, I will start with Mr. Sampey. You are recognized.

STATEMENTS OF JIM SAMPEY, EXECUTIVE VICE PRESIDENT AND CHIEF, OPERATION OFFICER, VALPAK; ARTHOR SACKLER, COORDINATOR, COALITION FOR A 21ST CENTURY POSTAL SERVICE, SACKLER POLICY SERVICES, LLC; AND FREDERIC ROLANDO, DIRECTOR OF LEGISLATIVE AND POLITICAL AFFAIRS, NATIONAL ASSOCIATION OF LETTER CARRIERS (AFL–CIO)

STATEMENT OF JIM SAMPEY

Mr. SAMPEY. Chairman Ross, Ranking Member Lynch, and members of the subcommittee, my name is Jim Sampey. I am the executive vice president and chief operating officer for Cox Target Media, headquarters in Largo, FL. We own Valpak Direct Marketing Systems and we are one of the largest direct mail firms in North America. Thank you for this opportunity to testify on what we agree is a looming crisis for the USPS.

Valpak has been in the business for over 42 years. We pioneered the concept of local cooperative direct mail in the United States. Valpak is owned by Cox Enterprises, based in Atlanta, which is one of the largest media conglomerates in the United States.

Valpak is a franchise organization, with locations in every State. Valpak represents more than 2,000 direct and franchised employees. Each year we assist more than 54,000 small businesses, from local mom and pops to large national companies. Today Valpak delivers savings and values to about 40 million households each month, and each year our familiar blue envelope carries some 20 billion money-saving offers in 500 million envelopes.

Just 3 years ago we opened a $220 million facility in St. Petersburg, Florida to accommodate our growth for the future. Our company is also aggressively entering the digital space in the online and mobile couponing business. This will allow us to reach new customers with our products and continue to serve as a leader in our industry. Our digital strategies will continue to complement our mail volume.

The nature of our business means that we watch the USPS and its issues very closely. We believe that the Post Office, under Jack Potter and now Pat Donahoe, have done a remarkable job in downsizing the Post Office to adjust for plummeting mail volumes, while maintaining high service levels. If you were to set aside the $5½ billion artificial financial burden to prepay future retiring health costs, which Congress imposed in the PAEA, the Post Office actually had an operating profit of $601 million over the last 4 years. We believe the Post Office's March 2, 2010 Action Plan: Envisioning America's Future Postal Service, was well designed, and except for its proposal to reduce the role of the Postal Regulatory Commission, we support it in all respects.

It seems to us that the Post Office is constantly getting caught up in the political machinations of Congress. It may not be popular to tell Congress that the bill was ill conceived, but look at what the PAEA did. It imposed a CPI-based cap on prices; it gave the Post Office virtually no new powers to cut costs; and at the last minute we were told that it was necessary to get the bill scored properly, Congress needed to impose a $5½ billion annual financial burden

to prepay future retiring health costs, a burden imposed on no other agency or company.

Valpak, along with all mailers, urges Congress and the Commission to address the financial issue by removing the $5½ million artificial annual burdens on mailers to pre-fund the postal retirement health benefits and require the Office of Personnel Management to recalculate the CSRS and FERS obligations using overpayments made by mailers toward these retirement expenses to help pay ordinary health benefit expenses.

On the cost-cutting items, we urge Congress and the Commission to allow the USPS to move to 5 day delivery. By recent polls, at least two-thirds of the people don't care that much about Saturday delivery, and it would allow the Post Office to save what should be about $3 billion annually and, second, allow the Post Office to close standalone money-losing post offices and replace them with retail facilities in place with high foot traffic.

This is not to say that we support all the Postal Service does. We are deeply frustrated with some of the pricing policies which have allowed it to lose $5 billion over the last 4 years on underwater products. As a prosperous company would not choose to offer products which lose money, and it is completely unacceptable that one that is on the brink of insolvency would continue to do so.

Last, we do oppose the Post Office's efforts to go into competition with existing customers. One example of this is the recently passed market test called Marketing Mail Made Easy. Easy for that to say. This proposal has generated a lot of opposition from the mail community. We don't think that cannibalizing the mail that is already in the system is the right strategy for growth.

I look forward to answering any of your questions you may have. Thank you.

[The prepared statement of Mr. Sampey follows:]

Subcommittee on Federal Workforce, U.S. Postal Service and Labor Policy
House of Representatives' Committee on Oversight & Government Reform Committee

Pushing the Envelope: The Looming Crisis at USPS
March 2, 2011

Statement of Jim Sampey on behalf of
Cox Target Media, Inc. and Valpak Direct Marketing Systems, Inc.

Chairman Ross, Ranking Member Lynch, and Members of the Subcommittee:

My name is Jim Sampey. I am Executive Vice President and Chief Operating Officer of Cox Target Media, Inc., headquartered in Largo, Florida. We own and operate Valpak Direct Marketing Systems, Inc., one of the largest direct mail companies in North America.

Thank you for this opportunity to testify. I have been with Cox Target Media and Valpak for more than 21 years. I have been a member of our company's senior management team for well over 15 years. (A summary of my job responsibilities and experience is appended to this statement.)

Let me begin by giving you some background on our company and how the Postal Service impacts our business. Valpak has been in business for over 42 years. We pioneered the concept of local cooperative mail in the United States several decades ago.

Our company is owned by Cox Enterprises, Inc., one of the largest media conglomerates in the U.S. with major holdings in newspaper, television, radio, cable, and Internet/interactive industries.

Valpak has more than 900 employees, including part-time and temporary workers. Another 1,000 sales reps and office staff work at Valpak franchises across the country and Canada. Just three years ago, we opened a $220 million manufacturing center in St. Petersburg, Florida, to accommodate our growth for the next 10 to 20 years.

Today, Valpak delivers savings and value to about 40 million households each month. And each year, over 500 million of our familiar blue envelopes carry some 20 billion money-saving offers throughout the country exclusively using the Postal Service. Valpak provides a valuable service — helping American families save money in these tough economic times and helping small businesses grow.

We are a national franchised organization with locations in nearly every state. We have a total of about 180 independently-owned franchises across the United States and Canada. Each year, we assist more than 54,000 advertisers — from local mom and pop businesses to large national companies — in promoting their products and services.

Our company is also aggressively entering the digital space in the online and mobile coupon business. This will allow us to reach new customers with our products and continue to serve as a leader in our industry. Our digital strategies will continue to complement our printed product strategies.

Because we mail about 10 million Valpak envelopes a week, we rely heavily on the timely delivery of our envelopes across the country. Year after year, we applaud the Postal Service for their outstanding service and for helping us be a leader in our industry. But the Postal Service does not just serve us -- those tens of thousands of businesses we assist rely on letter carriers in their area for the delivery of their advertisements to their targeted customers. And the timely delivery of their ads is critical because many times these businesses are staffing up to handle the increase in volume based on planned in-home delivery dates and special promotions.

A recent example of our effective partnership with the Postal Service is the successful implementation of the new Intelligent Mail barcode ("IMb") into our production process. IMb is a new technology that the Postal Service uses to track mail through its system. The barcode is placed on the mail pieces, tray tags and pallet placards. The information is communicated electronically to the Postal Service. Valpak was one of the Postal Service's first customers to implement IMb for its outbound mail, an important postal initiative for high-volume mail customers.

The nature of our business means that we watch the Postal Service and its issues very closely. We believe that the Postal Service, until recently under Jack Potter, and now under Pat Donahoe, has done a remarkable job of downsizing the company to adjust to plummeting mail volume.

We think that too many mailers take a short-term view only — and argue for almost any position that might result in lower postal rates now. Valpak takes a longer-term view — because we have no plans to leave. We were one of the few mailers which supported the Postal Service's exigent price increase request (Docket No. R2010-4) — not because we liked it, but because the Postal Service needed the money to operate. If we thought that the Postal Service was being mismanaged, we would feel differently, but that is not the case. We need the Postal Service, and want it to be operating well into the future.

Looking at the larger picture, the Postal Service is the heart of a $1 trillion industry which employs over 8 million people. Congress cannot ignore the broader impact of the Postal Service on this industry, and in turn, the impact of this industry on the nation's economy.

As you will see from our statement, we believe that much of the responsibility for the problems of the Postal Service lies with the Postal Accountability and Enhancement Act ("PAEA"), and we urge the new Congress to fix that flawed legislation now.

A. POSTAL SERVICE FINANCES AND THE POSTAL SERVICE RETIREE HEALTH BENEFIT FUND.

The Postal Service's financial condition is so dire it will not just need, but **require**, Congressional remedial action before the end of FY 2011.

Unfortunately, the source of this financial crisis is often misunderstood. Press and Congressional attention too often focus on the Postal Service's **gross loss.** That reported loss includes "artificial" financial burdens imposed on the Postal Service by Congress such as massive payments into the **Postal Service Retiree Health Benefits Fund** ("PSRHBF") to pre-fund health care benefits for future retirees, as mandated by PAEA.

Real understanding of the Postal Service's finances and evaluation of its business model requires focus on the Postal Service **net profit and loss**, based on its **current** operating revenues and expenditures.

Table 1 below shows Postal Service operating revenues and operating expenses over the four-year period FY 2007–FY 2010 under PAEA.

Table 1
Postal Service Operating Revenue and Expenses
FY 2007 – FY 2010
($, millions)

	FY 2007	**FY 2008**	**FY 2009**	**FY2010**
Operating Revenue (includes net investment/interest income)	74,963	74,932	68,036	66,921
Less: Operating Expenses	71,757	72,138	70,430	69,926
Operating Profit (Loss)	**3,206**	**2,794**	**(2,394)**	**(3,005)**
Funding of PSHRBF	8,358	5,600	1,400	5,500

	FY 2007 - FY 2010
Four-year Operating Profit	**601**
Four-year cost of PSHRBF	**20,858**

Sources: USPS 2010 Annual Report, p. 63; USPS 2009 Annual Report, p. 55.

In Table 1, "**operating expenses**" **include** all costs of health benefits for **current retirees**, but **exclude** money set aside to pay health benefits for **future retirees** — *i.e.*, payments to the PSRHBF are shown separately. (Prior to PAEA, the Postal Service funded retiree health care costs on a **current** basis, but did not prepay **future** costs.) Thus, the $8.5 billion loss reported for FY 2010 includes two components:

- a $3.0 billion loss from operations, referred to here as the **"operating loss,"** and
- the $5.5 billion PAEA-required contribution to the PSRHBF.

Starting in FY 2008, the Postal Service fell victim to the Great Recession, which accelerated the decline in mail volume. The result was an unprecedented decline in total revenues: **$6.9 billion** in FY 2009 and a further **$1.1 billion** in FY 2010.

From FY 2008 to FY 2010, expenses were reduced by $2.1 billion. But no matter how effectively the Postal Service managed its costs, it has been unable to reduce operating expenses as fast as mail volume and revenue have declined. Consequently, since PAEA, the Postal Service swung in four short years from an **operating profit of $3.2 billion** in FY 2007 to an **operating loss of $3.0 billion** in FY 2010.

Table 1 reveals a lesser known fact — that during the last four years the Postal Service actually had a **cumulative operating net income,** or operating "profit," of **$0.6 billion**. Generating a cumulative four-year operating profit of $0.6 billion with declining revenues must be considered an outstanding accomplishment. That amount, however, was far from sufficient to fund the **$20.9 billion** contribution to PSRHBF demanded by Congress under PAEA for the same four-year period.

Moreover, a **collection of loss-generating products** failed to cover their attributable costs by over **$5.09 billion**. Therefore, it is reasonable to conclude that the Postal Service's overall finances have been severely harmed by Postal Service pricing. Had the Postal Service been able to avoid those losses on underwater products, its cumulative operating profit during the last four years would have been around **$5.7 billion**. This demonstrates that if the Postal Service can sharply curtail costs and keep the price for postage where it is then over the long term the Postal Service can have a viable business — despite the Internet.

Although the cumulative record of operating income under PAEA has been commendable, the downward trend in FY 2009 and FY 2010 needs to be reversed, with the Postal Service returned to annual profitability. Operating losses in the most recent two years reflect serious pricing problems the Postal Service has with respect to underwater products. However, even those serious pricing problems are dwarfed by the aggressive funding of retiree health benefits required by PAEA — a statutorily-created problem that can be fixed only by Congress.

Retiree health benefits are a longstanding obligation for all levels of governments, as well as for many large corporations. The Postal Service has been funding pension benefits on a regular basis since 1971. In contrast, retiree health benefits traditionally have been an "off-balance sheet" item for the Postal Service, as well as the rest of the federal government. PAEA's aggressive funding schedule can be viewed as constituting an extraordinary requirement insofar as no other federal, state, or local government is required to pre-fund any of their retiree health care benefits. The driving force underlying the Postal Service's current financial bind is the fact that PAEA requires the Postal Service, **over the course of 10 years**, to deposit in the PSRHBF[1] sufficient funds to pay **all estimated** future retiree health care benefits which have been accumulating over decades — while also continuing to pay health benefits for all current retirees. This aggressive funding schedule mandates annual payments of $5.5 billion, while a variety of operating constraints also are imposed on the Postal Service. They include, for example:

(1) a statutory CPI cap that limits the ability to increase prices;
(2) statutory requirements that have resulted in the underpricing of certain postal products, *e.g.*, Periodicals;
(3) a statutory proscription against closing small post offices solely for economic reasons;
(4) tight restrictions on products which the Postal Service may offer;
(5) by-now-predictable Congressional resistence to closing and consolidation of facilities;
(6) under annual appropriation riders, a requirement to deliver mail 6 days a week; and
(7) statutory debt limit provisions.

In light of the constraints just described, it was completely unrealistic for Congress in December 2006 to expect the Postal Service to be able to generate sufficient free cash flow to meet PAEA's annual funding requirement for the PSRHBF. The CPI price cap alone guaranteed that the Postal Service could not generate such excess cash flow. If the federal government were to attempt to fund all of its retiree health care obligations in the same aggressive manner as PAEA requires the Postal Service to do (*i.e.*, over a 10-year period), massive tax increases far above any politically-acceptable level would be necessary. No doubt, these are just some of the reasons that in 2006 the Board of Governors felt constrained, as

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[1] As of October 1, 2010, the balance in the PSRHBF was $42.5 billion. *See* USPS 2010 Annual Report, p. 49. http://www.usps.com/financials/_pdf/annual_report_2010.pdf

fiduciaries for the mailing public, to take the politically-difficult step of strongly opposing passage of PAEA.[2]

In order to pay Congressionally-required contributions to the PSRHBF, which could not be funded with net cash flow from operations, the Postal Service's net worth has plummeted and it has had to resort to extensive borrowing. As a result of this disastrous legislation:

- Postal Service **indebtedness** has increased from **$2.1 billion** at the end of FY 2006, only months before PAEA was enacted, to **$12.0 billion** at the end of FY 2010.[3]

- The Postal Service's **net worth** has gone from a **positive $6.3 billion** at the end of FY 2006 to a **negative $13.9 billion** at the end of FY 2010.

The increased indebtedness has shifted onto the Postal Service's balance sheet a portion of its pre-existing liability for retiree health benefits that previously were neither funded nor accrued in the financial statements. True funding of those benefits will not occur until the Postal Service is able to generate operating profits sufficient at least to reduce its debt to the existing level when PAEA was enacted ($2.1 billion). That cannot happen until Congress enables the Postal Service to implement major cost reductions

One of the nine objectives contained in PAEA, 39 U.S.C. section 3622(b)(5), states that the modern system for regulating rates for market dominant products should be designed:

> To assure **adequate revenues**, including retained earnings, to maintain **financial stability**. [39 U.S.C. § 3622(b)(5) (emphasis added).]

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[2] *See, e.g.,* U.S. Postal Service Board of Governors letter to Senator Susan M. Collins, January 24, 2006 ("[W]e believe there are critical elements missing from this bill, as well as numerous burdensome provisions that would make it extremely difficult for the Postal Service to function in a modern, competitive environment.... [I]n keeping with our concerns that the Postal Service be able to provide the quality of service and reasonable rates ... we must oppose the passage of this bill.") http://www.usps.com/communications/news/press/2006/pr06_003.htm.

[3] Postal Service borrowing authority has been restricted, under both the Postal Reorganization Act of 1970 ("PRA") and PAEA, to no more than $3 billion per year, and an aggregate amount of no more than $15 billion. 39 U.S.C. § 2005(a).

The PAEA-imposed burden on the Postal Service to pre-fund all future retiree health care benefits within only 10 years, while operating under a CPI rate cap, has ensured Postal Service **noncompliance** with this critical rate-setting objective.

With the price cap constraint, no rate-making system designed by the Postal Regulatory Commission could have prevented the current financial crisis. Moreover, even without the price cap, it seems unlikely that any rate-making system would have been able to generate sufficient cash flow to fund the PSRHBF as mandated by PAEA, given market considerations (including, most especially, increasing competition from the Internet).

In the current year, **FY 2011**, despite the anticipated decline in volume and revenue, the Postal Service expects operating expenses to increase by $1 billion, resulting in a net operating loss (even before a further scheduled payment of $5.5 billion to the PSRHBF).

In March 2010, the Postal Service published *Ensuring a Viable Postal Service for America: an Action Plan for the Future* ("Action Plan"). The Action Plan was an impressive effort to take a long-range view of Postal Service finances, seeking the following seven legislative changes:

(1) Retiree Health Benefits Fund reform
(2) Flexibility to adjust delivery frequency
(3) Expand retail access while having flexibility to reduce expensive retail facilities
(4) Workforce contracts that are not constrained by craft limitations
(5) Market Dominant products price cap
(6) Streamlining the process for introducing new products
(7) Reducing the role of the Postal Regulatory Commission

Valpak generally agrees with the first six points, but disagrees with reducing the role of the Commission — the regulator of a government monopoly.

The Action Plan proposes a number of changes to the Postal Service's business model. However, the value of the postal monopoly has declined drastically, as evidenced by continued decline in the volume of First-Class Mail and the important contribution which that mail makes. Whatever residual value as the monopoly may still have, if any, is totally inadequate to sustain the infrastructure that Congress has imposed upon the Postal Service — such as maintaining uneconomic post offices, residential delivery 6 days a week, subsidies to Alaska passenger air transportation, etc. Consequently, even if all further payments to the PSRHBF were eliminated immediately, and all of the Postal Service's desired changes to its business model were adopted, such "improvements" apparently would not be sufficient to restore the Postal Service to the status of a healthy self-sustaining entity.

At the end of FY 2011, the Postal Service will not have sufficient liquidity to comply with the pre-funding requirement for the PSHRBF established by PAEA. Assuming that Congress resolves this liquidity problem in a manner that permits financial solvency and continued operation at least to the end of FY 2012, the question raised by (i) the continuing

loss of volume in First-Class Mail, (ii) the projected operating loss in FY 2011, and (iii) the lack of any financial cushion in the form of net worth or borrowing capability, is whether the Postal Service's business model is sufficiently robust to repair the financial damage inflicted by PAEA and achieve a return to sustainable profitability. To "right the ship," the Postal Service will need to think in somewhat more aggressive terms than thus far envisioned.

Volume variable costs are proving to be variable, with a lag — *i.e.*, those costs are coming down. That, however, is not sufficient. In this new environment, the Postal Service needs to do far more than simply adjust volume variable costs downward. Substantial reductions in costs traditionally considered "fixed" are required. Moreover, the Postal Service's precarious financial condition would indicate that those reductions need to occur sooner rather than later in order to restore operations to financial viability. The Postal Service needs to focus on increasing **operating income** with a vengeance, by moving simultaneously on several fronts.

1. Utilizing pricing flexibility as quickly as possible, making **every postal product** profitable in the sense that revenue from each product:
   (i) at least exceeds attributable costs, and
   (ii) makes a reasonable contribution to institutional costs (*see* 39 U.S.C. sections 3622(c)(2) and 101(d)).

2. Reducing the costs of **city carrier routes** by:
   (i) eliminating Saturday delivery, and
   (ii) beginning to replace expensive door delivery with curb delivery on all such routes where the revenues from mail delivered are less than the cost of delivery.[4]

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[4] Door delivery to 39 million residential addresses has an average annual cost that exceeds the average cost of curb delivery by almost $5 billion. *See* Government Accountability Office ("GAO") Report No. GAO 10-455 (April 12, 2010), *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Stability*, p. 36, Table 8. The Postal Service should consider all options to reduce these costs, such as charging for high-cost, high-quality delivery service, with a goal of improving the annual operating profit from such delivery by at least $2.5 to $3.0 billion. Door delivery alone has an average daily cost of $1.15. The job description of the Deputy Postmaster General position circulated by the Postal Service's executive search firm states that "[i]n FY 2009 $1.40 in revenue was generated per delivery stop. That number is **expected to drop to $1 by 2020**." Spencer Stuart, Position and Candidate Specification, United States Postal Service Deputy Postmaster General, p. 2 (January 2011) (emphasis added) http://postcom.org/public/2011/USPS%20Deputy%20Postmaster%20General%20SPC.pdf. For the 39 million residential delivery points that receive door delivery, elimination of Saturday delivery alone will not result in revenue per delivery stop exceeding the cost of

3. Reducing the cost of the **retail network** by closing uneconomic, redundant post offices, numbering at least in the hundreds, possibly thousands, within the next 2 to 3 years, replaced by lower cost alternatives.

For many of the above efforts to succeed, the Postal Service will need support from Congress.

The Postal Service's FY 2011 Integrated Financial Plan ("IFP") unhesitatingly states that by September 2011 the Postal Service will be faced with a cash shortfall well in excess of $2.0 billion, and insolvency. This forecast for FY 2011 seems set to demonstrate that the only thing worse than a short-term Congressional fix in FY 2010 may be no fix at all. It thus would appear that this year Congress will be required to address the Postal Service's fiscal situation. In FY 2011, Congress cannot avoid granting any relief from the PAEA funding requirement for the PSRHBF — unless it decides to have the government cease providing mail service to the country.[5]

Broadly speaking, Congress has two options:

- enact some **short-term**, stop-gap fix, as it so often seems to do — one that would allow the Postal Service to continue operating at least for another year, but keep it on the precipice of insolvency.

- enact a **longer-term**, hopefully more permanent, reform — one designed to provide Postal Service management with a more stable planning horizon.

The first option is not a particularly efficient way to run a business. The reputation of the United States Postal Service as a reliable delivery service has great value which Congress should strive to protect, not destroy. A continued high level of uncertainty and anxiety could induce some mailers to leave the Postal Service permanently in favor of competitive alternatives. That would be counterproductive to the goal of a financially-viable Postal Service that should be able to continue contributing to the PSRHBF according to a reasonable schedule. Valpak urges Congress to enact remedial legislation that extends beyond a year-to-year band aid.

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delivery alone. On routes where delivery cost exceeds revenue, no degree of reduction in processing cost can enable an operating profit.

[5] The Postal Service FY 2009 SEC Form 10-K notes that "[a]lthough P.L. 109-435 dictates the funding requirements through 2016, the amounts to be funded and the timing of funding can be changed at any time with passage of a new law or upon an amendment of existing law as passed by Congress and signed into law by the President." *Id.*, p. 20. http://www.usps.com/financials/_pdf/FY_2009_10K_Report_Final.pdf

Valpak also supports Congressional examination of, and action on, the $5.5 billion overfunding of pension benefits for postal employees participating in the **Federal Employee Retirement System** ("FERS")[6] and, even more importantly, the **Civil Service Retirement System** ("CSRS"), where the overfunding is estimated by the Postal Service Inspector General at $75 billion[7] and by the Segal/PRC Report at $50-55 billion.[8] These excess funds should be redirected to pre-funding PSRHBF.[9]

B. POSTAL SERVICE MANAGERIAL PREROGATIVES.

Like PRA before it, PAEA exhorts management to operate the Postal Service in a business-like manner, and toward that end it continued limited grants of managerial discretion to the Postal Service to control costs and operate efficiently. *See, e.g.,* 39 U.S.C. §§ 101, 401, 403, 404(a) and (b). But Valpak believes that, having given the Board of Governors that responsibility, it is essential for Congress to defend and protect the Postal Service's prerogatives to manage the company.

Even before the Postal Service's announcement of its March 2, 2010 Action Plan, it had been working to adjust the size of its workforce and other costs to the plummeting mail volume. Yet the Postal Regulatory Commission and Congress have continued to impose their own ideas of how the Postal Service should be operated. Unfortunately, many of these ideas are not based on a principle of operating the Postal Service in an efficient business-like manner.

Postal Service management has made strenuous efforts to reduce costs in the face of declining mail volume. Much more cost cutting will be needed, though, (i) to restore the Postal Service to profitability by repaying the billions of dollars it has been forced to borrow in order to fund future costs of retiree health benefits, as well as (ii) to pay whatever amount Congress will require for this purpose in the future.

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[6] Postal Service Office of the Inspector General ("OIG"), USPS-OIG Report Number FT-MA-10-001, Aug. 16, 2010.

[7] Postal Service OIG Report Number RARC-WP-10-001, Jan. 20, 2010.

[8] Report to the Postal Regulatory Commission on: Civil Service Retirement System Cost and Benefit Allocation Principles (June 29, 2010) by the Segal Company.

[9] Sadly, irrespective of the merits of the issue, Congress may be reluctant to transfer these funds from CSRS for fear of unmasking Congressional underfunding of these payments for other federal workers.

Many limitations now in the law were enacted by earlier Congresses, which directed those monopoly profits to achieve their political objectives, and at a time of relative economic plenty, when the postal monopoly could be relied upon to generate significant net income. Times have changed. The Postal Service is evolving, and now must implement a new, much leaner business model. Toward that goal, the Congress needs to support fully Postal Service efforts to remove impediments to cost reduction wherever feasible.

1. Six-Day Delivery.

On March 30, 2010, the Postal Service filed a request for the Commission to issue an Advisory Opinion under 39 U.S.C. section 3641 to address the Postal Service's proposal to eliminate regular Saturday delivery. In response, the Commission convened Docket No. N2010-1.

The Postal Service's request was demonstrably necessary to eliminate the substantial cost of Saturday delivery because it no longer can be justified in view of the decrease in mail volume over the past decade. Continuing volume decreases projected in the FY 2011 IFP and the USPS 2010 Annual Report reduce even further any necessity for Saturday delivery. Valpak participated in Docket No. N2010-1, filing both an Initial Brief[10] and Reply Brief[11] explaining why it believed that the record evidence in the docket overwhelmingly supported the Postal Service's proposal.

The Postal Service estimates that 5-day delivery could **save over $3 billion per year**. Since the Postal Service filed its request, 11 months have elapsed. It had been thought that the Commission's Advisory Opinion would be issued in December 2010, but the docket remains open and the issue is still under consideration.

Of course, even if the Commission were to issue an Advisory Opinion supporting 5-day delivery, it will be necessary for Congress to remove the appropriations rider which for nearly 30 years has required the Postal Service to maintain 6-day city and rural residential delivery service at the 1983 level.[12] Even if only to help fund the PSRHBF as required by PAEA, Congress needs to make a tough decision to permit the Postal Service management to adjust delivery service to match the decreasing volume and increasing number of delivery points.

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[10] http://prc.gov/Docs/70/70513/VP%20N2010-1%20Initial%20Brief.pdf

[11] http://prc.gov/Docs/70/70607/VP%20N2010-1%20Reply%20Brief.pdf

[12] *See, e.g.*, Consolidated Appropriations Act, 2010, Pub. L. 111-117, 123 Stat. 3034, at 3200.

With Congress yet to approve any appropriations bills for FY 2011, the federal government has been operating under a series of continuing resolutions. This provides Congress with an opportunity to help the Postal Service to begin right-sizing its retail and operations network in FY 2011. With every passing month the Postal Service is forced to incur the cost of Saturday delivery for yet another month.

2. Closing of Stations and Branches.

The Postal Service has both the authority and the responsibility to create and maintain post offices and other facilities as needed. 39 U.S.C. § 404(a)(3). The Postal Service also has the authority to close or consolidate post offices and other facilities, but closures of independent "post offices" with their own postmasters are subject to certain notice requirements and are subject to appeal to the Commission. 39 U.S.C. § 404(d). The ability to both open and close stations and branches are important managerial prerogatives of the Postal Service. Efforts to impede the Postal Service in these cost-cutting efforts are highly detrimental to Postal Service finances.

In Docket No. N2009-1, the Postal Service requested the Commission to determine whether its plan to consider closing certain stations and branches was a change that needed an Advisory Opinion under section 3641, and if so, to issue an Advisory Opinion. Valpak questioned the jurisdiction of the Commission, filing an Initial Brief[13] and Reply Brief.[14] Nevertheless, the Commission did issue an Advisory Opinion, advising the Postal Service to follow similar procedures when closing stations and branches as are used to close independent post offices. Advisory Opinion Concerning the Process for Evaluating Closing Stations and Branches (Mar. 10, 2010), pp. 61-65.[15]

The Commission has received several appeals under section 404(d) which relate to closure of stations and branches, and continues to entertain their consideration. Congress knew what a "post office" was when it used that term, and limited the Commission's authority to the closing of "post offices." Yet the Commission has refused to dismiss these supposed "appeals" on the ground that certain members of the public did not know the difference between (i) an independent post office and (ii) a station or branch.[16] Deficiencies in the

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[13] http://www.prc.gov/Docs/65/65865/VP%20N2009-1%20Initial%20Brief.pdf

[14] http://www.prc.gov/Docs/66/66094/VP%20N2009-1%20Reply%20Brief.pdf

[15] http://www.prc.gov/Docs/67/67174/Advisory_Opinion_031010.pdf

[16] The Commission holds to the view that it has authority over the closing of stations and branches despite the clear language used by Congress — independent "post offices" only. *See* Docket No. A2010-3, Order No. 477, Order Dismissing Appeal (Jun. 22, 2010), pp. 5-6, http://www.prc.gov/Docs/68/68568/Order_No_477.pdf.

Commission's legal analysis were discussed at length by Valpak, the Association of Priority Mail Users, Inc., and the Postal Service.[17]

Fortunately, Postmaster General Donahoe recently announced that the Postal Service will begin the process of closing 2,000 postal facilities, starting in March 2011. *See* "Postal Service Eyes Closing Thousands of Post Offices," Jan. 24, 2011, *Wall Street Journal*.[18] The Commission will have enough to do without taking on appeals of hundreds of stations and branches not expressly authorized by Congress. Such closures, and the costs savings which they enable, are an essential part of any leaner business model for the Postal Service.

C. UNDERWATER PRODUCTS.

Current postal law mandates that postal rates for each class of mail or type of service, cover attributable costs as well as make a contribution to institutional costs. This requirement was contained in the Postal Reorganization Act of 1970, and continues in current postal law, unamended by PAEA:

> **[p]ostal rates shall** be established to **apportion the costs** of **all postal operations** to **all users of the mail** on a **fair and equitable** basis. [39 U.S.C. § 101(d) (emphasis added).]

PAEA reiterated and clarifies this principle as a "requirement,"[19] as follows:

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[17] *See* Docket No. A2010-3, Answering Brief of Valpak Direct Marketing Systems, Inc., Valpak Dealers' Association, Inc., and Association of Priority Mail Users, Inc. (Apr. 19, 2010). http://prc.gov/Docs/67/67733/VP-APMU%20Answering%20Brief.pdf. *See also* Docket No. A2010-3, Comments of United States Postal Service Regarding Jurisdiction Under (Current) Section 404(d) (Apr. 19, 2010) and Docket No. A2011-5, Comments of United States Postal Service (Jan. 31, 2011) ("Congress has been presented with numerous bills that would expand the meaning of the term 'Post Office' to include subordinate stations and branches, but it has declined these opportunities to alter the original meaning of the term 'Post Office.'" p. 2.) http://www.prc.gov/Docs/71/71727/A2011-5%20Comments.pdf.

[18] http://online.wsj.com/article/SB10001424052748704881304576094000352599050.html.

[19] Although placed in a list of so-called pricing "factors," this principle is identified as the only "requirement" among the "objectives" and "factors" in section 3622(b) and (c), respectively.

> the **requirement** that each **class of mail or type of mail service** bear the direct and indirect **postal costs attributable** to each class or type of mail service through reliably identified causal relationships **plus that portion of all other costs** of the Postal Service **reasonably assignable** to such class or type. [39 U.S.C. § 3622(c)(2) (emphasis added).][20]

In its FY 2009 Annual Compliance Determination ("ACD"), the Commission noted that "The desirability of rates that recover attributable costs and make reasonable contributions to institutional costs is also supported by [39 U.S.C. §] 3622(b)(1) ["To maximize incentives to reduce costs and increase efficiency"], and [39 U.S.C. §] 3622(b)(5) ["To assure adequate revenues, including retained earnings, to maintain financial stability]."[21] FY 2009 ACD (Mar.

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[20] Underwater products are also noncompliant with other provisions of 39 U.S.C. section 3622:

(b)(1) "To maximize incentives to reduce costs and increase efficiency." Under no circumstance can deliberate below-cost pricing be viewed as maximizing incentives to reduce costs.

(b)(5) "To assure adequate revenues, including retained earnings, to maintain financial stability." By definition, when any product is underwater, its revenues are inadequate, and all such products reduce any opportunity to retain earnings as well as undermine financial stability.

(b)(8) "To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail." Postal reorganization under PRA was intended to eliminate subsidization within and between classes of mail. PAEA neither repealed that underlying constraint of PRA, nor did it authorize extensive subsidization within and between products or classes of mail.

(c)(12) "the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services." Any products that impose attributable costs in excess of the revenue which they provide cannot be construed as compliant with the need for the Postal Service to increase its efficiency and reduce its costs.

[21] In its FY 2009 ACD, the Commission applied 39 U.S.C. section 3622(c)(2) at the product level. *See, e.g.*, FY 2009 ACD, pp. 68 (First-Class Presort Parcels), 86 (Standard Mail Flats), 95 (Single-Piece Parcel Post, Bound Printed Matter Parcels, Media Mail/Library Mail, and Inbound Surface Parcel Post), 104 (Registered Mail and Stamped Cards), 106 (Address List Services), 107 (Confirm service), 111 (inbound letter post from Canada and Inbound Surface Parcel Post), and 112 (international inbound Registered Mail). *See also* FY 2008 ACD (Mar. 30, 2009), pp. 72-73, 77.

29, 2010), p. 68, n.5. The Commission has also concluded that underwater rates are unfair to other mailers. *Id.*, p. 31.

If, during an annual compliance review, the Commission finds that any rates are not in compliance with these principles of postal law or implementing regulations, it has no discretion to ignore the problem, because PAEA requires that the Commission: (i) "shall make" a written determination that non-compliant rates are "not in compliance" with PAEA; and then (ii) "shall take appropriate action...."

> (b) Determination of Compliance or Noncompliance.—
> Not later than 90 days after receiving the submissions required under section 3652 with respect to a year, the Postal Regulatory Commission **shall make** a **written determination** as to
> (1) whether any **rates or fees** in effect during such year (for products individually or collectively) were **not in compliance** with applicable provisions of this chapter (or regulations promulgated thereunder); or
> (2) whether any service standards in effect during such year were not met.
> If, with respect to a year, **no instance of noncompliance** is found under this subsection to have occurred in such year, the **written determination** shall be to that effect.
>
> (c) Noncompliance With Regard to Rates or Services.—
> If, for a year, a timely **written determination of noncompliance** is made under subsection (b), the Postal Regulatory Commission **shall take appropriate action** in accordance with subsections (c) and (e) of section 3662 (as if a complaint averring such noncompliance had been duly filed and found under such section to be justified). [39 U.S.C. § 3653 (emphasis added).]

In taking "appropriate action," the Commission exercises its broad remedial powers under 39 U.S.C. section 3662(c) relating to complaints[22]:

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[22] In addition, under 39 U.S.C. section 3662(d), the Commission has further authority in such cases:

> Authority To Order Fines in Cases of Deliberate Noncompliance.—
> In addition, in cases of **deliberate noncompliance** by the Postal Service with the requirements of this title, the Postal Regulatory Commission may order, based on the nature, circumstances, extent, and seriousness of the noncompliance, a **fine** (in the amount specified by the Commission in its order) for each incidence of noncompliance. Fines resulting from the provision of competitive products

> (c) Action Required if Complaint Found To Be Justified.—
> If the Postal Regulatory Commission finds the complaint to be justified, it shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance (such as **ordering unlawful rates to be adjusted to lawful levels**, ordering the cancellation of market tests, **ordering the Postal Service to discontinue providing loss-making products**, or requiring the Postal Service to make up for revenue shortfalls in competitive products). [Emphasis added.]

The Postal Service has reported that it has continued to hemorrhage enormous sums on money-losing products in FY 2010, as detailed in Table 2. Despite these large losses, many of which will predictably occur yet again in FY 2012, the Commission has yet to make any finding of noncompliance and take any action designed to reduce the hemorrhaging. Unless the situation starts a dramatic turn-around this year, Congress should be aware that the looming financial crisis will loom even larger next year and again in the year after that.

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shall be **paid from the Competitive Products Fund** established in section 2011. All receipts from fines imposed under this subsection shall be deposited in the general fund of the Treasury of the United States. [Emphasis added.]

Table 2
Loss-Generating Market Dominant Products, FY 2009-2010
(Exclusive of Special Services)

Product	FY 2009 Deficit ($, millions)	FY 2009 Cost Coverage	FY 2010 Deficit ($, millions)	FY 2010 Cost Coverage
First-Class Parcels	N/A	N/A	$1.2	99.9%
Inbound Int. Single-Piece First-Class Mail	$105.2	60.5%	$53.3	79.3%
Standard Mail Flats	$622.3	82.2%	$581.9	81.6%
Standard Mail NFMs and Parcels	$208.1	75.2%	$177.9	77.2%
Periodicals Within County	$14.5	86.2%	$25.4	74.2%
Periodicals Outside County	$642.8	75.0%	$598.0	75.0%
Single-piece Parcel Post	$62.0	91.9%	$134.0	82.1%
Inbound Surface Parcel Post	$2.4	84.5%	N/A	N/A
Bound Printed Matter Parcels	$8.5	97.7%	$27.6	92.1%
Media and Library Mail	$75.0	84.1%	$89.8	80.4%
Total	**$1,740.8**		**$1,689.1**	

Sources: Tables 1-4, FY 2009 Annual Compliance Report ("ACR"); Tables 1-4, FY 2010 ACR.

Although it might have been possible at one time to have believed that the Postal Service could generate sufficient revenue from high-coverage products to offset losses from underwater products, it now should be clear that those days are over. As demonstrated in Table 2, the combined loss of the 11 products in FY 2010 was $1,689.1 million. That amount constitutes the majority (56.4 percent) of the operating loss of the Postal Service.

1. Periodicals Class.

In FY 2010, the Periodicals class completed its fourteenth year of being subsidized by other mailers, adding another **$611 million** to a cumulative deficit that now has exceeded **$4.3 billion** in those 14 years. *See* Table 3. Moreover, in FY 2010, the Periodicals class achieved a new all-time low coverage of **75.46 percent**, with both Periodicals subclasses underwater.

A rate increase averaging **32 percent** would be necessary to bring revenues from Periodicals up to attributable cost in one step, and a rate increase of **16 percent** would be needed this year (and another next year) to bring Periodicals up to attributable cost in two equal steps. Such a large price increase would not have been necessary if smaller price increases had been ordered in the past — illustrating the danger of repeatedly deferring unpleasant but necessary action into the future indefinitely.

Under PRA, it took a decade for the Periodicals class to lose $2.2 billion for the Postal Service. Under **PAEA**, it has taken only **four years** for Periodicals to **lose** an additional **$2.1 billion**. Under PRA, the lowest coverage for Periodicals was 85.08 percent (FY 2005). Under PAEA, the coverage has never exceeded 84 percent, and it now has dropped almost another 10 percentage points.

Table 3
Periodicals Class — Revenue, Costs, Coverage, and Cross-Subsidies
FY 1997 — 2010

	(1)	(2)	(3)	(4)
PRC CRA	Revenue	Costs	Cover-age	Revenue – Costs
Fiscal Year	($, mill.)	($, mill.)		($, mill.)
Under PAEA				
2010	1,878.8	2,489.8	75.46%	-611.0
2009	2,038.0	2,680.0	76.04%	-642.0
2008	2,294.9	2,732.1	84.00%	-437.2
2007	2,187.9	2,635.6	83.01%	-447.7
Subtotal	**6,520.8**	**8,047.7**	**81.03%**	**-2,137.9**

Under PRA				
2006	2,124.8	2,487.6	85.42%	-362.8
2005	2,068.9	2,431.6	85.08%	-362.7
2004	2,100.0	2,323.3	90.39%	-223.3
2003	2,139.6	2,196.2	97.42%	-56.6
2002	2,066.9	2,280.4	90.64%	-213.5
2001	2,106.9	2,367.1	89.01%	-260.2
2000	2,076.3	2,354.8	88.17%	-278.5
1999	2,017.7	2,213.1	91.17%	-195.4
1998	1,972.8	2,129.0	92.66%	-156.2
1997	1,964.6	2,038.5	96.37%	-73.9
Subtotal	**20,638.5**	**22,821.6**	**90.43%**	**-2,183.1**
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TOTAL	**27,159.3**	**30,869.3**	**87.98%**	**-4,321.0**

The problem of underpricing of Periodicals has been raised in each prior Annual Compliance Review.

- In the first Annual Compliance Report under PAEA, Docket No. ACR2007, the Postal Service reported that Periodicals had failed to cover attributable costs, with class-wide cost coverage of **83.01 percent**. *See* Docket No. ACR2007, USPS-FY07-1, FY 2007 Public Cost and Revenue Analysis Report.

- The Postal Service's FY 2008 ACR revealed another losing year for Periodicals. The class's cost coverage for that year was up slightly, to **83.99 percent**. *See* Docket No. ACR2008, USPS-FY08-1, FY 2008 Public Cost and Revenue Analysis Report.

- FY 2009 resulted in another loss for Periodicals, with the Postal Service reporting that cost coverage had plummeted to **76.04 percent**. *See* Docket No. ACR2009, USPS-FY09-1, FY 2009 Public Cost and Revenue Analysis Report.

In all three ACR's, the Commission chose to avoid making a finding of a violation of the policies of Title 39, and ~~has~~ found some reason to defer taking corrective action.

In two successive ACD's, the Commission has deferred action on Periodicals due to the "soon-to-be-released" report of the Joint Task Force on Periodicals required by PAEA section 708 (uncodified). The report has been in preparation for the past several years with promised deadlines for issuance long past.[23] PAEA did not set a deadline for the report, and nothing would indicate that it is going to be submitted to the President and Congress any time in the near future. It is now known, however, that this report is no longer relevant with respect to lawful pricing of Periodicals, as the Postal Service's FY 2010 ACR states that during the course of the preparation of the report it has been determined that there will be nothing the Postal Service can do, within the confines of cost cutting and within-CPI price increases, that will adequately move Periodicals towards covering its costs. FY 2010 ACR, pp. 8-9. Accordingly, there is no justification for delaying Commission action based on the pendency of the long-delayed report of the Joint Task Force.

The Postal Service costing system has been under development and refinement for the last 40 years. Periodicals mailers alleged that Periodicals costing is badly flawed, and it is impossible to conclude that Periodicals cost coverage is under 100 percent.[24] However, the Postal Service Office of the Inspector General conducted an audit of Periodicals data collection systems and issued its report on December 7, 2010. That report concluded: "we found that Postal Service data collection systems and procedures accurately attribute costs to Periodicals based on existing cost attribution models." *See* Postal Service OIG Report No. CRR-AR-11-001 (Dec. 7, 2010), p. 2.[25] Accordingly, there is no justification for delaying Commission action based on supposed flaws in Periodicals costing.

Each time the Commission avoids taking corrective action, the problem worsens, making a corrective price increase larger than if the Commission had acted earlier.

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[23] "The PAEA section 708 provided a study of Periodicals conducted jointly by the Commission and the Postal Service. **That study will be published this spring** [2009] and will, among other things, address service issues of Periodicals mail." FY 2009 ACD, p. 55 (emphasis added).

[24] *See, e.g.,* Docket No. ACR2009, Initial Comments of American Business Media (Jan. 29, 2009), p. 3.

[25] http://www.uspsoig.gov/foia_files/CRR-AR-11-001.pdf

2. Standard Flats.

Standard Flats are one of six products in the Standard Mail class.[26] The Postal Service's Cost and Revenue Analysis ("CRA") report began providing data on the Standard Mail Flats product in FY 2008. In the three years since then, revenues from the Standard Mail Flats product have failed to cover its attributable cost by a cumulative total of $1.4 billion. *See* Table 4.

Table 4

Standard Mail Flats Revenue, Costs and Contribution
FY 2008 – 2010
($, millions)

Fiscal Year	Revenue	Attributable Cost	Contribution	Volume
2008	$3,663.7	$3,891.0	-$227.3	10,010.875
2009	2,866.0	3,488.3	-622.3	7,793.511
2010	2,579.4	3,161.3	-581.9	7,049.230
TOTAL	$9,109.1	$10,540.6	-$1,431.5	

Source: CRA for each respective year.

Although the CRA did not report on Standard Flats as a product in the CRA prior to FY 2008, separate cost and revenue data were available for flats, and from those data flats profitability could be determined. The Standard Mail Flats product is almost exclusively catalogs.

In its current ACR, the Postal Service admits that Standard Flats are not expected to become a profitable product for the Postal Service (despite the fact that operating profit is now a major goal adopted this year by the Postal Service). *See* FY 2010 ACR, p. 8. Unfortunately, this year's ACR minimizes the scope of the problem:

> In each of the last four fiscal years, these two [Standard Mail] products [Flats and NFMs/Parcels] did not cover costs. This is **of concern** to both the Postal Service and the Commission. [FY 2010 ACR (Dec. 29, 2010), p. 24 (emphasis added).]

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[26] The six Standard Mail class products are Letters, Flats, Parcels/NFMs, Carrier Route Letters, Flats, and Parcels, High Density and Saturation Letters, and High Density and Saturation Flats and Parcels. All of those products generate significant contribution, except for Standard Flats and Parcels/NFMs.

Losing $581.9 million in one year should seem to be more than a matter "of concern" to the Postal Service. It certainly would be a huge concern to a for-profit company.

The only good news discernable from Table 4 is that the loss on Standard Flats in FY 2010 compares favorably with the loss in FY 2009 — *i.e.*, a loss of "only" $582 million in FY 2010 versus a loss of $622 million in FY 2009. That reduction in net outflow was attributable solely to the decline in volume, not cost reduction.[27] It is neither fair nor equitable for mailers of other profitable products to be required to continue subsidizing Flats' catalog mailers — particularly not at 8 cents for each catalog sent.

Table 5

Standard Flats Unit Revenue, Cost and Contribution
FY 2009 – 2010

Fiscal Year	Revenue	Attributable Cost	Contribution
2009	$0.368	$0.448	-$0.080
2010	$0.366	$0.448	-$0.083

Source: CRA for each respective year.

PAEA gives the Postal Service significant flexibility and latitude when setting prices for market dominant products within profitable classes. Yet, in every price adjustment it has noticed under PAEA, the Postal Service has used that new-found flexibility to keep each successive price adjustment for Standard Mail Flats **below the systemwide average** for Standard Mail.

[27] In the absence of significant cost reduction, the chief hope for a further reduction in the annual subsidy would appear to lie in a further reduction in volume, a passive strategy not permitted to the Commission under PAEA.

Table 6

Standard Mail and Flats Percentage Price Increase

Docket No.	Flats	Standard Mail
R2008-1	0.865%	2.838%
R2009-2	2.306%	3.781%
R2010-4 (rejected)	5.134%	5.616%
R2011-2	0.835%	1.739%

In the price adjustment filed January 13, 2011, the Postal Service proposed a price increase for Flats (0.835 percent) that is only one-half of the CPI cap and the average increase for all Standard Mail (1.739 percent).[28] Even though the Postal Service is fiscally strapped, it is not clear that the Postal Service is serious intention to increase the coverage of Flats — at least for now. *See* Docket No. R2011-2, United States Postal Service Notice of Market Dominant Price Adjustment (Jan. 11, 2011), p. 16.

Considering the substantial amount of money that the Postal Service already has lost, and continues to lose by virtue of using money extracted from other mailers to subsidize Flats, the discussion in the FY 2010 ACR is quite brief. The Postal Service offers no hope for price adjustments designed to comply with the objectives and factors in section 3622(b) and (c), nor does it offer a defense for continued underpricing of Flats and failure to comply with section 3622(b). The FY 2010 ACR merely states that:

> Table 2 shows that the Flats product has a cost coverage of **81.6 percent** in FY 2010. The Postal Service believes that **pricing** and **efficiency measures need to be taken to ensure that this product covers its costs and makes an appropriate contribution toward institutional costs.** [FY 2010 ACR, p. 31 (emphasis added).]

The inability of the Postal Service to stop the financial hemorrhaging from any underwater class or product is of great importance. Cumulative losses on underwater products

[28] A price increase of 22 percent is still needed to bring revenue from Standard Flats up to attributable cost — a coverage of only 100 percent.

have helped put the finances of the Postal Service in a significant hole, and continuation of those annual losses threaten to do even more serious damage.

It often is stated that, under PAEA, the rate cap protects other mailers from an increase in their rates on account of subsidies to underwater products. That does not mean, however, that the cumulative effect of recurring deficits from underwater products will not affect other mailers and stakeholders, perhaps severely so, in a variety of ways. An operating deficit is an operating deficit, and the Postal Service has to find ways to pay its bills. Concurrently, the rate cap severely restricts increases in revenue, especially in an environment of little or no inflation. By way of illustration, the pending proposal in Docket No. N2010-1 to eliminate Saturday delivery to every residential address in the country is one such initiative. Its purpose is to help cover operating deficits that in no small way are attributable to underwater products such as Standard Flats. Elimination of Saturday delivery, if adopted, would affect every residential delivery point, and apply equally to all mailers and all products, not just underwater products.

3. Recommendations.

In its FY 2009 ACD, the Commission ordered the Postal Service to implement a plan to remedy the problem of underwater products. FY 2009 ACD, pp. 75, 86-87. But, in Docket No. R2010-4, it rejected the Postal Service's exigent price request which was partly an effort to begin to move Periodicals closer to cost coverage. In light of the Commission's exigent request rejection, the Postal Service now concludes that, despite the most optimistic cost cutting in the future, Periodicals, Standard Mail Flats, and Parcels cannot achieve cost coverage under the rate cap. FY 2010 ACR, pp. 8-9.

If adequate cost coverage cannot be achieved for Periodicals and Package Services through (i) cost cutting and (ii) cap-limited price increases, or as part of (iii) an exigent price adjustment, then the last available tool is for the Commission to do what is within its remedial powers under 39 U.S.C. sections 3653 and 3662(c).

- Valpak urged the Commission to order the Postal Service to increase prices for the **Standard Flats** product one-half of the way to cover its costs — an **11.0 percent** increase in the pending annual compliance review.

- And, similarly for the **Periodicals class**, Valpak urged the Commission to order the Postal Service to increase prices one-half of the way to cover its costs — a **16.0 percent** increase in the pending annual compliance review.

Thereafter, the Commission can consider what further increases will be necessary to have this product and this class make a reasonable contribution to institutional costs.

We bring these matters regarding Underwater Products to the attention of the Congress, because neither the Postal Service nor the Commission have demonstrated a willingness to make the tough decisions necessary to implement the provisions of PAEA under which each product and class must pay its own way. Absent meaningful action, the financial stress from Underwater Products is certain to continue, and perhaps grow even worse. In the next couple of weeks, the Commission will issue its ACD for FY 2010, and we will know whether it has taken the actions required by PAEA. If it does not take action, we urge Congress to step in to ensure that the law it wrote is being faithfully implemented.

Further, the Postal Service has asked Congress to amend the price cap so that it would apply to all Market Dominant products and not separately to each class. In general, we agree, but believe that any such legislation must be accompanied by a clear mandate to focus all future price adjustments so as to eliminate the current enormous losses being incurred from favored mail products.

D. MARKETING MAIL MADE EASY.

We conclude our testimony with some comments on a pending issue, where we believe the Postal Service is headed in the wrong direction with a new marketing incentive. This matter is now pending before the Commission, and we anticipate a decision in the near future.

The Postal Service has asked the Commission to begin testing a new "experimental product" — "Marketing Mail Made Easy" ("MMME") — proposed to be defined as a "new product [that] will reduce barriers to entry, encouraging small and medium-sized businesses to utilize the mail to promote and market their businesses to current and prospective customers simply and at an affordable price." Docket No. MT2011-3, Postal Service Notice (Jan. 12, 2011), p. 1.

Existing High Density and Saturation mail comes from a variety of sources. One source is mailers with shared mail entered by companies such as Valassis, Harte-Hanks, and Valpak. The total mail coverage ("TMC") programs of newspapers is a second source. Yet a third source is mail service providers ("MSPs"). Players in these three groups compete vigorously to get retail businesses to advertise through the mail, and to use their services when so doing.

MMME is designed to modify acceptance rules to urge businesses now using these three ways of mailing to pull their pieces from these existing mail channels, potentially jeopardizing existing mail. The Postal Service needs to consider that the success of new programs like MMME may come from cannibalization of existing mail. Valpak believes it is not a good business decision to harm your current customers in order to try to attract new volume. Valpak and many other companies have urged the Commission to reject this product as it does not comply with law applicable to market tests, and we await its decision.

Mr. ROSS. Thank you, Mr. Sampey.

Mr. Sackler, you are recognized for 5 minutes.

STATEMENT OF ARTHOR SACKLER

Mr. SACKLER. Thank you, Mr. Chairman, and good afternoon to you, to Ranking Member Lynch, and the members of the subcommittee.

The Coalition for a 21st Century Postal Service is pleased to present our views on what we also agree is a looming crisis for USPS. The Coalition's 33 trade associations and companies represent a major swath of a nearly $1 trillion industry that employs more than 7½ million people. It runs the gamut of paper communications; from forestry and paper companies, printers and technology providers to companies which create every type of mail.

There is far more at stake in how the Postal Service fares than the Postal Service itself: the future of an industry roughly 15 times the size of postal revenues, the huge number of jobs it supports, and the substantial impact that industry has on the economy. And we believe postal insolvency, which could happen by the end of this fiscal year without action, will have consequences not only for the Postal Service, but quite possibly for the Nation.

Given the state of the industry and potential postal insolvency, the Coalition believes it imperative for Congress this year to correct a core element of the financial imbalance, by eliminating a hidden tax assessed on postal ratepayers that was used to reduce the deficit and effectively subsidize retirements of non-postal Federal retirees, and repatriating that money over time to underwrite the pre-funding of retiree health benefits required by Congress. The $50 billion or more in overpayments to CSRS and the nearly $7 billion more to FERS constitute a vast hidden tax that would, if redirected, dramatically improve the position of the Service and, consequently, the industry and the public generally which it serves.

Some believe repatriating this money would constitute a bailout. With great respect, we strongly disagree. While these overpayments were caused by a good faith actuarial misinterpretation, they were nonetheless paid not by the American taxpayer, but by postal ratepayers. As the postmaster general pointed out, USPS's money comes almost exclusively from user fees, postage, and 90 percent of that comes from businesses. Having collectively funded the bulk of these overpayments, we believe the right outcome is to use the money to benefit the Postal Service and thereby those who depend upon it.

The alternative is insolvency. On September 30th, facing the choice of paying $5½ billion to pre-fund retirees' health benefits or paying its employees and keeping the lights on, as the postmaster general put it before, they will sensibly opt for the latter. There will be no legal or other consequences for the Postal Service or its managers, but it will be in default of an obligation.

Questions about its reliability will arise for those who do business with it. And will overseas holders of U.S. securities treat this as the first loose thread in unraveling the Nation's financial ball of yarn? What would that do to interest rates and yields for treasuries? After all, it remains the U.S. Postal Service. Insolvency must be avoided.

And if it isn't, the obligations won't simply go away. To the extent that the financial shortfalls for USPS overtake it, those obligations will fall to Congress. Then there will be the need for an actual taxpayer-funded bailout.

In our written statement we offer other recommendations we believe would help the Service and the industry grapple with the interrelated financial, structural, and innovative elements of this looming crisis. These include addressing the high cost of compliance with mailing rules, giving the Postal Service more flexibility to close facilities or offer certain non-postal products, more flexibility on negotiated service agreements, and more.

Without structural changes as well, financial transfers will only kick the proverbial can down the road, as has been noted several times during this hearing.

Mail remains an important communications channel. Even in its current fragile state, the postal system remains pervasive and effective. Yet, despite these attributes, challenged by disruptive technology and retrenching resulting from the recession, our system is struggling. Mailers and suppliers have undergone dramatic changes the past 2 years, collectively enduring hundreds of thousands of layoffs, the shuttering of numerous businesses, and other dislocations. The result has been unprecedented budgetary pressure on mailers to reduce their costs of distribution.

No one can force anyone to mail. Mailers have choices. Because of the Internet, first class, the cash cow of the system, is effectively no longer a monopoly and continues to sink like a stone. Each account going online is costing a dozen bills, a dozen payments, and several promotional pieces each year. The decline in first class threatens the system's financial stability.

Similarly, when prices rise, there is more pressure on catalogers, other advertisers, and periodicals to use alternatives, decrease the weight and size of their mailing, otherwise reduce their mail exposure. Like first class mailers, they have choices via the Internet and other marketing channels. The concomitant effect on suppliers is just as significant. Less mail means less paper, printing, and technology business.

Thank you, Mr. Chairman. We believe that all of this financial pressure on mailers puts a premium on holding prices down while maintaining service. The Coalition is prepared to work with you and your colleagues to stave off a decline of the Postal Service. It need not be inevitable. I would be happy to respond to any questions you may have.

[The prepared statement of Mr. Sackler follows:]

Statement of
Arthur B. Sackler
On behalf of the
Coalition for a 21st Century Postal Service
Concerning
"Pushing the Envelope: The Looming Crisis at USPS"

Good afternoon, Mr. Chairman and Members of the Subcommittee. The Postal Service remains an indispensable medium of commerce and communications in the 21st Century but, as such, it is the last link of a chain of distribution for, and a supplier to, a nearly $1 trillion industry that employs more than 7.5 million people. That industry runs the gamut of paper communications: from those who grow the trees through paper companies, printers, technology providers and on through companies which create mail of every type. This includes financial houses, telecommunications, insurance, utilities, mail order merchants, small businesses and the many other companies which place bills and statements into the mail, magazines and newspapers, advertisers and cataloguers, parcel shippers, new technology and business model providers, and more.

There is far more at stake in how the Postal Service fares than the Postal Service itself: the future of an industry roughly fifteen times the size of postal revenues, the huge number of jobs it supports, and the substantial impact that industry has on the economy as a whole. And, we believe insolvency, which could happen as early as the end of this Fiscal Year without action, may well have consequences: not only for the Postal Service, but possibly for the nation.

My name is Art Sackler, and I am one of two coordinators of the Coalition for a 21st Century Postal Service. I am also Executive Director of the National Postal Policy Council, an organization of large business users of First Class Mail, and a member of the Coalition. The thirty-one trade association and corporate members of the 21st Century Coalition span the entire spectrum of the enormous industry outlined above, positioning them to provide you with views that are broadly representative of that spectrum.

The Coalition greatly appreciates the opportunity to testify in light of the critical financial and structural issues confronting not only the Service, but the entire industry that relies upon it, and to present our views on how those challenges might be addressed.

Given the state of the industry, and the looming insolvency of the Service, the Coalition believes it is imperative for Congress this year to correct one of the core elements of the postal financial imbalance: by eliminating the hidden tax assessed on postal ratepayers for decades that was used to reduce the deficit and effectively subsidize the retirements of non-postal federal retirees, and repatriating that money to underwrite the prefunding of retiree health benefits required previously by Congress. The $50 billion or more in overpayments to the Civil Service

Retirement System (CSRS), and the nearly $7 billion more to the Federal Employees Retirement System (FERS), constitute a vast hidden tax that would, if redirected over time, dramatically improve the position of the Service, and consequently the industry and public generally which it serves.

Some believe that repatriating this money would amount to a "bailout" of the Postal Service. With great respect, we emphatically disagree. While we believe these overpayments were made because of a good faith misapprehension of applicable actuarial standards, they were nonetheless paid. Make no mistake: USPS has virtually no money of its own; it nearly all comes from user fees in the form of postage, and 90% of that comes from businesses. So, having collectively funded the bulk of these overpayments, we believe the right and just outcome is to put the money to use in a way that will benefit the Postal Service, and those in business and among the general ratepaying public who depend upon it.

The alternative is insolvency. On September 30 of this year, facing the choice of paying the Treasury $5.5 billion to prefund retirees health benefits, as required by the Postal Accountability and Enhancement Act (PAEA), or paying its employees and keeping the lights on, the Postal Service quite sensibly will opt for the latter. When it does so, there will be no legal or other consequences for USPS or its managers. But it will be in default of an obligation. Questions about its longer-term reliability and predictability will arise for those who do business with it. Of perhaps greater concern, are observers and holders of U.S. bonds and securities, especially overseas, going to see this as the first string peeling away toward unraveling the nation's financial ball of yarn? What will that do to the cost of borrowing: interest rates and yields for Treasuries? After all, it remains the *United States* Postal Service. Insolvency must be avoided.

And if it isn't, the obligations to postal retirees for pensions and health prefunding will not simply go away. To the extent that the financial shortfalls for USPS eventually overtake it, those obligations will fall to Congress. Then, there will be need of an actual bailout.

The Challenges Facing the System and the Industry

Despite the Manifest Value of the Mail, Mailers will Make Objective Business Judgments about Use of the System

Mail remains one of the great values available not only to mail users, but to the public generally. Even in its current, fragile state, the American postal system remains approximately eight times larger than any other system worldwide; it is more pervasive, efficient, effective (with on-time deliveries hovering generally in the mid-90%s for First Class), and cheaper, than its overseas colleagues. Whether mailing a piece sealed against inspection, a magazine or newspaper highly prized by readers, or seeking the best return available from a promotion via any advertising delivery system, its reliability and security are unmatched.

Yet despite these outstanding attributes, directly challenged by disruptive technology and the ongoing retrenching resulting from the recession, our postal system is in a struggle that could be nearly existential. Business mailers who contribute 90% or more of the Postal Service's

volume and revenues, and their suppliers, have undergone traumatic changes over the past two years that have transformed the industry and required dramatic restructuring. Mailers and suppliers have collectively endured hundreds of thousands of lay-offs, the shuttering of numerous businesses, and other such dislocations. The result has been unprecedented pressure from within to reduce the costs of distribution.

It is a truism that nonetheless should be stated: no one can force anyone to mail. Mailers have choices. Primarily because of the Internet, First Class, the cash cow of the postal system, contributing nearly three times its cost of moving mail from point A to point B, has become virtually competitive. (For comparison, it takes three pieces of promotional mail to equal the contribution from one letter.) Even in our now recovering economy, as promotional mail rebuilds somewhat, First Class continues to sink like a stone – off another more than 6% in the latest financial report from the Postal Service. And, its effect is multiplied: for every, say, bank account that switches from paper to electronic, USPS loses a dozen statements, a dozen payments, and from six to fifteen promotional pieces a year. Still accounting for more than half of the Service's revenues, the continued decline in First Class is ominous, and threatens the financial stability of the system going forward.

The impact on other classes of mail is significant. When prices rise, even in as relatively small an increment as next month's indexed increase, given the razor-thin margins of the post-recessional world, the effect is magnified. The result from these increases is more pressure on catalogs, other advertisers, and periodicals to use alternatives, decrease the weight and size of their mailings, and take other steps that will reduce their exposure to the mail, and slow postal revenues. Adding to that having to make up the steep fall-off in First Class contributions may be a bridge too far for some of these businesses to survive, let alone thrive and create jobs.

The concomitant effect on the supply chain to mailers will be just as significant; reduced pieces of mail mean less business and fewer jobs for paper companies, printers, technology suppliers and more. Together, the shrinkage implicit from these prices will have implications for jobs and business not only in the paper communications sector, but in the economy as a whole.

It is a strange juxtaposition for mailers and suppliers that have been unable to raise prices, in some cases for at least a decade, to confront a system that operates as if it can. For mailers, by far the largest part of paper distribution costs, greatly outstripping paper, ink, printing and more, is postage. For example, for catalogs, postage makes up well over 50% of the cost of distribution. Postage is now the prime target of attempted cost savings in the distribution area.

The bottom line here is no matter how attractive this medium, mail users will make cold, clear, business-based decisions about how to distribute their products or their bills. That puts a premium on holding mail prices down while maintaining excellent service by, and providing innovative products and pricing from, the Postal Service. Mailers would like to continue to take full advantage of a proven system, but simply will be unable to if those conditions cannot be met.

The Problems Confronting USPS

The problems confronting USPS are well-known, but warrant a brief review. They fall into three categories: financial, structural and innovative. They overlap and, regrettably, to some degree are mutually reinforcing of a slide in fiscal stability.

Financial

- The prime financial cause of USPS' breathtaking losses since 2008 is the $5.5 billion annual payment to prefund postal retirees health benefits. According to USPS, absent that payment, it would have been in the red only approximately $500 million. When the payment was required in the Postal Accountability and Enhancement Act of 2006, the Service was flush with volume and revenue. No one predicted that the floor would drop out from under both, rendering the payment a currently unaffordable luxury. Moreover, the continued decline in postal employees has not been factored in, so the $5.5 billion annual payment now appears to constitute an overpayment, as well. And by contrast, few in the public sector, and even fewer in the private sector, prefund at all – let alone when there is already nearly $40 billion in this particular till.

- The proportion of USPS costs still hovers around 80% for wages and benefits to its employees. Notwithstanding extensive automation, and quite aggressive costcutting over the past two years, that proportion stubbornly does not move. It is far too large to simply ignore. It would have been heartening to see a focus between USPS and its unions and management associations on addressing the crisis confronting them mutually in a joint and constructive way. Unlike with the auto and, before them, other industries, such as airlines or steel, there was no reopening of contracts and examination together of what could be done.

- The Coalition wants to praise both USPS and its employees for the huge $10 billion in cost cuts -- including reduction of head count through attrition, and revision of some work rules, such as for longer carrier routes -- they have achieved over the past two years. Unfortunately, it has not been enough – not nearly enough. And we say "unfortunately" with deliberation. The wrenching changes in employment and budgets throughout the industry since 2008 makes us very empathetic to the plight in which postal management and labor find themselves. But it was only through those wrenching changes that the industry was able to adjust to new financial realities.

Structural

- The postal system is vastly overbuilt; by some estimates by a factor of nearly 100% based on current and foreseeable volumes. In a situation such as this, any private sector company would close and consolidate outlets, and redesign its

distribution network to become more efficient. USPS does not have this latitude; it is severely inhibited in its ability to manage down and restructure for a new reality. The law currently prohibits USPS from closing a post office based solely on financial reasons. If it does decide to close a post office or other facility, it encounters extensive opposition, including through a formal appeals process to the Postal Regulatory Commission, from affected communities. It also runs into strong opposition in Congress from those representing the districts and states encompassing the affected areas. Last year's plan is a perfect example, when the number of potential closings dwindled from in the four-figures to less than one hundred.

- Work rules are another problem. In order to restructure, USPS needs the latitude to efficiently reassign employees, and redesign what they may be required to do. Current work rules largely prevent transfers among crafts or other such changes that would be necessary to help slim down and streamline the system. Moreover, mailers essentially subsidize inefficiencies in the postal system. This plays out in a number of ways. For example, in the case of magazines, extra and unnecessary personnel are diverted to processing those periodicals, which distorts and expands their costs and contribution to overhead.

- USPS also does not have sufficient flexibility in the area of nonpostal services. While the Coalition believes USPS should not be permitted to compete with the private sector outside the direct postal sphere, it should have more authority to partner with the private sector, through more worksharing and retail opportunities.

Innovation

- The Postal Service has taken steps over the past two years to innovate, with mixed success. The flat rate box for Priority Mail has been a hit, but the various "Sales" for certain Standard and First Class mail have met with modest success, at best. One problem is that there is a major emphasis on preserving every cent of revenue. USPS conditions access to these sales and other incentives on adding volume in a sometimes complex formula. When there is a healthy business, that kind of effort to drive up volume is a good strategy. But when the business is hemorrhaging volume at a record rate, first stop the bleeding. Remove the complex conditions and try to retain volume and market share; then build. To the extent that some First Class Mail, for example, which might otherwise have been removed by a mailer, stays in the system, it is worth a multiple to USPS, as outlined previously.

- Similarly, USPS has been far too conservative on pricing. As far as we know, the Service has not experimented with the notion of simply reducing prices in a category of mail, even temporarily, in a bid to regain market share. There are reasons for this, such as Sarbanes-Oxley compliance, or PAEA's pricing factor that mail must cover both attributable and some contribution to institutional costs,

pointed to by USPS. Nonetheless, when cost coverages are well more than attributable costs, there is easily some room for reduction, notwithstanding these requirements.

- Relatedly, the Service has, with increasing frequency, imposed substantial additional costs upon mailers to prepare, qualify and verify mailings. For large mailers, these compliance costs can range into the 7- and 8-figures. For smaller mailers, the proportion can be similar. These are costs which are not compensated for in worksharing discounts. They are simply additional expenditures on hardware, software, personnel and training that constitute an unfunded mandate to mailers. Examples include the booklet rule change of 2009, the pending folded self mailer rules, Move Update requirements, and the implied (soon to be mandatory) rule changes for preparation and sorting of flats for the new Flat Sequencing System (FSS). A change as simple as redirection of drop shipments because of postal plant closures or processing changes can affect a great deal of mail and add costs; in many cases a logistics provider does not learn of such changes until a driver arrives at a USPS plant.

- Negotiated service agreements in the Market Dominant (MD) area have stagnated. NSAs are quasi-contracts that permit some individuation of service and pricing. Encouraged by PAEA, the process to achieve them through the Postal Regulatory Commission is too cumbersome, time-consuming and expensive. A potentially fertile ground for innovation is being choked off. Not only have there been relatively few MD NSAs, but some that had been achieved are not being renewed.

- Relatedly, Commission regulations label both market dominant and competitive rate agreements as "Negotiated Service Agreements." This causes some confusion and is inappropriate, in our view, as these two types of agreements are quite different and subject to very different statutory and regulatory requirements. We urge the Commission to distinguish between the two. We suggest competitive product agreements be labeled "Contract Pricing Agreements." A key feature of the PAEA was to enable the Postal Service to negotiate prices for these services with its customers. This has worked reasonably well, but regulations that deem each contract a separate product and a statutory provision requiring approval of every contract by the Postal Service Board of Governors are cumbersome and generally dissimilar to practice in the private sector. We believe the Postal Service will make specific recommendations to address these shortcomings, and we expect to support those

Recommendations to Address the Challenges to the Postal System and the Industry

Following are a number of recommendations for change endorsed by the Coalition, which we respectfully commend to Congress. They address the urgent issues confronting the

system and the industry, as well as some matters of lesser importance where change would nonetheless prove beneficial.

Pension Fund Overpayments Must Be Restored to the Benefit of the Postal Service

As discussed earlier in this statement, pension fund liabilities have been greatly overpaid through the years. Through an independent actuarial evaluation by the Segal Company, and the PRC's report on the matter, as well as a study by the Hay Group for the Postal Service's Inspector General, it is clear that there has been at least $50 billion in overpayments to the Civil Service Retirement System (CSRS) Fund. And, now, we understand it has been established that an overpayment exists to the Federal Employees Retirement System (FERS) Fund, as well. We strongly urge Congress to direct that both be repatriated to the beneficial use of the Service in addressing its financial issues, much as has been contemplated in at least three bills introduced last year: H.R. 5746, S. 3831and S. 4000, and importantly this year by Senator Susan Collins in section 101 of her bill, S. 353.

Specifically, we recommend that:

- The current CSRS overpayment be transferred from that Pension Fund to the Retiree Health Benefits Fund to fully prefund that obligation, as imposed by PAEA. Such prefunding could be amortized, or paid in lump sum. Should any funds remain, they should go first to postal debt reduction, and then to retained earnings. The Coalition firmly believes that there should be no room for discretion or interpretation in this provision. The money must be returned.

- A similar approach should be taken for the repatriation of any overfunding for USPS in FERS. Whether amortized or in lump sum, that money should be returned to USPS. Moreover, given the ongoing overfunding, no increase in USPS' contribution should be required at this time.

There should not have to be any intervention by Congress, however. Section 802(c) of PAEA provides a process for assessing, analyzing and adjusting any surplus or liability to the CSRS Fund. The Service and the Commission carefully followed the requirements of Subsection 802(c)(1)(A) and (B), respectively. The result was a confirmation of the huge overpayment to the CSRS Fund. Under Subsection 802(c)(2), it was incumbent on the part of the Office of Personnel Management to "reconsider its determination," and "make appropriate adjustments." Nonetheless, despite the mandatory language of Congress – "shall" reconsider, "shall" make – OPM has declined to make the adjustment necessary to comport with the Segal Company's findings and the Commission's report. Evidently, a provision that many observers, including this Coalition, find to be crystal clear, needs to be sharpened. As a result, we specifically recommend that:

- Section 802(c)(2) be revised expressly to require OPM to change its determination or redetermination consistent with any report issued under subsection (c)(1)(B), provided that, should OPM disagree with the Actuary's findings, it be given an opportunity to

present its views to the Commission publicly prior to the issuance of the Commission's report.

The Postal Service Should Have Much Greater Latitude to Manage Its Facility Inventory

As previously noted, the Postal Service is consistently inhibited, if not outright prevented, in any attempt to systematically reduce the number of post offices and other postal facilities to reflect the realities of today's mail volumes. Post offices may not be closed for purely financial reasons (39 USC Sec. 101(b)), and the closures of both post offices and other facilities frequently draws substantial opposition from communities, Members of Congress, and others. While we understand the concerns underlying that opposition, and under other, financially advantageous conditions, would continue to recognize the need to balance fully the requirements of USPS with those of other interests, such is not the case today. We have an urgent financial situation which must be addressed. One way to do so is to loosen restrictions on USPS' ability to adapt, while still taking into account the concerns of its customers – both commercial and the mailing public. Therefore, the Coalition recommends:

- USPS should be permitted to close mail processing centers and post offices or related facilities based upon business needs, but founded on five principles:
    - Clarify that customers' and USPS' business needs both be addressed
    - Provide a business impact statement
    - Provide a cost/benefit analysis with respect to customers
    - Add support for providing other retail alternatives
    - Maintain community identity by retaining all ZIP codes.

The Postal Service Should Be Able to Provide More Nonpostal Services

The Coalition agrees in general with other postal stakeholders that one key to a path to financial recovery for the Service is to provide more services that the public wants or needs. While we do not believe that blanket relief on this score would be productive, we recognize the need to give the Postal Service some additional ability to seek new sources of revenue. New postal products that meet the changing needs of the marketplace stand a better chance of retaining or attracting business. Given the severe budget limitations that governments at all levels face, the Postal Service, with its widespread retail network, is a natural place for government agencies to work with the public.

At the same time, we would be concerned should the Postal Service move too far afield from its core mission. Unrestrained venturing into private sector offerings may have counterproductive effects such as cannibalizing business and jobs from affected industries, or exposing all postal customers to losses from any such ventures in the start-up phase or from simple failure. Those same concerns are manifestly not present for the offering of additional governmental services at every level of government. The convenience factor should be a powerful marketing force for USPS on this approach. Hence, we encourage changes that would:

- Expand authority for nonpostal services to cover a full range of governmental services at every level. With perhaps some severely limited exceptions, that authority should not

extend to services provided by the private sector. Mailers should not be exposed to risk of cross-subsidization for startup costs or failure of any nonpostal ventures. One proviso: that opposition does not extend to actions USPS may be able to take under existing law concerning advertising on vehicles, in post offices, building naming rights, and related opportunities.

The Collective Bargaining Process Should Be Updated to Reflect Changes Recommended by the Presidential Commission on the Postal Service

The collective bargaining process is both integral to the relationship between the Postal Service and its employee organizations, and a means for mutually addressing problems confronting the institution. The Coalition recognizes its importance, but also recognizes that its current design is not as adaptable to the potentially existential financial issues facing the Service as it could and should be. The current system has resulted in such recent counterproductive or even disconnected results as: a large cost-of-living increase in 2009, one of the worst financial years for the Postal Service in memory; when it is more important than ever that the parties agree on fixes to stabilize USPS, the Postal Service and the two unions with which it is currently bargaining are at impasse; and work rules inhibit inter-craft transfers and other options that would give USPS more flexibility to address its structural problems.

For reasons such as the above, the Coalition believes the collective bargaining process is in need of adjusting and updating. The Presidential Commission on the Postal Service reviewed the matter of collective bargaining in-depth, and made a number of recommendations to improve it. We believe those recommendations continue to have merit, as they would help encourage the parties to reach agreements without going to arbitration, and would narrow the issues whenever arbitration is unavoidable. Thus, we recommend that:

- The collective bargaining process be modified. The industry supports the proposal of the 2003 Presidential Commission generally, and recommends further rigorous exploration of interest arbitration that incorporates a "Last Best Offer" provision. We support the following:
    - Basic Process – a negotiation process, beginning 90 days prior to the expiration of an existing agreement, followed by a 30-day mandatory mediation process and, if mediation fails, an immediate 60-day interest arbitration process.
    - Mandatory mediation and "Med-Arb" – The 30-day mandatory mediation process would be conducted by a mediator who would become a member of the arbitration panel should mediation fail. The purpose of the mediation process would be to either reach a negotiated settlement or to narrow the range of issues to be submitted to interest arbitration.
    - Interest Arbitration – The 60–day interest arbitration process recommended by the Presidential Commission was to have a three-person arbitration panel comprised of three neutral arbitrators, one having served as mediator. The interest arbitration process would incorporate the Last Best Offer mechanism and a 10-day period during which the parties would have a final opportunity to reach a negotiated settlement prior to the arbitration panel's final award.

- The Coalition also believes that, as proposed by Senator Collins in section 102 of S. 353 and by Senator Tom Carper in subsections 3(e)(3)(B)(i) and (ii) of the postal bill he introduced last year, S. 3831, arbitrators should also be required to take into account the financial condition of the USPS and the provisions of PAEA. Those inclusions seem indispensable to reaching a solution that makes sense for the system on a global basis. And the provision is fair: in challenging economic times, it favors the Postal Service. In better economic times, it favors the employee organizations.

- Finally, the Coalition believes that pay comparability is a complex issue. The entire mailing and supplying community can and should provide some elements of appropriate comparability. Therefore, the Coalition suggests measurement be expanded to include the entire mail supply chain; an amalgam of businesses could be used to reach what we believe would be equitable results on a broader base of jobs invested in or dependent upon the postal system.

Workers Compensation Rules Should be Revised to Provide a Switch to Retirement Benefits Upon Reaching the Requisite Age

As admirable and appropriate a system for assisting injured or disabled workers as workers compensation is, it is intended to come to the financial aid of workers who can no longer fulfill the requirements of their jobs. But just as workers who retire change from regular compensation to retirement benefits, so it should be for those who are receiving workers compensation. When they reach 55 or whatever the prescribed retirement age is, benefits should be changed to those from retirement systems. The workers compensation burden for the Postal Service is enormous, and far larger than it should be or is sustainable under current conditions. Therefore, the Coalition recommends:

- Workers compensation, like compensation from employment itself, should not be guaranteed for life. Rather, there should be an orderly transition to retirement benefits as there is for workers not disabled.

The Postal Service Must Take into Account Compliance Costs on Any New Requirement for Mailing

As discussed above, the Postal Service often adjusts rules concerning qualification, verification and the like of mail. Initiatives such as the CASS Cycles, Move Update and the Intelligent Mail Barcode (IMb) require major investments in money, staff time and other resources of mailers to comply. These additional expenses, ranging into the 7- and 8-figures are not, or are inadequately, compensated for through discounts or otherwise, and precipitate substantial budgetary pressures on mailers. That is true for any given change, and particularly so with respect to cumulative effect. There is no requirement to obtain comment or undertake a comprehensive cost/benefit analysis, as USPS currently is not subject to the Administrative Procedures Act or Executive Order 12866 and its requirements for cost/benefit analysis of any proposed rule change, although we would not support subjecting the Service to either or both.

Nonetheless, the Coalition believes that the impact of compliance costs has become so severe that it must be addressed. Therefore, we recommend that:

- In order to ensure that there is adequate input concerning impact by those affected to USPS whenever it contemplates rules changes respecting qualification, entry, verification of the mail and otherwise that do not require review by the Commission or are not de minimis (to be defined), USPS should be required to:
    - provide notice in the Federal Register and at least 30 days for comment; and
    - provide a cost/benefit analysis with respect not only to USPS, but to its affected customers.

The Negotiated Service Agreement (NSA) Process Should Be Streamlined and Made More Flexible

As we've noted throughout these comments, the circumstances of USPS have severely changed in a relatively short period of time. These changed circumstances dictate that more aggressive ways to retain and, optimally, recoup volume must be considered. One means of encouraging more volume is through individually tailored agreements with mailers. The current process for NSAs in the Market Dominant classes is not user-friendly; it is too long and too expensive, heavily contributing to the relative dearth of new agreements and the failure to some of the older ones.

We believe the PRC, in consultation with USPS and mailing interests, and, of course, with input from any other postal stakeholders wishing to comment, should assess what could be done to streamline the process. From a legislative standpoint, the requirement of extending the same conditions to mailers "similarly situated" (39 USC Sec. 3622(c)(10)) should be loosened to enable more individuation of these agreements. Such individuation would, in our judgment, have a considerably better chance of fostering more agreements and retaining or building volume for USPS. Therefore, the Coalition recommends:

- The process for NSAs should be streamlined. We believe the current process is too long and too expensive. Plus, some flexibility should be introduced into the definition of "similarly situated," in order to give USPS more freedom to develop innovative approaches.

- A proposal such as that of Senator Collins to similar effect in section 103 of S. 353, also should be pursued.

USPS Should Be Authorized to Deliver Wine and Beer

USPS is today not able to deliver wine and malt beverages ordered by customers. Deliveries of these products are subject to state regulation, and can be made in some states and not in others, as well as being subject to varying restrictions. It is not an uncomplicated subject that would need to be worked out. However, the Coalition believes that a general authorization

such as proposed by Senator Carper in section 3(d) of S. 3831, subject to some collaborative work with the states, would be a first step. Therefore, the Coalition supports:

- Permitting mailing of wine or malt beverages by a licensed winery or brewery, under regulations to be issued by USPS and taking into account state restrictions.

An Annual State-of-the-Industry Report Should be Required

Senator Collins, in section 106 of S. 353, proposes that an annual report on the mailing industry be conducted by the Commission. We believe the Senator's proposal is an important notion that would give all stakeholders an up-to-date profile of the industry, and help guide decisions on operations and policy. We would, however, define mailing industry to include all suppliers, so that the entire spectrum of this major industry worth, again, nearly $1 trillion, would be profiled.

Thus, we recommend that:

- An annual report on the state of the mailing industry, to be defined as including mailers and suppliers, be required.

Conclusion

The Postal Service and the nearly $1 trillion industry and 7.5 million jobs that depend upon it are at a crossroads caused largely by the recession and the application of disruptive technology. Changes rippling through the industry as a result have begun what may be an irrevocable effect not only on the industry, but on the Service. Absent quick and thoughtful action by Congress, the Service is likely to continue to decline and lose market share. Down that road lies insolvency and, eventually, a bailout.

Mr. Chairman, the Coalition is prepared to work with the Subcommittee, the rest of Congress, and other postal stakeholders to avoid those outcomes and preserve the ubiquity, effectiveness and affordability of a still essential medium of commerce and communications for the 21st Century.

Thank you again for the opportunity, and I will be happy to respond to any questions from Members of the Subcommittee.

Mr. ROSS. Thank you, Mr. Sackler.

Mr. Rolando, you are recognized for 5 minutes.

STATEMENT OF FREDERIC ROLANDO

Mr. ROLANDO. Good afternoon, Chairman Ross. Congratulations again on your chairmanship. And good afternoon, Ranking Member Lynch. Welcome back from Afghanistan. And greetings to the other members of the subcommittee.

I am pleased to be here today on behalf of the nearly 290,000 members of the National Association of Letter Carriers. We are honored to be the public face of the U.S. Postal Service, an agency mandated by the U.S. Constitution and one of America's oldest, proudest, and most essential institutions.

I have submitted a written statement, but in my few minutes here I would like to leave you with five points to consider, some of which counter the conventional wisdom.

It is worth nothing that the figures I will cite are from official sources. We can all form our own opinions about public policy, but we should start from shared facts.

First, the Postal Service remains a vital part of our society and our economy; it provides the only truly universal delivery and communications network in the United States, serving every corner of this country, from the most rural areas of Montana to every city block of Manhattan, 6 days a week. For several years in a row the public has named the Postal Service the most trusted Federal agency in America, in large part because of its dedicated and professional work force.

The Postal Service is a vital infrastructure service that is not only an essential element of the country's financial payment system, but also a key facilitator of business and communications for the 150 million homes and businesses it serves. According to a 2009 study by the Postal Service, the annual value of transactions moving through the mail exceeds $30 trillion, underlining its importance to the health of our Nation's economy.

Second, there is indeed a financial crisis at the Postal Service, one we must address for the sake of the economy and the millions of workers employed by the mailing industry. But it isn't the crisis you might think it is. Let me explain.

With the Nation still suffering from the worst recession since The Great Depression, mail volume has fallen, a trend exacerbated by Internet diversion. And yet the Postal Service has been running an operational profit. You heard that correctly, postal and profit in the same sentence.

In the most recent quarter alone, postal operations had a profit of $226 million, taking in more than a quarter billion dollars over operating expenses. That brings to $837 billion the net operational profits over the past 4 years. And this has been achieved by increased productivity, labor-management partnership, fair and flexible work adjustments, and performance and quality that have lifted customer satisfaction, all while maintaining the most affordable postal rates in the world.

But while the Postal Service is operating more smartly than ever, it faces a huge burden unrelated to its daily work. The 2006 congressional mandate to pre-fund future retiree health benefits for

the next 75 years, and to do so within 10 years, and obligation faced by no public agency or private firm in America, imperils the Postal Service. In the past 4 years, the Postal Service has made $20.9 billion in pre-funding payments. It is that unique obligation during a recession that has plunged the Postal Service into a financial crisis.

Point three, fortunately, there is a good solution. The Postal Service has a surplus of between $50 and $75 billion in its pension funds, according to two independent audits, because of overpayments made since 1971. Congressional approval to let the Postal Service make an internal transfer of its own money derived from the sale of products and services would leave both the pension and retiree funds in far better shape than virtually all such accounts in this country.

Why? Because not only have daily Postal Service operations been carried out efficiently, the agency has been highly responsible with future obligations, all this, let me emphasize, without using any taxpayer money for over a quarter century. We are simply asking that the Postal Service be allowed to use its own money, as any responsible business would.

Bipartisan agreement is forming on this crucial reform. Senators Tom Carper and Susan Collins have endorsed this solution and drafted legislation to implement. I am happy to learn that Representative Connolly of this subcommittee has prepared a bill addressing this issue, one that builds on prior work by Ranking Member Lynch.

Chairman Ross, we hope you and your colleagues will embrace this bipartisan consensus on pre-funding reform.

Fourth, while this proposal, backed by the Postal Service, has no downside, that is not the case with some of the other USPS ideas. Eliminating Saturday service, for example, would be disastrous. It would save about 5 percent of the postal budget by sacrificing 17 percent of service; it would inconvenience millions of small business owners who transact business on Saturdays and Americans who need medicines on the weekend; it would add 80,000 postal employees to the jobless rolls; it would imperil the Postal Service's future by forcing customers to turn elsewhere. And as competitors fill the vacuum, future revenue would decline. All this to save an amount barely half the annual pre-funding payments. No business would choose this option over an internal transfer of its own funds, and neither should we.

Finally, the Postal Service has a bright future. The current challenges aren't the first since Benjamin Franklin served as the first postmaster general, nor will they be the last. As realists, we know we must adapt to society's evolving needs. The mail mix, for example, is shifting, with too little first class mail these days. As the economy improves, we have to watch the mail flow and adapt as needed. Even as we speak, the overall mail volume is rising for the first time in 4 years.

We have lots of ideas on new services to offer the growing number of home-based businesses, on expanding our work with UPS and FedEx as their most economical option for last mile delivery, and on adding to what letter carriers already do to protect community and national security.

I would like to conclude by congratulating all the new members of the subcommittee. We believe these are nonpartisan issues in the tradition of bipartisan cooperation that has characterized this subcommittee as worth nurturing. We look forward to working with all of you on postal issues and to find bipartisan solutions to the challenge before us. NELC has demonstrated repeatedly in recent years that it is prepared to do its part to help preserve the long-time viability of the Postal Service by serving the American people and helping the businesses that rely on universal service to grow and prosper, and we remain every bit as committed to that goal today.

Thank you.

[The prepared statement of Mr. Rolando follows:]

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Testimony of

Fredric V. Rolando

President, National Association of Letter Carriers

to a hearing titled "Pushing the Envelope: The Looming Crisis at USPS"

by the

Subcommittee on Federal Workforce, Postal Service and Labor,

Committee on Oversight and Government Reform, U.S. House of

Representatives

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Good morning Chairman Ross and Ranking Member Lynch, and greetings to the other members of the sub-committee. I am pleased to be here today on behalf of the nearly 290,000 members of the National Association of Letter Carriers. Letter carriers are proud to be the public face of the Postal Service. Together with hundreds of thousands of other postal employees, we provide the only truly universal delivery and communications network in the United States – a network that serves every corner of this country, from the most rural areas of Montana to each and every city block of Manhattan, six days a week. Together, we have made the Postal Service the most highly trusted federal agency in America for several years running. Thank you for inviting me to testify on the future of the Postal Service, an agency mandated by the U.S. Constitution, and therefore one of America's oldest and most-essential institutions.

The crisis at the Postal Service is not looming. It's here and it has been evident for at least four years. Addressing this crisis is vitally important to the U.S. 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 a key 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. According to a 2009 study by the USPS the value of transactions moving through the mail exceeds $30 trillion annually – an astounding figure that underlines the importance of the Postal Service to the health of our economy.

The past four years of recession have been the most difficult in the history of the USPS and of the mailing industry in general. Although the economy has begun to recover, we are not out of the woods yet. As we prepare for the NALC's 19th annual "Stamp Out Hunger" national food drive on the second Saturday in May, we know that tens of millions of American families are still suffering in the aftermath of the crash of 2008. For the Postal Service, a full recovery won't come until the housing sector stabilizes and the 25 million Americans who are still unemployed or underemployed find good jobs. So even as we discuss postal reform today, Congress and the administration must also work together to address the nation's jobs crisis if postal reform is to be at all effective.

Over the past four years, the Postal Service has reported what appear to be jaw-dropping losses amounting to more than $20 billion. But these results are misleading and cannot be accurately compared to those reported by other companies.
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 – and urgent -- 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 despite continued electronic competition. (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).**

Let me emphasize this point – in operational terms, the Postal Service has been profitable. In the first quarter of fiscal 2011, it posted an operational profit of $226 million as mail volume grew and the economy showed more signs of recovery.

So 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 109th 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.

The Postal Service, its employees and its unions have responded with tremendous resilience to the crisis, which began for us in 2006 when the housing bubble began to

burst and the credit crunch took hold. Thanks to the flexibility of the parties in finding solutions at the collective-bargaining table, the USPS has reduced the size of its workforce by more than 100,000 employees since 2007 while maintaining high-quality service at the most affordable postage rates in the developed world. I am proud to say that my union, the NALC, has been a responsible and reliable partner in helping the Postal Service react to the steep decline in mail volume stemming from the Great Recession. Working together we strove to negotiate flexible and fair methods for adjusting all 160,000 city letter carrier routes to ensure 8-hour assignments -- boosting efficiency and saving hundreds of millions of dollars. In fact, thanks to these negotiations, we adjusted routes nationally three times over 18 months and are now undertaking a fourth round of adjustments. Using the pre-crisis method of adjusting routes would have taken years.

But endless downsizing and cutting service is not the answer to the Postal Service's financial problems, nor to ensuring its future. Congress should sensibly and permanently reform the pre-funding provisions of the law and allow the Postal Service to use its surplus in the CSRS pension fund to meet its future retiree health obligations. This is what any rational business would do in similar circumstances. We also respectfully urge you not to embrace reforms that will do more harm than good – such as eliminating Saturday delivery or interfering with postal collective bargaining in ways that will prevent the postal community from finding win-win solutions to the Postal Service's long-term challenges.

Congress should fix the pre-funding policy first

The Postal Service is the only enterprise in America, public or private, that is required to pre-fund future retiree health benefits. But it's even worse than that. We are being forced to massively pre-fund for benefits payable 75 years out into the future – that is, for employees that have not even been hired yet. In the private sector, pre-funding retiree health benefits is optional. Most companies handle such 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. (See Attachment #1, the 2010 report on post-retirement benefit funding produced by Towers Watson, p. 20 Figures 27 and 28.) Indeed, with a balance of $42.5 billion, the Postal Service Retiree Health Benefit Fund is large enough to cover expected costs for the next 25 years.

The Postal Service's heavy pre-funding of retiree health care costs in recent years makes it impossible to compare its recent financial results with those of any other company. No private company would have done what the Postal Service has done over the past several years, which was to borrow massively to pre-fund future retiree health benefits in the middle of a recession. In short, the USPS has been forced by law to use most of its borrowing authority to make $20 billion in payments to pre-fund retiree health benefits, rather than to invest for the long term or to restructure its operations. In view of these facts, we believe the single most important thing this sub-committee should do to address the crisis facing the Postal Service is to permanently reform the pre-funding provisions of the law.

Fortunately, there is a way to do this without retreating from the goal of pre-funding retiree health benefits. As we learned from independent reviews by two highly reputable private sector actuarial services firms, the Office of Personnel Management has effectively overcharged the Postal Service for some $50 billion to $75 billion in pension costs associated with service performed for the taxpayer-funded Post Office Department (P.O.D.) before the U.S. Postal Service was reorganized in 1971. Both the Hay Group's study for the USPS Office of Inspector General and the Segal Company's report for the Postal Regulatory Commission concluded that the methods used by the OPM unfairly shifted tens of billions of costs from the tax-payer backed P.O.D. to the rate-payer supported USPS. Thanks to hearings conducted jointly by this sub-committee and its counterpart in the Senate last year, a number of legislative proposals have emerged to instruct the OPM to fairly recalculate the Postal Service's balance in the Civil Service Retirement and Disability Fund and to allow the Postal Service to use the resulting surplus in the Fund to meet the cost of its retiree health prefunding obligations. On the Senate side, a bipartisan consensus has formed on this crucial reform – both Senators Tom Carper and Susan Collins have endorsed this solution and have drafted legislation to implement it. I am happy to learn that Rep. Gerry Connolly of this sub-committee has prepared a bill that addresses this issue among others. Chairman Ross, we hope that you and your colleagues in the majority on this committee will embrace this bipartisan consensus on pre-funding reform.

Such reform would correct what independent experts agree is a grossly unfair allocation of costs made by OPM in 2007, and allow Congress to repeal the hard-wired and

crushing pre-funding schedule in the Postal Accountability and Enhancement Act of 2006. And it would also grant the Postal Service the financial space to restructure itself for the Internet age.

Congress should retain six-day delivery

As you know, the Postal Service has asked Congress to give it the authority, without congressional approval, to reduce the frequency of delivery from the currently mandated six days per week. For now, it is proposing to eliminate Saturday mail delivery, but giving the USPS this authority could open the way for further reductions in service in the years ahead. We shared our strongly held views on this issue with this sub-committee last 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.) In our view, eliminating Saturday delivery would be a strategic business blunder of the first order. It would save very little money and risk the loss of far more revenue over time. Cutting service (and inconveniencing millions of customers) is not a way to strengthen the Postal Service. In America, business is conducted 24 hours a day, seven days a week. Millions of 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. Almost 4,000 of these small companies have asked NALC to contact the PRC to express their opposition to the plan. Firms like e-Bay and mail-order prescription drug companies like Medco are huge users of Saturday delivery, as are the customers of FedEx and UPS who use the Parcel Select service that allows them to

purchase low-cost last-mile delivery services from the Postal Service. When *The Economist* magazine learned that the USPS was proposing to end Saturday delivery in America, it reluctantly started testing alternative methods for Saturday delivery. Weekly newspapers and direct advertisers who value Saturday delivery will follow suit. If implemented, the elimination of Saturday delivery would jeopardize the Postal Service's future, slashing delivery service by 17% in return for a questionable 4% reduction in costs.

At a time when the nation is suffering an acute jobs crisis, throwing 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 that co-sponsored H. Res 173 in the 111th Congress oppose the elimination of Saturday delivery. We urge you to reject this proposal as well – because it is not in the nation's interest.

Congress should not tamper with postal collective bargaining

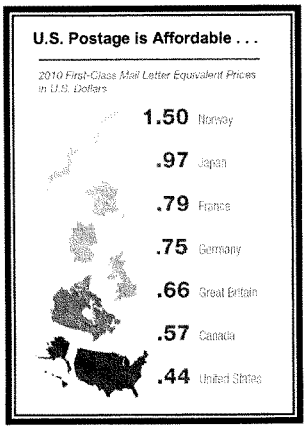
As this hearing takes place, a huge national debate is going on about the merits of public employee collective bargaining at the state and local level. Although we are federal employees and negotiate with an agency funded by the customers we serve (and not by taxpayers), we are gratified that the American public supports collective bargaining rights for public employees by a 2-1 margin, according to a recent Gallup poll published in the *USA Today*. The 40-year history of postal collective bargaining supports the wisdom of the public's view.

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 worked well not only for the USPS and its employees, but also for 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 slightly (3.4% from 1972-2009) – even as postal labor productivity has increased by more than 43 percent. Of course, the real cost of our benefits has increased as the cost of insurance from FEHBP has soared along with private sector health care costs, 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 reliable service -- there has never been a strike, lock-out or a disruption of essential postal services since the Postal Service was created. It has also permitted 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 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 48% for postage compared to an increase of 141% for private delivery.



. . . 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	218.1
Pct Inc	413%	422%

Note: PPI = Producer Prices; CPI = Consumer Prices

Source: Bureau of Labor Statistics

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 Postal Service has proposed changes to this section of the law, seeking to highlight managerial objectives among the factors to be considered by arbitration boards while neglecting to mention any employee objectives that are typically presented to arbitrators. Most specifically, it would like to instruct arbitration panels to give extra weight to the financial condition of the Postal Service when rendering their decisions. Such a change 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.

Unfortunately, the Postal Service has played fast and loose with the facts on the issue of interest arbitration. 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 – to serve alongside a union-appointed arbitrator and a neutral chairman of the 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 factor special status is unwarranted. We don't think Congress should put its thumb on the scale in favor of management (or labor). The existing law is fair to both sides. In layman's terms, let's not fix what's not broken – there are plenty of other things to fix in the Postal Service.

Conclusion

While reforming 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. We should note, however, that overall mail volume is now, for the first time in four years, increasing even as the level of First Class remains problematic. Still 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.

Congress should clear the way for the Postal Service to develop new uses of its retail and delivery networks to serve the needs of businesses and the public. We believe Section 3(b) of the bill introduced by Senator Carper last year (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 September of this year, 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. If we can overcome the challenge of the pre-funding crunch, the entire postal community – including management, the unions, the mailers and Congress – can use our experience and energy to help the Postal Service adapt to the evolving needs of the country.

Let me conclude by congratulating all the new Members of Congress who are serving on the subcommittee. We believe the Postal Service is a non-partisan issue and that the tradition of bipartisan cooperation that has long been a hallmark of this subcommittee is worth continuing and nurturing. We very much look forward to working with all of you 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, reduce costs 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.

Mr. ROSS. Thank you, Mr. Rolando.

We have been called for votes. We have about 11½ minutes to go. Mr. Lynch and I have agreed that we are going to try to do 5 minutes each, and then we will recess and come back right afterwards and finish then. So those who need to go, go ahead and go. I will start with a series of questions.

Mr. Rolando, one of the things that was pointed out in the GAO report, Mr. Herr who was here in the first panel, indicated that, USPS now has costly excess capacity. Is that something that you can comment on? Are you aware of excess capacity, whether it be in distribution or wherever?

Mr. ROLANDO. I don't know what he was referring to, no.

Mr. ROSS. OK. With regard to also another recommendation the GAO had in terms of collective bargaining and binding arbitration, his recommendation was that the financial condition of the U.S. Postal Service should be taken into consideration in the binding arbitration procedures. How do you feel about that?

Mr. ROLANDO. His wish is granted because the financial condition of the Postal Service has been considered in every arbitration that we have had. The arbitrators are required to consider the arguments of both parties, and in every interest arbitration we have had that issue has come up and been considered by the arbitrators.

Mr. ROSS. I appreciate that perspective.

To all three of you, you all recognize, I think, that the recession has had an impact on mail. I mean, there was an increase in volume from 1990 to 2007, when we have seen a decrease. I will start with you, Mr. Rolando. Do you think that the U.S. Postal Service has done enough aggressively to cut costs? And, if not, what would you recommend that they further do?

Mr. ROLANDO. I think they should continue what they are doing, to work with the unions on win-win solutions. I know my union has worked with them aggressively for the last few years on adjusting routes to the change in volumes, which, by their own numbers, has saved them over $1 billion, and I think we need to continue to work together through negotiations and in between those negotiations on these win-win solutions.

Mr. ROSS. Mr. Sackler.

Mr. SACKLER. Well, Mr. Chairman, the Postal Service and its employees have indeed cut a lot of costs out of the system, but by definition, looking at the situation that it is in, it hasn't been enough. We think that, to get to your previous question, our understanding is that the system is overbuilt by almost a factor of two and that there needs to be a drastic realignment and restructuring, closing and consolidation of facilities, and for that there will need to be some change in the law and there will have to be support from Congress because——

Mr. ROSS. So you agree that there is excess capacity.

Mr. SACKLER. Yes, we do.

Mr. ROSS. OK.

And Mr. Sampey, with regard to costs.

Mr. SAMPEY. Yes, I would say that they have done a great job between the unions and the administration in the Post Office. They have done a fantastic job to manage the costs. And I think there is more that they can do if some legislative activities are taken to

give them a little more room to work on the cost side of the house. We are very supportive of the Postal Regulatory Commission, especially on the pricing side, to give some oversight, but I think the management and the union have a lot of opportunities to take additional dollars out of the business if we give them a little bit of latitude with legislative activities.

Mr. ROSS. Mr. Sackler, back to you. You touched on this in your opening remarks, about if the Postal Service defaulted on its obligation to the Treasury. Could you expound on what impact you think that would have? I mean, assuming we did nothing and they couldn't meet their obligation, they have exceeded their $15 billion borrowing limit, or met it at least, what is the outcome?

Mr. SACKLER. As we understand it, there are no legal operational or practical consequences for USPS or its managers. But the implications in terms of how people look at the Service and the fact that whether or not it is functioning largely independently, it is still an arm of the U.S. Government. And to have an arm of the U.S. Government default on an obligation, even if the actual impact is only technical, you have to think, well, what are those who are holding our bonds and have the future of our finances in their hands thinking? It is all a psychological game.

Mr. ROSS. It could affect our credit rating.

Mr. SACKLER. Exactly.

Mr. ROSS. OK.

Last, Mr. Sampey, you want to comment on that?

Mr. SAMPEY. Just one comment on that. I think Pat brought it up in his statement. I think the industry confidence in the Post Office, and some of the challenges that they are having right now, you know, there are a lot of folks out in the industry that are saying should we move to digital, should we move to something else, for fear of where the Post Office is going to end up. I think whatever we do, we need to do it quickly. I think we need to move on this as a cohesive group and work together and figure out how do we get the confidence back. The Post Office has done a great job and the quality of service has been fantastic.

Mr. ROSS. Thank you.

Mr. Lynch, you are recognized for 5 minutes.

Mr. LYNCH. Thank you, Mr. Chairman. I just want to make a couple of clarifications. I know that my dear friend from Florida, Mr. Mack, commented that government doesn't have the ability to help business make the necessary reforms.

I just want to remind the gentleman that the U.S. Postal Service is a unique business; it was actually created by the U.S. Congress and it is one of the few institutions that is explicitly provided for in the U.S. Constitution. Government has done a pretty good job over the past 236 years in guiding the Post Office in providing universal service 6 days a week and has done a pretty good job, as some of the polling out there has indicated, that our postal employees are the most trusted public employees in the United States today.

I would also like to point out with respect to the suggestion that OPM is correct in their assertion that the overpayment does not exist, for the benefit of the new Members especially, I just want to

sort of lay out the history here of OPM denying obligations and what the results have been.

Going back to 2002, the Postal Service pension fund was found to be overfunded by OPM by $78 billion, and we in Congress had to go back in 2003 and tell OPM you have to straighten this out. So there was an overpayment there of $78 billion.

Then in 2003 OPM attempted to make the Postal Service pick up the responsibilities for military service pensions, obligations for Postal Service employees. So if they are in the service, they wanted the Post Office to pick up their pension credits that were due because of the military service, and we said that would not be right. So Congress rejected that attempt.

In 2009 we found that OPM used an exaggerated 7 percent health care appreciation inflation forecast instead of the 5 percent that is the industry standard, and that resulted in an overpayment of $13.2 by 2016. So we had to go back and we ordered OPM cut that out, use the industry standard. So OPM then went back and changed it.

Now the Postal Service has been overcharged by $75 billion for its share of CSRS pensions for folks for their pension credits before they became USPS employees. People have to understand that. These are pension credits for folks before they went to work for the Post Office, but they have been overcharged and the Post Office is picking up the inflation for those costs.

So there is a whole history here of the OPM. And, look, anybody can make a mistake, but in every single case OPM overcharged the Post Office by tens of billions of dollars. So that is the record we have here. Those are the facts, and there does seem to be a—oh, and by the way, OPM wrote a rather gratuitous letter that they thought, by God, the Post Office should have to pre-fund their health care obligations 100 percent, pre-fund it by 100 percent. But if you look at what OPM is doing, they pre-fund their obligations at 40 percent. So you would think what is good for the goose is good for the gander, but that is not the case.

So I just wanted to make those clarifications just for some of the newer Members that are onboard here.

Mr. Rolando, in my remaining time, before I run up the Hill, I want to ask with respect to going from 6-day delivery to 5-day delivery, that affects your membership, the letter carriers, and the mail handlers dramatically. Is there any information that you would like Congress to have before, or do you think the Post Office should provide to Congress before we make that decision?

Mr. ROLANDO. Well, I think it is important that it not only affects my members, it affects thousands and thousands of businesses across America who have contacted the NALC directly have responded to the NALC in terms of their objections to 5-day delivery and how it would affect them, and we——

Mr. LYNCH. I don't mean to interrupt you, but, in fairness, I have to tell you I heard loud and clear from the folks that have catalogs and magazines that apparently they use Saturday as their delivery day because they want folks to, on their day off, actually read the product that they deliver. So you are right, it is not solely in your interest. But go ahead.

Mr. ROLANDO. That was what I wanted to say, the effect on the businesses, not to mention the public and the customers.

Mr. LYNCH. All right, thank you.

Mr. ROSS. We are going to recess to go take our votes, and we will return after this first vote, and then we should be able to finish up. Thank you for your patience. We will be back.

[Recess.]

Mr. ROSS. I would like to call us back into order and I would now like to recognize the gentlewoman from the District of Columbia, Ms. Norton, for 5 minutes of questions.

Ms. NORTON. Thank you, particularly, Mr. Chairman, for rushing back, because I know you have to go to the floor again. I wish I did.

Let me say how helpful all of your testimony has been. You have reinforced a lot of what the Postal Service itself has said. And I want to say to you, Mr. Rolando, I have walked with my letter carrier. He is an indispensable party to the American people, far beyond delivering the mail. There are people who have nobody but a letter carrier to speak to every day, particularly the elderly. They greet him at the door even if they've got a walker. Thank you for all you do. You are wonderful. Your letter carriers are the best.

I want to just straighten two things out for my own thinking, certainly. I am well aware of what collective bargaining does for those in trouble. There is nothing more valuable than to have the cooperation of level-headed unions when you have to manage a downsizing of any kind. Everybody ought to know that the reason the Postal Service has been able to do what it does is because its collective bargaining partners understand the business as well as the business with whom they are dealing, so I congratulate you. I know the sacrifices you have made. And you don't see the postal workers out here screaming and hollering because they believe fairness has been accorded because it has been bargained. So I agree with your testimony; don't tamper with collective bargaining. If you really want to mess up this situation, just mess with collective bargaining.

Now, Saturday delivery. I read your testimony on Saturday delivery. I want to know is it subject to collective bargaining.

Mr. ROLANDO. Saturday delivery?

Ms. NORTON. Is that bargained over?

Mr. ROLANDO. No, it is not.

Ms. NORTON. Now, you make a pretty compelling case that there would be very little savings. The thing that has made me interested in Saturday delivery is this overwhelming number of Americans, 75, 80 percent say, OK, if that is what you have to do, that is what you can do. But you make a pretty compelling case not simply about inconvenience to people. I understand that; people, of course, in hard times, have to take that. But loss of business, that bothers me. What do you mean about the loss of business? Who will get that business if Saturday delivery in those locations—and let's assume we had, in my hypothetical, no Saturday delivery in just some locations, but some you did have it. In any case, where would the business go to and what would that mean for future business for the Postal Service?

Mr. ROLANDO. First, if I could, I would like to just comment on the 75 to 80 percent that you just alluded to.

Ms. NORTON. Yes.

Mr. ROLANDO. You have to understand it really depends on what you ask people as to how they are going to respond. If you ask people if they would rather have an increase in postal rates or lose a day of delivery, you are going to get one set of answers. If you are truthful with people and give them the real options, would you rather the Postal Service be allowed to transfer their own money from a surplus in their pension fund or lose a day of delivery, I think you get a completely different answer.

Ms. NORTON. And, of course, Mr. Sampey's testimony, and I think the testimony of the first panel, was that it did not include Saturday delivery; they just said if you dealt with these overpayments that you would have a profitable enterprise. So go ahead. So that takes care of the question.

Now, what about the loss of business? Who would get the business?

Mr. ROLANDO. Well, there is always going to be a need for delivery on Saturday. We talked about prescription drugs and other things that the American people are going to need. Somebody is going to fill that vacuum.

Ms. NORTON. And you think that would have an effect on future business for the Post Office or that would carry over into your Monday through Friday business?

Mr. ROLANDO. Absolutely. It would affect the current business; it would affect the growing part of the business, which is people shopping online and parcel delivery when people are home on Saturday. It is just not a good idea where there are a lot of innovative things.

Ms. NORTON. Let me ask you one more question, then, because you have made me understand that. We had some testimony here about thousands of postal workers that are on worker's compensation that could be on retirement. Would you clarify that? Why don't they just retire?

Mr. ROLANDO. I am not real sure what the gentleman was referring to, but I know there have been proposals with regard to worker's compensation which we certainly are willing to look at. The important thing is that we don't punish our employees who are injured on the job and that we treat them fairly.

Ms. NORTON. And there was some concern that these workers had no intention of coming back to work. Now, I know the retirement age is 55, but somebody 55 these days better come back to work if you possibly can.

Mr. ROLANDO. Sure.

Ms. NORTON. I wonder if the union will take a close look at that, because it will not sound good to the American people if you are carrying people who could then be carried on their earned retirement benefits.

Mr. ROLANDO. Again, it is all how it is characterized. That is why I would have to take issue with the comment that was made. We would have to look behind it, because we certainly want to look for a way to treat these people and not punish them.

Ms. NORTON. Thank you very much.

Mr. ROSS. Thank you, Ms. Norton.

In light of no other Members here to inquire and us about ready to go in for another vote here, we are going to adjourn. I want to thank the gentlemen of our second panel and appreciate you all being here, taking time out of your schedule. We have just scratched the surface and look forward to working with you all on this issue. Thank you all very much and have a good day.

[Whereupon, at 4:20 p.m., the subcommittee was adjourned.]

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